

# SMEs' Development in Afghanistan: Issues and New Management Perspectives

Mohammad Habib Abdullah  
Beijing Normal University, Zhuhai, China

This research focuses on SMEs' development in Afghanistan: issues and new management perspectives. This study has been conducted and finished with an in-depth research results, findings, as well as recommendations for not only SMEs' owners but also relevant governmental and non-governmental organizations as well as financial institutions. The study mainly included surveys through questionnaire—with both open and close-ended questions—as well as face to face and virtual interviews with owners of SMEs, governmental and non-governmental organizations and financial institutions like lending banks. For data collection, the main target groups were owners of the SMEs. More than 100 SMEs were selected as sample size and were reached and asked for their opinions about research questions and other open and close-ended questions among which more than 90 responses were received (40 from small and more than 50 from medium sized enterprises). Apart from SMEs, interviews with three relevant governmental and three non-governmental organizations as well as three financial institutions like lending banks were conducted. Based on main findings of this research, limited access to sustainable finance, insecurity, high operational cost, lack of support, and limited access to national and international markets are the most current and main challenges of SMEs in Afghanistan. Findings of this research also show that the service and the e-commerce sectors are making great advancement comparing to manufacturing sector in Afghanistan owing to more and more people's access to internet every day. In fact, Afghanistan has a great opportunity for e-commerce since people's access to internet has been increasing dramatically—from 4.7 million users in 2018 to 7.65 million users in 2020. Furthermore, according to findings of this research, most of the SMEs in Afghanistan are also referring to e-business mainly because of avoiding from being taxed by the government or getting licenses. This paper also provides some recommendations for SMEs owners, governmental and non-governmental organizations (donors).

*Keywords:* SMEs, Afghanistan, access to finance, financial institutions, banks, non-governmental organizations, donors, e-commerce

## Introduction

### Background of the Study

In all around the world, Small and Medium-Sized Enterprises (SMEs) are considered as the engine for economic growth of a country, especially for developing countries. Comparing to developed countries, SMEs

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Mohammad Habib Abdullah, Postgraduate, The Belt and Road School, Beijing Normal University, Zhuhai Campus, Zhuhai, China.

Correspondence concerning this article should be addressed to Mohammad Habib Abdullah, Karte Zahiruddin, Mazar-e-Sharif, Balkh 1702, Afghanistan.

in developing and underdeveloped countries like Afghanistan can play a crucial role for the employment and overall economic growth of the country, and that's because of two main reasons.

On the one hand, establishing SMEs, particularly in the case of Afghanistan, doesn't require and need high skill and technology, rich business knowledge—at least at the beginning—as well as huge investment. On the other hand, Afghanistan, as an underdeveloped and unpredictable country, lack highly qualified individuals, high technology, and huge capital. Therefore, SMEs are the most ideal, effective, and efficient method for the employment and economic growth of the country.

In fact, SMEs have played key roles particularly in Afghanistan's economy by putting millions of Afghans out of poverty. Therefore, one of the top priorities of the Afghan government has always been to work on small and medium enterprise development by supporting them both financially and non-financially—especially after 2004, when the Afghan government formally adopted market economy.

SMEs make up almost 80 percent of Afghan businesses, half of the country's GDP, and employ more than one third of the labor force (Mashal, 2014). However, according to the Ministry of Industry and Commerce of Afghanistan, about 70% SMEs in Afghanistan are located in rural areas and almost all of them function illegally—without licensing and registration at the Ministry of Industry and Commerce. In fact, they don't get license and register themselves mainly because Afghanistan is a very fragile and unpredictable country, especially when it comes to the economy, and thus it get affected very easily from disasters, or global pandemic like Coronavirus. Also, most of the SMEs in Afghanistan, particularly those which are located in rural areas, don't make a lot of profit. Therefore, those SMEs which don't register and get license, don't want to put themselves in trouble and pay tax to the government and abide by the other regulations of the government.

In fact, the main reason of the Afghan government's supports of SMEs has been that the large investments have been limited owing to Afghanistan's unpredictable and fragile economy as well as uncertain political and security situation. Thus, the Afghan government has been putting more efforts on SMEs, and trying to attract more international donors and supporters for them so that they can function better and ultimately support Afghanistan's economy. Currently, however, SMEs facing security and other challenges which need to be dealt with urgently.

As a matter of fact, probably Afghanistan is the only country in the world in which most of the SMEs function illegally—without registrations and licensing. According to the Ministry of Industry and Commerce of Afghanistan, as of 2020, 40,598 businesses registered themselves at the Ministry and got license. However, how many of those businesses have been collapsed or failed so far, there is no exact evidence or figure exists at the Ministry of Industry and Commerce. Yet, in 2020, according to a statistic, 92.59% of small enterprises were affected greatly by the COVID-19.

Moreover, according to the World Bank report which considers business laws of 190 countries, in 2019, Afghanistan ranked 167 in doing business—a jump from 183 in 2018. In fact, in 2019, Afghanistan was considered as the top improver by improving an ideal business environment for doing business. In doing business, Afghanistan improved its score by more than 10 points to 47.77. The main reason for this remarkable improvement was that in 2017, Afghanistan implemented five main reforms to improve the business climate. These reforms were in areas of starting a business, getting credit, protecting minority investors, paying taxes, and resolving insolvency.

However, according to the World Bank's Doing Business Report of 2020, Afghanistan ranked 173 among 190 countries in the world which shows a drop of six points from 2019 in which Afghanistan ranked 167, and

based on the World Bank's report, that's mainly because Afghanistan, during one year, didn't have any noticeable achievement in almost seven indexes of business.

But recently, Afghanistan has worked on its legal framework and made it easy for startups to start their businesses. Most of the investor guarding plans have been strengthened to a large extent which in turn helped Afghanistan's economy to grow. As a matter of fact, Afghanistan, for the last few years, has taken some measure in order to make it easy to do business in the country. One of these remarkable measures was to reduce the cost of starting a business by entrepreneurs. In fact, the cost to start a business was remarkably reduced to 6.4% of the income per capita from 82.3%.

Thus, in starting a business, Afghanistan ranks 49 in global ranking. However, in some areas, it's almost at the end of the ranking. For example, in registering property, it ranks 186 globally, in dealing with construction permits, it ranks 184 globally, and in enforcing contracts, Afghanistan ranks 181 globally. For instance, in order to register the transfer of a property in Afghanistan, it takes 250 days which is more than twice of South Asian Countries' average (114 days). Furthermore, in 2020, Afghanistan ranked 26 in Protecting Minority Investors' area.

According to the government officials, the Afghan government has mostly supported and gave incentives to startups and that's mainly because comparing to SMEs and large businesses, startups need less support. In other words, the profitability of startups is high, considering the support they get from the government. Providing an ideal business environment, establishing industrial parks, offering financial aids and lending as well as decreasing water and electricity expenditures are the classic examples of government's supports to startups.

As a matter of fact, in 2016, the Ministry of Finance of Afghanistan, announced that any entrepreneur who starts a business will be financially waived for three years, especially tax. Hence, that year Afghanistan was rewarded the prize of "The Best Country for Supporting Entrepreneurs" in the Middle East. This prize is given each year by the UAE to the countries which supports business in their own territory.

What's more, with the adoption of new tax law, tax payment was made easier. In fact, the time which used to be spent by entrepreneurs to pay their taxes in 2017 was 270 hours; that's five hours less than South Asia countries' average which is 275 hours. Furthermore, the time of corporate income tax adoption was also reduced to 111 hours from 217.5 hours.

So given all above mentioned points, this study explores new issues and management perspective on the way of SMEs' development in Afghanistan. It explores opportunities and challenges as well as other factors affecting SMEs' development in Afghanistan by conducting in-depth research of those issues through qualitative (One-on-One Interview, Case Study Research) and quantitative (Survey research) methods. It discusses about role of small and medium enterprises not only in the Afghan economy but also their roles in Afghanistan's trade with other countries, especially neighboring ones. In other words, this research does not discuss about micro and large companies and their development in Afghanistan, but it would rather focus only on SMEs' development as well as new issues and management perspective of SMEs in Afghanistan, what challenges they face, what opportunities they have, and ultimately it will be discussing how they are helping Afghanistan's economy and trade.

### **The Significance of This Study**

SMEs are mostly known as the engines of economic growth of a country which contributes greatly to

innovation, employment, and overall economic of the country. In fact, SMEs lead to a greater employment and ultimately economic movement in the country. As a matter of fact, when it comes to the GDP, SMEs play a key role by enhancing employment which not only leads to poverty reduction but also entrepreneurship in the country. It also brings a lot of skills in the country since every one starting a business would give its best shot in order to succeed in the market and that brings his/her skills out and thus it will lead to more competition as well as innovation and ultimately economic growth of a country. Moreover, since SMEs are present in a wider geographical area of a country, comparing to large business or big companies, it can help greatly to the better and fair income distribution.

Therefore, findings of this research are expected to not only help current and future SMEs' owners in Afghanistan to get in-depth knowledge of opportunities, challenges, and more importantly new issues along with their management perspectives related to their development in Afghanistan, but also for the governmental and non-governmental organizations—especially relevant ones—it gives practical knowledge of challenges with which SMEs encounter on their development process as well as other factors affecting those enterprises' development so that they can make relevant laws, regulations, and strategies for the development of SMEs in Afghanistan.

### **Research Aims and Questions**

The main objective of this research is to answer following questions mainly through surveys, related literatures, and more importantly in-person and virtual interviews with SMEs' owners, relevant governmental and non-governmental officials (NGOs), as well as relevant financial institutions:

- What are the most current issues for SMEs' development in Afghanistan?
- What are the new management methods to deal with these new issues?

### **Features and Innovations**

Since enterprise development is almost a new phenomenon in Afghanistan, a specific research, particularly about issues and new management perspectives for SMEs' development, hasn't been done before. In fact, there are some researches which have been done in enterprise development specifically in Small and Medium Enterprise Development by some Afghan researchers before, but these researches are discussed either generally or they are already outdated owing to the economic, political, more importantly COVID-19 situations, the context of Small and Medium enterprise development in Afghanistan has changed significantly since then. Previous researches were also focused either on quantitative or qualitative approaches. However, this research is a new attempt to gather most recent data about SMEs' development in Afghanistan and will have several features some of which are as follows:

- This is the most updated research with the most recent information about SMEs' development in Afghanistan, especially post/after COVID-19.
- Unlike previous researches, this research uses both qualitative and quantitative approaches.
- This research is more focused on in-person interviews with both Afghan SMEs' owners as well as related and relevant officials.
- This research focuses on new issues and new management perspective regarding SMEs' development in Afghanistan.
- The data in this research are more practical, comprehensive, and inclusive since it covers more than 100 SMEs of different kinds with different geographical location in Afghanistan.

## Literature Review

An enterprise is a group of individuals who share a common goal with one another. In order to achieve that goal, they have specific resources, most important of which are people, money, time, materials, and energy. The resources are considered the inputs and the achievements of the goals are considered as the output of the process; and the degree of success of the enterprise is often measured by the ratio between the outputs and inputs which is called productivity.

### Theories About Small and Medium Enterprises

Defining SME is quite challenging, because different scholars have defined it differently all around the world (Sitharam & Hoque, 2016). According to Baumbach (1982), definition of SMEs differs from employees' number, size of the enterprise, type of industry, and country. Jasra, Khan, Hunjra, Rehman, and Azam (2011, p. 25) stated that "SMEs are a business but not a public limited company, having more than 250 workers in manufacturing and service industries including trading businesses".

Moreover, small enterprises are defined as enterprises which employ fewer than 50 people and whose annual turnover or total annual balance sheet does not exceed €10 million (Definition of "small" and "medium-sized" enterprises (SMEs), 2017). Small enterprise is one that has a relatively small share of its market and its essential characteristic is that it is managed by its owners or part-owners in a personalized way—not through the medium of a formalized management structure (Curran & Blackburn, 2011). Medium-sized enterprises, however, are defined as enterprises which employ fewer than 250 people and whose annual turnover does not exceed €50 million or whose total annual balance sheet does not exceed €43 million (Definition of "small" and "medium-sized" enterprises (SMEs), 2017). Comparing to medium-sized enterprises and large companies, small enterprises work and operate to earn a small amount of profit (Alarape, 2008).

According to the World Bank data (2011), in Afghanistan, any enterprise that consists of 100 employees and a maximum sale of 995,355 AFN per year is called Small and Medium Enterprise. According to the Ministry of Industry and Commerce officials of Afghanistan, in their definition "Small" enterprises employ between 5 and 20 people, and "medium" enterprises employ between 20 to 100 individuals (Mashal, 2014).

Small and medium enterprises are vital for development of a country—Helps reshaping the productive sectors—Generates employment—Creates an environment for entrepreneurship—Promotes innovation (Gherghina, Botezatu, Hosszu, & Simionescu, 2020). A robust SME sector contributes vastly to the economy in terms of Gross Domestic Product (GDP), by bringing down the unemployment level, reducing poverty, and promoting entrepreneurial activities (Khan & Adel, 2019). SMEs make up about 80 percent of Afghan businesses, half the country's GDP, and employ more than one third of the labor force (Mashal, 2014).

### Theories Regarding Enterprise Development

Enterprise Development (ED) is the process of developing small or medium companies (Robyn, 2020). In fact, it is about growing existing companies—rather than developing start-ups. It is enterprise development which leads to growth (Alattar, Kouhy, & Innes, 2009). It includes providing an ideal climate for SMEs' growth.

Enterprise Development is different from other forms of development as the intention and goal of the development is on a company rather than an individual (Robyn, 2020). The methods of Enterprise Development differ substantially and can vary from training and mentoring to financial investment or grants (Robyn, 2020).

As a matter of fact, small enterprise development is the process of growing small enterprise both financially and non-financially. In other words, small enterprise development is providing an environment for a small enterprise to make more profit, hire more individuals, and ultimately to expand its production capacity. Medium enterprise development, however, is the process of developing a medium-sized enterprise in terms of finance, people, and scope of its activity and so on.

### **Theories Concerning Factors Affecting SMEs' Development**

Regarding performance of SMEs, there is wide variety of literatures (Chittithaworn, Islam, Keawchana, & Yusuf, 2010). These literatures focus on factors that affect the performance of SMEs in all around the world. There are also some researches done internal and external factors affecting SMEs' performance. Enter international markets, good customer relationship, and good supply chain system are the main external factors affecting the performance of SMEs (Jahur & Quadir, 2012). Among the external factors, competition is believed to be one of the important determinants of SMEs development (Govori, 2013). However, managerial qualities, technology, and lack of skilled labor are identified as internal factors affecting the performance of SMEs (Noreen & Junaid, 2015).

Access to finance is a main obstacle for SMEs' development, particularly in developing countries (Nkwabi & Mboya, 2019). Regulations of the governments can also be one of the factors affecting SMEs (Amaradiwakara & Gunatilake, 2017). With changing regulations, it is difficult for small firms to bear the compliance cost (Christianson, 2003). Support of the government policies as pivotal for the development and sustainability of SMEs (Asia, 2018). Infrastructure of a country can be one of the leading factors for the success or failure of an SME (Okpara & Kabongo, 2009).

Weak infrastructure within judicial system may lead to corruption which negatively affects the development of SMEs (ABD, 2005). Corruption and red tape can increase the business costs and may make the product uncompetitive in the market (Luiz, 2002). When it comes to the countries which have the worst corruption, Afghanistan ranks almost the last. In 2018, it ranked 172 out of 180 countries globally. Hence, with such a ranking that shows that Afghanistan almost has the worst climate for doing business which makes it difficult for businesses to survive.

Effective managerial skills are must for the development of SMEs (Wasilczuk, 2000). For SMEs to develop and gain competitive advantage, besides managerial skills, SMEs need to have access to appropriate and updated technology (Rogerson, 2001). Moreover, having effective managerial skills and access to updated technology will not bear the fruits if entrepreneurs do not have the marketing skills of how to sell their products (Gartner, Starr, & Bhat, 1999). The significance of marketing is universally accepted and recognized for all businesses, especially for small and medium-sized businesses (Al-Mahrouq, 2010).

Creativity is the process of developing and creating new and workable concepts, commodities, and ideas (Botha, 1999). Creativity and innovation are the backbone of entrepreneurship and growth (Mansfield, Rapoport, Schnee, Wagner, & Hamburger, 1971). Owner's personality and entrepreneurship skills are linked with creativity and innovation which positively affect the performance of SMEs (Leitão & Franco, 2011). These skills have a strong impact on the strategic framework of business operations (Leburić & Krneta, 2004).

The main challenges of SMEs in developing countries are lengthy and complicated procedures and documentation to raise finance from the market, absence of sufficient necessary infrastructure, lack of physical access to markets, psychological access to consumers, and high bureaucratic to utilize the schemes (Kannan &

Sudalaimuthu, 2014).

The main challenges of SMEs are the lack of enough and timely supply of fund, high cost of fund, problem to raise capital from equity market, procurement of material at less competitive cost, storage problem, package issue, lack of linkage to international markets, lack of infrastructure and advanced technologies facilities, less skilled employees, complication of business law and lack of support and mechanism for rehabilitation of sick business entities (Venkatesh & Muthiah, 2012).

The major drawback of SMEs is high-security requirements to access finance, availability of short-term loans, high capital cost, lack of accounting, and bookkeeping knowledge of staff to maintain proper financial statements and book of accounts and high iteration of loan installment (Habibi, 2016). Major problems of SMEs are inability to market the products and maintain product's quality, lack of skilled technicians and workers, poor management skills of entrepreneurs, lack of quality assurance, scarcity of resource, high employee turnover ratio, access to market and lack of awareness from marketing tool, high interest rate, lack of commitment to innovation and customer satisfaction and lack of research and development facilities (Chowdhury & Alauddin, 2015).

There are five main challenges which are the most effective in Afghanistan; insecurity, corruption, poor governance, and Finance (Schoofs, 2014). Meanwhile, uncertainty of business environment and decreasing market confidence, dependence on donor organizations for startup support, limited productive diversity, limited access to credit, quality control and creativity, lack of industrial energy, and access to markets are the issues SMEs face in Afghanistan (Mashal, 2014).

The challenges faced by SMEs are lack of reliable financial records, lack of capacity in business planning, limited product diversity, limited access to markets, and informal status of business (Switchasia, 2017). However, public corruption, unreliable electricity, vacuum policies, and law, weak capacity of legal structures, absence of proper land registration, adverse taxation, lack of skilled labor, and unavailability of proper data are some of the challenges stated by the USAID in Afghanistan (Halabi, Barrett, & Dyt, 2010).

Keeping in mind all above literatures, although there are several researches available on SMEs' challenges globally as well as few researches on SMEs' challenges in Afghanistan, they are not sufficient since they are mainly outdated and can't be implemented in today's world which is post-COVID-19 world. Hence, one of the main objectives of the current research is to focus on factors affecting SMEs' development in Afghanistan, specifically challenges, and thus to fill the gap of the previous literature.

### **Theories Concerning Previous Management Models**

There are mainly nine quality management models discussed by the previous researchers. The management model includes leadership, commitment, product design, quality department, supplier quality management, training, employee relations, quality data and reporting (Saraph, Benson, & Schroeder, 1989). A quality management model consisted of the commitment of top management, supplier quality management, customer focus, benchmarking, design quality management, internal quality information usage, SPC usage, employee empowerment, involvement, employee development, supplier's performance, and product quality (Ahire, Golhar, & Waller, 1996).

Moreover, the management model proposed by Flynn, Schroeder, and Sakakibara (1995) consists of seven factors which include top management support, quality information system, process management, workforce management, supplier involvement, product design, and customer involvement. Furthermore, Powell (1995)

has proposed a model of quality management based on top management commitment, effective communications, and employee involvement. Also, the quality management model which has proposed by Black and Porter (1995) consists of 10 factors including people and customer management, supplier partnership, communication, customer satisfaction, external interface management, strategic quality management, teamwork, operational quality planning and improvement measurement systems, and corporate quality culture.

What's more, according to Rao, Solis, and Raghunathan (1999), the principles of quality management are 13 and they include top management support, strategic quality planning, quality information availability, quality information usage, employee training, employee involvement, product/process design, supplier quality, customer orientation, quality citizenship, benchmarking, internal quality results and external quality results.

Also, the principles of quality management include upper management support, employee involvement and commitment, quality education and training, teamwork, and use of statistical techniques (Bayazit, 2003). However, based on Rad's (2005) model, quality management includes top management commitment and stability, employee involvement, focus on internal and external customers, strategic quality planning, teamwork and quality culture, open communication, continuous improvement, management by facts to solve problems, focus on customer satisfaction, building positive relationships with suppliers and partners, and monitoring and evaluation of quality.

So keeping in mind all above mentioned studies which have very little contribution from Afghanistan as well as the literature on SMEs in Afghanistan's context is very limited, this study tries to fill the gap and add to the body of knowledge by exploring the opportunities, challenges, and other factors affecting the performance and development of SMEs in Afghanistan as well as issues and new management perspective of SMEs' development in Afghanistan, particularly regarding issues and new management perspective after COVID-19.

### **Findings of the Literature Review**

For the secondary data collection, a thorough literature review was done in order to get in-depth knowledge of SMEs' development in Afghanistan including factors affecting SMEs' growth, challenges that SMEs have been facing so far, quality management methods of SMEs, financing SMEs and so on.

### **Literature on the Context of SME Sectors in Afghanistan**

Afghanistan, unfortunately, has been dependent on foreign aids for decades now. In other words, since 2001, with the rise of new government after several years of civil wars which put the country in ruins and instability as well as with the failure of Taliban, the international community has been helping hugely, especially between 2001 and 2014, Afghanistan received a huge amount of money and other supports from international community. This support still went on after 2014; yet after new presidency election and after new president came to power, the supports from international donors have been significantly reduced. However, the Afghan government hopes that Afghanistan will be less dependent to foreign aids by 2025.

The main reason behind the government's claim of being less dependent by 2025 is that it has been focusing and working more on its engines recently, and its engines are SME sector. In other words, although SMEs in Afghanistan are still facing wide variety of challenges but the Afghan government has been supporting its SMEs recently and that's because it realized the importance of SMEs that they can play for the economic growth of the country.

Most recently, for example, the Afghan government has passed a law in which several incentives are given for new businesses, especially for Startups. Under that law, the Afghan government also made SMEs not to pay

their tax for three years upon their establishment. More importantly, since Afghanistan has a fragile and unpredictable economy, the risk of large businesses/companies is high. Given these reasons, the Afghan government has been prioritizing SMEs recently.

However, among all SMEs in Afghanistan, the Afghan government supports and prioritizes those SMEs which are more profitable in the country or those SMEs in which Afghanistan has advantage and thus is more productive than others; for example, SMEs in mining sector because Afghanistan is one of the countries which, according to several findings, has natural resource worth of multitrillion dollars, and one of those natural resources is mine. Thus, the Afghan government has been focusing on SMEs of mining sector so that it can get the most out of its one of the great advantages.

The Afghan government is also supporting and prioritizing SMEs of fresh and dry fruits and that's because Afghanistan is among the countries which has the best fresh and dry fruits with high quality both in the region and the world. For example, it has been the third consecutive year that the Saffron of Afghanistan ranks first in all around the world. In fact, Afghanistan exports up to 20 tons or more of its highly qualified Saffron to international markets, such as China, Pakistan, India and etc.

Last but not least, the Afghan government has also been supporting and prioritizing handicraft industries like carpets which are mainly made by women in north of Afghanistan mostly in Balkh and Faryab provinces. As a matter of fact, the Afghan made carpets or Afghanistan's carpets, like its Saffron, are one of the top carpets with best quality globally. Every year, the Afghan government exports its carpets in all around the world, including USA, UAE, and most of the Asian and European countries.

#### **Literature on the Context of Women in SMEs**

The overall business environment in Afghanistan has developed since 2001, when the Taliban government failed and new government came to power. This situation enabled women to start their own businesses in which they had upper hand like for example in handicrafts or making carpets. In other words, the Afghan women have started to establish their own businesses after 2001 since they found that ideal opportunity to start their own businesses. However, the opportunity which they had and they currently have is not equal with the one which men has in Afghanistan because unfortunately, women in Afghanistan, comparing to men, have been given less business opportunities owing to different social restrictions they have in the country.

As a matter of fact, women in Afghanistan not only contribute to handicrafts or carpet making but they also play an important role in agriculture development of the country. For example, since Afghanistan is one of the countries in which almost 70% its people are busy in agriculture and agriculture activities are mostly done in rural areas and thus in rural areas women work shoulder to shoulder with their men in agriculture.

In other words, although women play almost the equal role in agriculture sector of Afghanistan, in which some of SMEs are involved, they don't get rewarded or they don't get support for their work. That's why in Afghanistan, there have not been more women-owned businesses. However, recently given to some supports form the government and other international donors, women-owned businesses are increasing.

#### **Literature on the Impacts of Corruption and Conflict**

Afghanistan is one of the worst countries when it comes to corruption in the world and this corruption exist almost everywhere in the country, especially in governmental organizations. From a guard in the gate to the highest position in the hierarchy are unfortunately corrupted. In other words, in most of the cases, from the

guard at the gate to the heist position in the hierarchy of the governmental organizations ask for money in return to the work they do for others. According to international transparency corruption perception index of 2020, Afghanistan ranked 165 out of 180 countries globally and that shows how corrupted Afghanistan is in corruption.

Therefore, one of the main challenges which SMEs in Afghanistan face with is corruption. In fact, one of the main reasons why most of the SMEs in Afghanistan don't register themselves and ultimately don't get license is that most of the governmental organizations including those which are relevant to SMEs are corrupted. In other words, the government mostly supports or gives incentives to those SMEs which are close to top governmental officials. Sometimes, even the SMEs are owned by the top governmental officials, and thus will support their SMEs all along.

Moreover, Afghanistan is one of the most insecure in the world. According to Global peace index, Afghanistan ranked 158 out of 163 countries in 2019. Also, according one more findings, Afghanistan is the most dangerous country in the world with a lot of civilian casualties annually and the people of Afghanistan is the unhappiest in the world while the people of Iceland are the happiest. The insecurity in Afghanistan is mainly the result of people's illiteracy and poverty. Insecurity has affected almost every aspect of Afghans' life including SMEs in Afghanistan.

As a matter of fact, one of the other main challenges which SMEs in Afghanistan face with is insecurity, and this has made the country to be economically fragile and politically unpredictable in the world. Most of the medium-sizes enterprises don't want to broaden or develop their enterprises from medium-sized to the larger ones mainly because they are afraid of their security or owing to unpredictability of the political situation in the country, and this means that Afghanistan lose one of the biggest source of revenue and ultimately it means slow economic growth.

According to the Afghanistan Chambers Federation, in 2020 1,400 Afghan businesses, almost all of which were medium-sized enterprises with minimum capital of \$200,000, have left the country and went to Turkey. In fact, according to Khan Jan Alekozay, the deputy of Afghanistan Chambers Federations, since the security threats are high, most of the businessmen in Afghanistan allocate 25% of their revenue for their security. Despite this, 1,400 of them left the country and went to Turkey in 2020.

### **Literature on SMEs' Development Needs**

Development comes mainly by carrying out the needs. In each and every country, SMEs have different demands based on their needs. In Afghanistan, however, SMEs basically need three main supports. In other words, currently for their development, SMEs in Afghanistan need three main supports from both relevant governmental organizations and non-governmental organizations (NGOs) as well as financial institutions like banks. These three main demands needed by the SMEs are sustainable financial supports, technical supports, and managerial supports.

First of all, SMEs in Afghanistan need sustainable financial support from the governmental and non-governmental organizations (donors), more importantly from the financial institutions like banks. Most of the SMEs, for the time being, in Afghanistan establishes or starts or have started already with personal savings as well as with the support of family or friends which are not sustainable.

In fact, based on one finding, almost 70% of SMEs in Afghanistan, particularly small-enterprises, start their businesses with the support from their families and friends. That's why, according to one more finding,

only 2 out of 10 SMEs could survive and 8 fail in the second year of their establishment. So, there should be strong trust and network between SMEs and financial institutions like banks in Afghanistan so that most people will be encouraged to bring their talents out and start their own businesses which ultimately will lead to economic development of the country. However, unfortunately for the time being, most of the lending banks in Afghanistan have very high interest rate; for example, for 300,000 AFN, banks charge 90,000 AFN interest, according to Mahboba Zamani, one of the Afghan business women.

Secondly, SMEs in Afghanistan need strong technical support in order to meet with global standards. As a matter of fact, since most of the people in Afghanistan, including entrepreneurs, are illiterate and also poor, they either can't afford to buy to take specialized courses in the area they want to work or they are currently working or they can't afford to buy the needed machines. So, they use mostly basic methods or simply human labor which do everything by hand.

Therefore, the governmental and non-governmental organizations, should take several measures in order to support SMEs by providing trainings to SMEs owners and staff, and also their required machines in order to run their businesses effectively and efficiently. However, hopefully, there are some non-governmental organizations (donors) such as ACEBA, NRC, GIZ, ILO and son on which provide both training and machines for qualified SMEs in order to develop and broaden their business activities. Yet, the government is required to not only support SMEs itself but also attract more international donors so support SMEs in Afghanistan, especially technically, so that SMEs of Afghanistan can also compete globally by expanding themselves to international markets.

Last but very definitely not least, the SMEs in Afghanistan highly and urgently need both business and financial management supports from both the governmental and non-governmental organizations so that they can deal with a new phenomenon they face effectively such as COVID-19. Most of SMEs in Afghanistan don't meet standard level since, in some of the cases, no one in the company knows anything about management and how to manage the business overall. In other words, according to one finding, almost 75% of SMEs in Afghanistan are located in rural areas and that means that they are illiterate of required knowledge of the management.

Moreover, in today's world of globalization and more importantly digitalization, in order to survive and keep shining in the national and global markets, its highly recommended for SMEs to be well-equipped with the required knowledge of standard management methods, and this knowledge comes from training they get, and this training requires resources which most of the SMEs in Afghanistan either don't have or can't afford to have. Therefore, the government of Afghanistan is responsible to take this issue very seriously and support SMEs in all these areas by itself or attract more NGOs to do these services for SMEs in Afghanistan.

#### **Literature on the Provision of Business Development Services (BDS) and Finance for SMEs**

There have been mainly two methods of supports by NGOs or donors to SMEs in Afghanistan and those two methods were either outsourcing of BDS or directly offering them BDS by mostly offering trainings through national and international experts. Between these two supports, the second one has proved to be most effective and efficiently since it consisted of providing direct supports (training) which are offered mainly by International Non-Governmental Organizations and other big donors.

Moreover, BDS support also involves access to finance easily, especially for women since access to finance is limited to women in Afghanistan because most of the Afghan women who want to start a business

are dependent on their families which include either their husbands or other relatives like father, brother and so on. However, not only donors (INGOs) have supported businesswomen financially but also the government itself supported women who wanted to start a business to some extent. But, these donor funded programs are limited to some of the SMEs, while most of the SMEs which function in rural areas are far from these supports. Therefore, access to sustainable finance should be one of the main priority of all involving parts (government, NGOs, banks) and because of without access to sustainable financing, it is highly probable that soon or late most of SMEs will fail/collapse.

### **Literature on Government Policies and the Business Enabling Environment**

A favorable enabling atmosphere is essential for success of SMEs. The Afghanistan National Development Strategy (ANDS) and the Afghanistan Compact are the main guiding documents for promoting the enabling environment in Afghanistan. ANDS' agenda for private sector growth and development combines all of the recommendations and planned actions made by the government, non-profit organizations, and the private sector. This, along with the promotion of female leadership opportunities and the various vocational training programs for women in both urban and rural areas supported by international donors, represents a step toward formalizing gender mainstreaming in Afghanistan.

Moreover, in 2008, the government initiated the National Action Plan for Women in Afghanistan (NAPWA), and the Ministry of Women's Affairs (MoWA) formally addresses women's problems in the sense of a patriarchal social and political structure. The presence of the MoWA, which is exclusively dedicated to women's issues, is a major accomplishment on a formal level. Despite its poor place in the still largely patriarchal social and political structure, MoWA raises consciousness about women and society simply by its existence.

At a national level, in June 2007, the Enabling Environment Conference for Successful Private Sector Contribution to Growth in Afghanistan was held. The conference's guidelines, concrete steps, time frames, and responsible agencies shaped a detailed plan for the coming years. Given the difficult circumstances in the world, a number of actions related to developing policies have made good progress.

However, the proof need for various types of policies for weak and unpredictable situation, the government's capacity to enforce them, and the non-facilitative danger of further complicating business and promoting corruption all remain unanswered. 1) Simplifying rules and procedures and enhancing compliance, and 2) addressing human capacity issues were two recommendations relevant to enabling SME BDS services.

Similarly, major efforts are being made to promote trade through the promotion of exports. The Afghan-American Chamber of Commerce, the Afghan Business Council in Dubai, and the Afghan Embassy are all working to make trade between the two countries easier. Additional funding is being provided by regional and western countries to facilitate trade.

What's more, skills growth, as well as advisory services and BDS promotion, have been prioritized in license and trade-related regulatory policies at both the national and provincial levels. Licensees were also given training on important topics like marketing and procurement. In addition, the Ministry of Commerce and Industry (MoCI) has passed a SME policy for agro-business in collaboration with the Ministries of Agriculture, Irrigation, and Livestock (MAIL) and Mines and Petroleum (MoMP), as well as other strategies aimed at facilitating limited mining.

### **Research Methodology**

This research has specifically discussed new issues and their management perspectives which SMEs in Afghanistan face on their development, especially after the global pandemic of Coronavirus which has turned a new page in global order. The data in this research have mainly gathered from two main sources: face-to-face interview with SMEs' owners, relevant governmental as well as non-governmental organizations (NGOs), financial institutions and previous literatures available in SMEs issue.

As a matter of fact, primary data were collected by conducting either face-to-face or virtual interviews with 50 small and 50 medium-sized enterprises, relevant governmental organizations like Ministry of Industry and Commerce, Ministry of Economy, Ministry of Finance as well as Afghanistan Chamber of Commerce & Investment and also non-governmental organizations like ACEBA, GIZ, ILO, NRS and so on. Further, interview with three lending banks such as Afghanistan International Bank (AIB), Afghanistan Islamic Bank and Ghazanfar Bank as well as interviews with 10 professors from different universities has also greatly contributed to the primary data collection. The secondary data, however, were gathered from in-depth studying existing literatures regarding SMEs in Afghanistan and the world, especially in developing and underdeveloped countries like Afghanistan, academic articles, and so on.

### **The Subjects**

The subjects participated in this study were 50 small and 50 medium-sized enterprises located in Afghanistan, particularly in six major provinces such as Kabul, Balkh, Herat, Nengarhar, Kandahar, and Faryab. The researcher's focus was mainly on enterprises located in rural area of Afghanistan since -particularly in the case of small enterprises—almost 70% of them are located in rural area.

As a matter of fact, the researcher used sampling technique and the total sample size of this study was 50 small and 50 medium enterprises. Responses of the subjects were gathered via the questionnaires which were distributed among them. The SMEs that were questioned and interviewed in-person were mostly in Kabul, Balkh, and Faryab provinces. However, some SMEs that responded to the survey questionnaires through virtual interview were from other major provinces of Afghanistan like Herat, Nengarhar, and Kandahar.

Moreover, governmental and non-governmental organizations, financial institutions like banks which interviewed were all in Kabul, Balkh, and Faryab. In short, the followings were considered for the interview:

- 50 small and 50 medium-sized enterprises' owners. These SMEs were from different parts of Afghanistan with different businesses who could represent most of businesses of their kinds and who had more experiences than others. They were also well aware of new issues faced by SMEs in Afghanistan.
- Governmental organizations such as Ministry of Industry and Commerce, Ministry of Economy, Ministry of Finance, Afghanistan Chamber of Commerce & Investment as well as their subordinates in other provinces like The Balkh Directorate of Industry and Commerce and the Balkh Chamber of Commerce & Industry. The main objective of interview with governmental organizations were to get knowledge about new management perspectives which SMEs should adopt with in order to deal with new issues they face, especially post-COVID-19.
- Non-governmental organizations (NGOs) or international organizations that support SMEs in Afghanistan such as GIZ, ACEBA, ILO, and so on. The main objective of interview with these organizations was to not only get knowledge about new management perspectives which SMEs should consider in order to deal with new issues they face, especially after COVID-19, but also challenges they face currently.

- Financial institutions like lending banks such as Afghanistan International Bank (AIB), Islamic Bank of Afghanistan, and Ghazanfar Bank. The interview was conducted with these banks in order to get knowledge of how SMEs deal with their financial issues such as financing, lending, as well as what are the main challenges of SMEs when it comes to financing and why there is mistrust between banks and businesses, particularly SMEs, in Afghanistan.

- 10 relevant professors from both public and private universities of Afghanistan. They mainly include professors from Kabul University, Balkh University, Faryab University, Kardan University, Ghaleb University which are located in Kabul as well as Taj University and Rah-e-Sadat University which are located in Balkh province. The main objective of interview with professors was to get their knowledge about challenges and opportunities which SMEs have in Afghanistan as well as both issues and management perspectives of SMEs' development in Afghanistan.

### **Research Methods**

Owing to the lack of enough literature on issues and new management perspective of SMEs' development in Afghanistan, both qualitative and quantitative research methods were used in this research.

A survey through a questionnaire on challenges and threats affects small and medium enterprises development in Afghanistan as well new issues facing by SMEs, especially after COVID-19 from SMEs' owners and a survey through a questionnaire on opportunities and new management perspective for SMEs from relevant governmental and non-governmental organizations. A total of 100 questionnaires were distributed among 50 small and 50 medium-sized enterprises located in Kabul, Balkh, and Faryab provinces out of which more than 90 were collected back as complete responses.

For data collection, the study utilizes questionnaire consisted of a total of 20 close ended questions and 5 open ended questions. The questionnaire had three sections. The first section contained socio-demographic details of respondents. Second section consisted of the factors like challenges and threats and opportunities affecting the performance of SMEs, and the last section had questions related to issues and new management perspective of SMEs in Afghanistan. The effects of COVID-19 on businesses were also included. The questions were short, simple, and crystal clear.

Furthermore, in this research, sampling technique and Google Form were used, and they spread through personal and friends' networks, and then data were gathered in excel format for analysis and findings. Questionnaires used for SMEs were mainly reflecting on issues and new management perspective on SMEs' development in Afghanistan. Data were collected from both male- and female-owned enterprises. As a matter of fact, the data were gathered from SMEs of different sizes which were mainly dealing with wool and cashmere, motorcycle, carpet, wheat, oil, gas, handicrafts, dress, candy, cake, flour and other service providers.

Researcher also prepared both open- and close-ended interview questions based on research questions and conducted in-person and online interview regarding new issues and management of SMEs' Development in Afghanistan with both SMEs' owners and governmental and non-governmental organizations. The main objective of the interview was to get in-depth knowledge of SMEs' development in Afghanistan, including opportunities, challenges as well as issues and new management perspective.

Names of some of the SMEs were gathered from the relevant governmental and non-governmental organizations. For instance, "ACEBA" assisted in accessing over 20 SMEs with whom they have worked and supported before. Moreover, some financial institutions in Kabul, Balkh, and Faryab like Ghazanfar bank also

introduced some of their client SMEs, and thus have interview with them regarding challenges, threats, effects of COVID-19 as well as new issues they have been facing with currently.

To find out exact answers for research questions, researcher analyzed each interview question accordingly. In other words, interview questions were made and arranged into two groups of respondents; SMEs owners and governmental as well as non-governmental organizations. Some of the questions, however, were asked not only from SMEs owners and governmental as well as non-governmental organizations but also financial institutions and professors. Below, for questions related to SMEs, it's written SMEs/O in front of it, which means SMEs' owner while for questions related to governmental and non-governmental organizations, it's written G & N-G/O which means governmental and non-governmental—including international organizations. Those interview questions were:

- (1) What are the current challenges facing by SMEs in Afghanistan?—SMEs/ O
- (2) What are the threats for SMEs in Afghanistan?—SMEs/O
- (3) What are the opportunities for SMEs in Afghanistan?—G & N-G/O
- (4) What are the recent issues regarding SMEs in Afghanistan?—G & N-G/O
- (5) What are the new management perspectives for SMEs in Afghanistan?—G/O
- (6) How can financial access be a barrier for SMEs in Afghanistan?—SMEs/O
- (7) Do you have your family support? When do you do business?—SMEs/O
- (8) Which factors did encourage you to start your own business? Any economic problem?—SMEs/O
- (9) What do you think the government should put in place to solve the problem affecting SMEs in Afghanistan as well as to meet the current issues' demands?—SMEs/O
- (10) What have the effect of COVID-19 been on your business?—SMEs/O
- (11) What is your recommendation for those who want to start a small and medium-sized enterprise from scratch?—SMEs/O

However, the open-ended questions were:

- How has the SME's changed in the past five years? And do you predict what will happen in the next 5 to 10 years?
- How is financing important for the businesses, particularly for the business you are doing?
- Who's making the greatest advancement in the SMEs? What are they doing and how can we advance the SMEs?
- What have the effect of social medial been on the promotion of your business?

### **The Procedure of the Experiment**

The whole research lasted a semester (18 weeks). First, the researcher conducted an in-person interview with 30 small and 40 medium-sized enterprises located in Kabul, Mazar-e-Sharif (Balkh) and Maymana (Faryab), especially rural areas. This was because 70 percent of small enterprises of Afghanistan are located in rural areas. Then, the researcher conducted an online interview following a questioner with 20 small and 10 medium enterprises located in other three major provinces (Herat, Nengarhar, and Kandahar) in order to get in-detail answers of research questions.

Also, the researcher conducted in-person interviews with governmental and non-governmental organizations including international donors' agencies located in Kabul, Balkh, and Faryab and distributed questioners to them. Furthermore, to know more about SMEs development in Afghanistan, especially about

issues and new management perspective, the researcher referred to 10 relevant university professors in Kabul University, Balkh University, and Faryab University because they are well-equipped with the most updated knowledge of this issue.

The researcher undertook a regional trip to Kabul and Faryab provinces for in-depth assessment of retailers, wool and cashmere, motorcycle, carpet, wheat, oil, gas, handicrafts, fruit, cake, candy, and flour service providers. In addition to this, the researcher undertook a comprehensive field trip to Balkh province, where he conducted face to face interview with some of the SMEs' owners, and these were from cashmere and wool, fresh and dry fruits as well as carpet businesses. In fact, these businesses were representing Balkh province's major and common SME enterprisers.

Moreover, in Balkh province, four main interviews were conducted and three focus group discussions were held on February 5, 2021 and February 13, 2021. The main interviews were with the head of the ACEBA (donor), a manager from the Balkh Directorate of Chamber of Commerce and Industry (BDCCI), zone manager of Afghan Women Chamber of Commerce and Industry (AWCCI), and the Head of a Cashmere and Wool Industrial Company. The interview questions were designed to get answers of challenges, opportunities, effects of COVID-19, and other current issues and new management perspective regarding SMEs' development in Afghanistan.

What's more, visits to Faryab were conducted from 14 to 18 February 2021 to get in-depth knowledge of SMEs in that province. There also some important and key interviews with not only some of the SMEs' owners but also local governmental officials like the head of the Faryab Directorate of Industry and Commerce were conducted. The SMEs which interviewed were mainly from enterprises like dry fruits, fresh fruits, handicrafts, cashmere and wool, and flour.

Furthermore, between 20 and 23 February 2021, some of the SMEs, governmental and non-governmental organizations, and financial institutions like banks were interviewed in Kabul. The objective to travel in Kabul was to get in-depth knowledge of issues and new management perspective in SMEs located in Afghanistan. That's why the researcher met with a wide variety of SMEs and governmental as well as non-governmental organizations and financial institutions like banks. All of the above interviewees were asked a number of open and closed-ended questions regarding SMEs development in Afghanistan, particularly about new issues and their management perspectives.

### **Research Results and Findings**

The SMEs are very crucial for the overall economic growth of each and every country, especially underdeveloped and developing countries because comparing to large business/companies, SMEs, particularly small-sized enterprises, don't need huge investment, rich experience, and developed technologies, and thus there are not riskier in fragile countries. That's mostly true in this case of Afghanistan, the country with the fragile and poor economy as well as poor security.

This part discusses the findings of face-to-face and virtual interviews with SMEs' owners, governmental and non-governmental organizations, financial institutions, and university professors.

#### **Findings on the Demand and Supply of SMEs' BDS**

In this section, the researcher included his findings relating to the demand and supply of SME business development services.

### **SMEs Demand for BDS**

The research discovered that SMEs have a substantial demand for BDS, based on a combination of four main criteria: consistency, relevance, turnaround time, and versatility, based on discussions with key stakeholders. SME demand for BDS can be either cross-cutting, such as common needs irrespective of industry or form of business, or tailored in a technological, strategic, or bespoke manner to the business process.

As a matter of fact, short- or long-term, simple, advanced, or specialized, cross-cutting and personalized needs can differ from case to case. Furthermore, depending on the changing background of individual companies, they may move from simple to advanced levels. The researcher divided the needs into “micro or small enterprises” and “medium or relatively large enterprises” based on triangulation of survey results and primary data from interviews.

### **Identifying SMEs' Needs and Supporters' Goals**

In fact, a large percentage of micro and small businesses are unlikely to understand the significance of BDS due to a lack of “business literacy”. The majority lack the comprehension skills needed to comprehend their true needs and progress to the next stage of business size and sophistication.

The researcher discovered that enterprises with low growth potential tend to be numerous and contribute to the informal economy's survival. Owing to the pressures of external factors in the business world, such as unnecessary scrutiny from corrupt officials, many people choose to stay small. Given Afghanistan's fragile state, entrepreneurs (particularly from this group) are more likely to seek opportunistic quick gains, deal making, low or no risk/cost options, and high flexibility to adjust as opportunities arise. These are fundamental roadblocks that obstruct the acquisition of useful skills, limiting potential development.

Other SMEs, on the other hand, are more likely to provide a solid foundation for formal economy growth. These are referred to as promising enterprises because they have a variety of driving factors, including a willingness to develop against structured processes, information and capability absorption ability, and expansion ability; powerful backward (distribution network) and/or upward (dispersion or real economy) linkages; and an enterprising mentality and attitude that makes for effective organizational and business management (Arowomole, 2000).

In this context, donor facility managers also struggle to recognize and choose promising enterprises to graduate from smaller to larger firms, and donors struggle to optimize the efficacy of their support by selecting/targeting promising enterprises with the greatest potential to increase employment and reduce poverty.

There is an acknowledgement amongst stakeholders met that baseline literacy is low, that attention needs to be paid to the fact that a large number of small business owners are illiterate, and thus the training programs provided for them have to be adapted to reflect this.

Due to the low literacy and numeracy levels of most entrepreneurs, a lack of market knowledge, and insecurity, traditional informal methods of doing business in Afghanistan remain entrenched. Traditional informal approaches, on the other hand, have proven to be an effective risk management technique when applied to the fragile context, which necessitates far greater resilience, versatility, opportunistic, and deal-making conduct. Furthermore, in order to keep distance from negative interest groups (such as corrupt government officials, kidnappers, terrorists, warlords, politically active individuals, competitive businesses, or ethnic groups), these strategies necessitate a low profile, a small scale, no formal accounts, and discreet operations.

### **The Legacy of Past BDS Programs**

From the mid-2000s onwards, the growth of the private sector in Afghanistan became a priority for government agencies. Despite this, the government did not have a SME policy until 2009, and the strategy was not enforced until 2011. Donors and their implementing agents have traditionally used a mix of two tactics in the last decade to ensure a supply for SMEs' rapidly changing BDS needs. There are the following:

- Build a BDS provider market by outsourcing BDS to local BDS firms and/or training them to boost their efficiency for better results.
- To provide direct assistance, which will be carried out by project personnel. This is the model chosen by organizations such as AKDN, ASMED, and AREDP, which are recruiting and educating national staff to deliver BDS with the assistance of expert advisors and specialists often hired in foreign markets.

Stakeholders claim that the first generation of private sector development (PSD) projects developed a moral hazard by disproportionately disbursing donor funds over short time periods in the context of a fragile socio-political, economic, and security situation, resulting in unsuccessful and unsustainable interventions.

A majority of beneficiaries tend to have similar aspirations for free services, which were accepted and artificially stimulated early market growth, paving the way for current PSD intervention platforms. According to current trends, the younger generation (typically aged from 20 to 30, from business families, local power center families, or international returnees) is better informed and capable of understanding and appreciating business concepts.

### **Existing Donor-Funded Business Development Services Programs**

Advisory, BDS, and technical assistance are often provided by donor-funded initiatives and non-governmental organizations (NGOs). There are, however, isolated cases of more market-driven supply, such as Afghanistan Growth Finance, which was established in 2007 by Small Enterprise Assistance Funds (SEAF) and supports larger SMEs through commercial financial products and advisory services.

### **Challenges, Gaps, and Availability of BDS**

In Afghanistan, the main challenges for BDS providers are achieving impact, outreach, cost efficiency, and sustainability.

- Choosing and identification of enterprises: Identifying targets with the necessary level of awareness, retention potential, and inspiration for donor projects is difficult. The low to no risk nature of participation, on the other hand, tends to be a major factor attracting beneficiaries (not necessarily entrepreneurs) to donor-driven ventures. Verifying the validity of information given by beneficiaries is often difficult and expensive, since producing or creating documentation and falsifying physical objects to win loans, bids, or grants is not unusual. While referral strategies are thought to be a safer alternative, they still carry the risk of nepotism.

- Most of the implementing agencies have recognized the need for experience in diagnosing market needs, as well as the ability to recognize the main problem(s). Company owners usually have lists of demands that they prioritize, but business development requires diagnostics may become distorted if they are focused solely on demand rather than further study or review. This evaluation is difficult due to a lack of business analysis skills among project workers or BDS providers. The problem is compounded by the fact that business diagnosis is often based on face value and subjective evidence. The Business Incubation Hub (BIH) emphasizes entrepreneurs' limited capacity to objectively consider their own desires, goals, and acknowledge hard facts about their businesses.

- Efficiency, relevance, processing time, and versatility of BDS: Useful BDS can only be given when the problem is clearly described in its context and/or when there is a chain of problems that would necessitate long-term handholding, mentoring, or coaching help for the beneficiary. Efficiency (knowledge and capacity to solve the problem); importance (bespoke software to solve the problem); turnaround time (time taken to provide or implement the solution); and flexibility (time taken to provide or implement change) (adaptability to the changing context and situation).

- Detection of BDS competent suppliers: In Afghanistan, seeking capable service providers is a major issue. The demand for BDS providers tends to have a lot of promise, but it is largely dependent on donor funds and interventions. As previously stated, SMEs cannot be forced to bear the expense unless they see the service as having real value for their company or whether it can be calculated using agreed-upon main performance metrics. Furthermore, customer satisfaction with BDS is frequently a concern, owing to a mismatch between requirement and poor service quality.

### **Achieving Sustainability of Business Development Services**

BDS suppliers that survive in the market are largely guided by donors, and they often complete formalities for businesses requiring financial or non-financial assistance from donor-funded programs or banks. Furthermore, since the inception of ASMED, the policy of outsourcing direct in-house provision to outside private (and, to a lesser extent, not-for-profit) providers have been heavily promoted, with the expectation that BDS providers might become private business training centers, institutions, or local consulting firms.

In the current Afghan context, however, establishing a BDS provider market and requiring them to be self-sustaining and non-donor based is difficult. According to discussions with the Afghan government and implementing agencies of donor-funded programs, a BDS providers' market is unlikely to be competitive in the short to medium term without donor funding.

### **Findings on SME Access to Finance and the Provision of Funding**

In this section, the researcher focused on SMEs' access to finance and financing, as well as a thorough examination of Afghanistan's overall financial system. This provides a look at sector's underlying problems and how they impact small businesses.

### **The Afghan Financial and Banking System**

The Afghan financial and formal banking system is under-developed, narrow, and fragile. In particular, after rapid growth of microfinance provision between 2002 and 2006, the number of Afghans accessing microfinance loans has declined sharply. In December 2013 registered institutions, including First Microfinance Bank of Afghanistan (FMFB) and the Islamic Cooperative Movement, had 337,000 clients including 227,000 savers and 163,000 borrowers.

Afghanistan's financial and formal banking system is underdeveloped, small, and vulnerable. After a period of rapid growth in microfinance provision between 2002 and 2006, the number of Afghans using microfinance loans has sharply decreased.

Banks will deploy a more proactive strategy to increase their share of lending channeled to SMEs, according to the World Bank, IFC, and managers of donor facilities, as the general business climate improves. To learn from the lessons of the recent past, stakeholders agreed that programs that help financial institutions to increase their exposure to SMEs would be needed.

After a period of rapid growth from 2006 to 2009, the microfinance sector was restructured, leaving Afghan Microfinance Institutions (MFIs) with a weak reputation and operational capability. MFIs that are part of international networks (and have a strong track record of working with DFID in other conflict-affected areas like northern Uganda) have experienced major losses in Afghanistan. The number of MFIs still operating in the country has dropped from 14 to 6, and their scope has shrunk by nearly half. Due to the rollover of bad loans and the higher average amount lent by FMFB relative to its peers, the overall gross portfolio appears stable.

Furthermore, field research in Kabul, Faryab, and Balkh has verified feedback that basic numeracy and literacy, as well as financial literacy, are lacking, and that clients are unable to grasp the fundamentals of finance as well as the complexity of most modern financial items. Investing in financial capacity will be critical and in line with government and donor priorities around the world.

### **Access to Finance at the Base of the Pyramid**

Microenterprises and small businesses have a very poor penetration of formal finance, according to the researcher's findings in Balkh and Faryab. Microenterprises and small businesses seldom use banks in Faryab province, but larger businesses do, mainly for depositing funds obtained or to be transferred. Micro-enterprises need basic financial services, according to interviews with ACEBA, Hand in Hand, Ghazanfar Bank, and other non-governmental organizations (like a safe place to protect their savings; payment and remittances). Currently, they primarily use Hawala (Money Transaction), remittance circuits, and currency changers to obtain these facilities.

Furthermore, microfinance goods do not adequately address the needs of the rural economy, and an embryonic banking system's expansion into rural areas is not a priority. Mobile banking and other technology-based solutions have yet to be confirmed, and pilots such as M-Paisa have stalled. There's also room for more models, especially those based on Sharia-compliant financial products. The fledgling Islamic investment and finance cooperative movement has a greater average loan size than most MFIs, a higher percentage of loans going to small businesses (rather than microenterprises), and agriculture accounts for 35 percent of loans in the most prosperous northern provinces. There's also room for more models, especially those based on Sharia-compliant financial products.

### **Systemic Risks to the Financial System**

The new IMF assessment applauds the Afghan government's efforts to press for important changes, but states that delays have been experienced in implementing "the value added tax and sending to parliament the anti-money laundering and counter-terrorist financing legislation, as well as amendments to the central bank rule." There are still systemic flaws in the financial sector, especially in the banking system, which need to be addressed more aggressively. Specifically:

- The capacity of Da Afghanistan Bank, Afghanistan's central bank, to carry out its regulatory and supervisory mandate is still limited;
- Da Afghanistan Bank did not take all restructuring decisions after the World Bank shared the findings of the twelve bank audits in 2012<sup>86</sup> 87; and
- The national payment system is still in its early stages and cannot deal with uncontrolled cash and Hawala transactions.

While of a technical nature, the possibility that Afghanistan will be added to the Financial Action Task Force/General Authority for Investment and Free Zones international cooperation agreement's black list is a

major source of concern for the Afghan banking sector's reputation and integrity, and its ability to maintain correspondent banking relationships with the international community, especially in Europe and North America, will be jeopardized.

During interviews in Kabul, it was reported that blacklisting would put a stop to many current attempts to expand donor programs like the German-managed and World Bank-funded Afghanistan Credit Guarantee Facility, and that the threat is already limiting Afghan banks' ability to support foreign trade transactions like opening correspondent banking lines and accepting letters of credit on banks of Afghanistan. According to DFID, both the Upper and Lower Houses of Parliament have passed anti-money laundering legislation since the IMF assessment, but several more measures must be taken to satisfy international requirements.

### **SME Needs for Financial Services**

Despite the fact that access to finance is only ranked as the fourth most significant obstacle in the latest World Bank Enterprise Survey, a higher proportion of Afghan companies (43.6 percent) see it as a major constraint, relative to the South Asia region (33.4 percent) and global averages (31.2 percent).

### **Obstacles to SMEs Access to Financial Services**

Despite the high demand for credit, there are a number of barriers to credit delivery that prospective projects will need to address, including the following:

- On religious grounds, the majority of clustered companies oppose interest-bearing loans, believing that financial products and systems are incompatible with their religious beliefs;
- High interest rates, lengthy regulatory procedures, short maturity terms, and onerous collateral criteria (usually a property title for banks and a character reference from a locally appointed conventional community representative for MFIs) are all reasons for concern;
- Acquisition of modern tools and machinery through increased access to loans would entail relevant training, in addition to pre-existing forms of learning through the apprenticeship system, and;
- The size of loans (ranging from 5,000 to 25,000 Afghanis) is inadequate to meet most of the needs of small businesses; loans of \$25,000-\$50,000, which are especially in demand from medium-sized businesses, are difficult to come by in the Afghan market today; furthermore, there is a mismatch in repayment schedules, as demand is for medium-term facilities, while offers are for shorter-term facilities.

These factors can play a role in businesses' self-exclusion from the formal financial sector. However, there are other factors that affect self-exclusion, such as a lack of confidence in banks following the failure of the Kabul Bank (small and micro-entrepreneurs have negative perceptions of the banking sector), and a lack of understanding of the position of self-sustainable financial institutions, because of low financial knowledge.

### **Existing Donor-Supported Programs Addressing SME Access to Finance**

According to the results, the US policy in Afghanistan to support access to finance is uncertain, while the World Bank and IFC initiatives have more clout and are progressing well. The World Bank's additional support for the Microfinance Investment Support Facility for Afghanistan (MISFA), in addition to pre-existing donor funding, will be targeted at the poorest households, and MISFA will need to devote all of its human resources to making the best use of the funds. The roll-out of the Collateral Registry at Da Afghanistan Bank is sluggish, and little is being done on the institutional and capacity-building fronts because foreign experts who were previously seconded to Da Afghanistan Bank over the last decade have not been replaced.

At the lower end of the industry, the Microfinance Investment Support Facility for Afghanistan (MISFA) is the leading provider of wholesale funds and capacity for the microfinance sector. The World Bank will provide new funding and technical assistance to the poorest households (as part of their new Access to Finance Program's "Targeting the Ultra-Poor" component). MISFA is unlikely to have the resources or corporate culture to represent the small and medium-sized segments of the market in the immediate future.

### **Financial Product, Actor and Instrument Variety**

According to the interviews conducted, there is still a long way to go in terms of widening the variety of financial goods, actors, and instruments available to Afghan SMEs. However, a few donors are working to solve this issue, including the World Bank, which recently approved a \$50 million Access to Finance Initiative, and USAID, which is refocusing its FAIDA program. Lack of product design competence, unmet demand for Islamic finance, a lack of suitable and bespoke financial products, a lack of diversity of suppliers, and high service costs are among the major gaps and weaknesses. Each of these is discussed in greater depth here.

### **Financial Products**

A general lack of competence in developing, marketing, and selling the right financial products required by SMEs has been identified as a major bottleneck across the financial sector. The urgent need to resolve the lack of middle and senior management competencies in banks in general, and understanding the needs of the SME segment of the market in particular, was a recurring theme among interviewees in the public sector, Afghan institutions, MFIs, and bankers.

Many key financial firms have several senior positions that are unfilled, and recruiting expatriates is costly and may pose security and cultural concerns. Longer timelines, better matched with businesses' cash flow needs (and seasonal cycles in rural and agribusiness sectors), have been identified as basic criteria by interviewees and other sources. Furthermore, medium-term equipment financing tends to be in demand, and strategies such as asset-backed funding, leasing, Islamic (Ijara), and hire-purchase can be used to meet this demand.

### **Islamic Finance**

In large segments of the Afghan business community, there has been clear feedback from interviewees and field evaluations, as well as during the inception process, that there is cultural and religious unease with debt and interest items. As a result, businesses of all sizes, shapes, and types anticipate that the government, regulators, and donors will press financial institutions to expand their use of Sharia-compliant financing.

However, practitioners who have conducted pilots of Islamic products claim that they are not widely used by providers and consumers due to their complexity and high cost, which serve as barriers to adoption. Several unsuccessful attempts have been made to fix the enabling climate for Sharia-compliant financial products tailored to Afghanistan's socio-cultural background. Wide variety of stakeholders, including market authorities, officers, religious scholars, legal advisers, and customary and legal courts, will need capacity building.

### **Financial Providers**

In the absence of the detailed audit of banks in Afghanistan, and of consolidated audited data on financial sector, assessments during the inception phase remain valid.

- The banking system that represents more than 80 per cent of the financial system is not aligned to serve the smaller end of the market. Moreover, the data available on customer needs that are accessible are biased towards urban and more secure areas.

- There are few respected regulated financial institutions, including a few commercial banks such as AIB, and a few microfinance institutions dominated by First Microfinance Bank of Afghanistan (FMFB) that represent around 38 percent of microfinance clients and borrowers and around 50 percent in volume of the microfinance market.

- Between 2010 and mid-2013, MISFA was focused on restructuring the microfinance sector and only recently considered a careful expansion of its support to new players and a development of its range of activities. It will take time to make the microfinance sector attractive again to new players after the departure of reputed industry leaders such as ASA and BRAC bank.

The lack of diversity of formal providers, means that the financial needs of many Afghans are fulfilled through traditional and informal services.

### **Cost of Finance**

Even when borrowers are not religiously opposed to paying interest and find some banks and MFIs willing to lend them money, they object to the high interest rates charged, especially by MFIs. This is a difficult problem, and it will likely remain so because doing business in Afghanistan is costly and risky.

Furthermore, there is a small willingness to broaden bank portfolios in priority economic sectors (like manufacturing), and agriculture sector is notoriously difficult to evaluate for commercial banks or finance using conventional microfinance methods. Moreover, there is little competition, limiting the downward pressure on costs. Many donor programs are being phased out, and new programs are being planned to be more market-driven and cost-shared, placing additional pressure on blended cost of funding.

As a wholesale apex facility refinancing the microfinance sub-sector, MISFA is expected to reduce the cost of funds across the board. However, it is unclear if it has had any impact on the cost of funds for microfinance beneficiaries so far, according to interviews with practitioners.

What's more, the SMEs that responded to the survey are diverse in terms of business types, nature, and scope. They varied in terms of capital size and monthly average revenue, as well as job size and age. Manufacturing and service providers accounted for approximately 60% of the SMEs so far. The manufacturing SMEs have needed to access grants, donor funds, loans from other personal sources, and have included a significant amount of capital from their other personal companies, while the service providers typically do not have larger financial needs.

Given the less favorable economic conditions in Afghanistan, trade businesses usually need more resources and stocks. As a result, the market is less inclined to trade, import/export businesses. During the study, the researcher just came across a few trading companies. This fact in Table 2 reflects a finding that fewer investors are investing in Afghanistan's business activity. Entrepreneurs tend to operate with little to no resources. A large number of manufacturing businesses reflect self-sufficiency and reduce reliance on imports while generating employment for more people regionally.

### **Ratio of Access to Finance and SME Needs**

The study asked SMEs a question as well as additional details about whether they had accessed bank funding for their companies in recent years. 7% (7/100) of SMEs said they had used bank loans, while 8 percent (8/100) said they had used bank loans more than once. The SMEs who obtained loans claim that the loan application process is straightforward, but it involves a considerable amount of time, paperwork, and a long background of business. This represents the credit performance and productivity of line employees as well

as credit administration at banks and SME lending institutions. People usually assume that having a loan from a bank is either exceedingly difficult or necessitates personal references, and that they do not meet any of the conditions to receive a loan from a bank.

Banks and financial institutions, on the other hand, believe they have fantastic channels, have well-trained credit processing workers, and are constantly developing their loan-giving operation. However, almost all remaining SMEs claim that bank loans are too costly because their companies aren't profitable enough to cover loan interest costs while still leaving some money on the table.

### **Suggestions of the SMEs Regarding "Access to Finance"**

The study included extensive background information on the SMEs, their needs, sources of finance for their businesses, the importance of financing for businesses, and available options, as well as several "Open Ended" questions that encouraged the SMEs to write about any issues they face in running and sustaining their businesses. Financial institutions/banks, the central bank of Afghanistan, as well as the private sector/SMEs, have all benefited from the SMEs' suggestions, guidelines, and concepts. The recommendations, along with the results of the interviews and meetings with SMEs, have been classified so that they can be counted and evaluated and commented on.

The survey authorized SMEs to broaden their recommendations; at the end of the survey, 47% of surveyed SMEs had a recommendation. SMEs could write their suggestions in Dari/English narrations in an open box on the survey. The advice and narrations were classified and counted manually. More than one recommendation was included in SMEs that included recommendations. The average response rate per SME is two (meaning that every SME had at least 2 recommendations).

More than half of the guidelines state that bank loans are prohibitively costly, and that lower interest rates are preferred. According to interviews, SMEs believe the government should interfere either by providing SMEs with loan subsidies or by imposing strict controls on financial institutions to keep interest rates as low as possible. Surprisingly, 20% of the responses from SMEs address the need for donor funds, despite the fact that this question was never asked in the survey. More ventures are preferred by SMEs, as more donor funds in the form of grants and no-interest loans.

This has generated a high degree of expectation for SME and other forms of entrepreneurs. 26% of SMEs wished to obtain loans with Islamic terms and conditions or loans tailored to the needs of startups. There are many Islamic loan products available at different banks, but sadly, few people are aware of them or do not recognize people or SMEs they are unfamiliar with. Bank loans with daily on-time repayments are difficult for SMEs to pursue.

SMEs typically require longer-term loans with lower repayment amounts, as well as loans that are less costly. The majority of the responses (80% of all responses) focus on the financial institutions/banks improving loans, loan conditions, lower interest rates, faster processing duration, new/customized loan products, easily accessible facilities, and improved customer support in one way or another.

### **Challenges of SMEs**

This study looks at the challenges that arise before and during the start-up of a company, the challenges that SMEs face during their operations, and the challenges that SMEs face in the business world. It also highlights the regulatory restrictions and threats that companies face.

**Setting up a Business**

It is difficult for investors to determine whether or not to start a company in Afghanistan, which is fraught with difficulties. The challenges begin with the establishment of SMEs, especially small businesses, and continue as the company grows. They would not, however, simply vanish with the business's closure. One of the most common ways of doing business in Afghanistan, for example, is to copy other people's ideas. In the Afghan industry, starting a new company entails first identifying a profitable business and then replicating the model. In certain cases, the product formula and even the process of production are copied, causing competition to be hampered. In fact, for rivalry, the playing field is not leveled.

Donor organizations must now focus on the development of innovative business concepts. Donor organizations should concentrate their resources on SMEs that incorporate innovative technologies, strategies, and processes; however, the government should focus on intellectual property rights and regulation. Chemical formulations are not patentable under the new Intellectual Property Rights Law, which is a challenge for some manufacturers. Meanwhile, existing SMEs must be supported to expand; for example, resources must be readily available, technological assistance must be readily available, competition must be fair, and markets must be expanded.

Furthermore, paperwork, capital requirements, and stacks of documentation such as tax forms, contracts, bank statements, and so on should not make it difficult to start a new small business; rather it should be easy to do so. SMEs should be excluded from bureaucratic paperwork, capital requirements, taxes, and everything else that discourages them from growing. Instead, they must be provided with educational, financial, legal, and political assistance, as well as tax exemptions.

For example, bureaucratic business licensing is an obstacle to entry; updating business licenses with the ministry of commerce and industries still takes a long time. The process of renewing a license can take up to a month. Renewal of licenses necessitates a large number of paperwork and signatures, which raises the time and expense of processing licenses, raising the market for brokers and encouraging corruption. Investing in the development of new business concepts and using e-governance to reduce bureaucratic processes may thus be beneficial.

**Barriers to Growth**

Other challenges which cause slow growth and likely failure of most existing SMEs once they have successfully established are barriers which include cultural, political, legal, economic, and social factors that stifle the growth of startups and small businesses. The label "Made in Afghanistan" has a negative reputation in the Afghan market, prompting some manufacturers to label their goods as "Made in Iran" or "Made in Pakistan". Since customers have little faith in Afghan brands; they have more faith in brands from other countries.

Meanwhile, in the Afghan industry, illegal and unethical competition is ignored and surpassed. Competitors use some unlawful means to stifle competition or erect entry barriers. The market's existing manufacturers, for example, refuse to do business with SMEs. Others make music without obtaining a license. Some SMEs, on the other hand, have been able to keep up with consumer demand, while others have struggled and even closed their doors.

Costly money, high taxation, the necessity of standard marks, and low consumer trust are all economic factors. Since the interest rate is so high, only high-return companies can survive in the market. Meanwhile,

capital-intensive businesses are difficult to start. Furthermore, SMEs are not only denied tax breaks, but they are also required to pay the same taxes as large businesses. In fact, the taxes charged by SMEs and large industries are similar, which could be called a barrier to entry.

Another thing that has shrunk the market is the lack of a proper local online payment system. Online transactions are common among young people who have access to the internet. Although online sales are a lucrative market for SMEs, they are unable to sell their goods due to a lack of local online payment systems. Some startups, including those that sell on Facebook and other sites, also accept cash on delivery.

The National Unity Government's (NUG) lack of funding for SMEs and entrepreneurs is one of the political reasons. There are currently no or limited plans available to support SMEs; in Herat and Kabul, more than 100 newly formed companies were closed in 2018 and more than 400 were closed in 2019.

Furthermore, ACCI is currently monopolized, serving only the needs of a few big sharks in the industry. The Afghanistan Chamber of Commerce and Industries (ACCI) has no plans or services to assist small businesses. A separate body should be formed to put SMEs together so that they can assist one another in the market by purchasing each other's products and services.

To summarize, rebranding Afghan goods, fair market competition, tax holidays, lower interest rates, improved banking practices, anti-corruption efforts, and better management practices in the Afghanistan Chamber of Commerce & Industries (ACCI) may all be beneficial to the establishment of more and more SMEs.

### **Climate for Entrepreneurs**

The majority of the participants believe that the business environment has changed recently, but there are still many challenges and concerns to be addressed. From legal standards to market access, these concerns abound. Some of the issues may be effectively addressed by the government, while others are related to entrepreneurs and companies. One such issue is the government's inconvenient payment procedure for contractors. Payment by the government to contractors takes a long time, which is why most SMEs, especially startups and SMEs, are hesitant to enter into contracts with the government. Since most startups and small businesses are cash-strapped, they can't afford to wait months for payment. As a result, startups and small businesses are barred from taking advantage of government contracts.

In addition, market insecurity and ambiguity are two other factors that make doing business for SMEs more difficult. For example, when a market catches fire or a bomb goes off nearby, startups and SMEs are the ones that suffer the most. Not only because of the physical damage to the company, but also because of the reduced flow of customers to the market and, as a result, a decrease in revenue. Finally, the business climate could be strengthened if the government could take action to simplify procurement processes, allow prompt payments, and protect markets.

### **Rule of Law**

Lack of law enforcement, legal loopholes, and lack of law are all legal factors that stymie the growth of SMEs and startups. For example, some market producers who do not have any licenses do not pay taxes and use child labor, lowering the cost of production and market prices significantly. Thus, rivalry becomes more challenging. Furthermore, in order to draw more consumers, some companies make exaggerated statements in their promotional messages, regardless of the market implications.

Moreover, Afghanistan's procurement legislation discourages small companies from engaging in government procurement contracts. Procurement law favors large firms over small businesses; for example, to

win a contract, companies must demonstrate comparable expertise, which SMEs lack, and such contracts require a certain amount of bank balance, which is generally more than a SMEs has. SMEs are barred from receiving government contracts due to similar legal conditions.

Furthermore, the law's write-up and text are difficult to comprehend, resulting in a low rate of reading and comprehension of the law. The text of Afghanistan's existing laws, especially those aimed at the general public, should be rewritten to make them more understandable; otherwise, the country's compliance rate will remain low. The general opinion is that a new wave of law-abiding entrepreneurs is expanding through the industry. These new business owners are inspired and dedicated to their workers' interests, the public interest, and government responsibilities.

As a matter of fact, starting a small business in Afghanistan is difficult. The licensing agency's requirements for licenses, contracts for renting an office, getting a substantial sum of money in the bank (one million AFN), and a slew of other requirements make it difficult for people to get their companies licensed in the first place. For example, SMEs are now forced to fill out all tax forms and report to the taxation agency even though they have no operation, resulting in additional fees to brokers who fill out the required paperwork and forms for SMEs.

Thus, black market of unlicensed SMEs is emerging in industry, resulting in market loss and unfair competition. The presence of unlicensed companies has made it impossible for licensed businesses to do business. Taxes, dealers, and other costs must be charged by the licensed company, resulting in higher rates and lower competition. Hence, rewriting and amending the legislation to fix existing problems may be helpful.

### **Data Analysis**

The SMEs that filled questionnaire were diversified in terms of types, nature and scope of businesses. They were diversified in sizes of capital and monthly average sales, employment sizes and age. Around 80% of the SMEs were manufacturing and services providers. The service providers commonly do not have bigger financial needs whereas the manufacturing SMEs accesses to loans, donor funds, loans from other personal sources and have included a good amount of capital from other personal businesses.

Trade businesses generally require bigger amounts of capital and stocks, and the market is less trending towards the trade and import/export businesses—given the less favorable conditions in the economic context of Afghanistan. This fact in Table 2 reflects to a finding that fewer investors are inputting capitals in a business activity in Afghanistan. Entrepreneurs prefer to work without or with less capital. A number of manufacturing businesses give us a reflection of self-sustainability and reducing dependency on the imports, while creating room for more workers to get work or job in the country.

Table 1

#### *Overall Information About Data Collection*

Number of SMEs that questionnaire was shared	100+
Sample size	100
Number of SMEs that responded to questionnaire	90+
SME response rate to questionnaire	90% +
Number of financial institution and banks that questionnaire was shared	3
Number of governmental organizations that questionnaire was shared	3
Number of non-governmental organizations that questionnaire was shared	3

### Company Sizes—Employment

The SMEs that participated in the survey vary in their size of employees, asset and investment and monthly average sales. Most of the SMEs (50%) have less than 10 employees including the owners, friends, family advisors, and supporters. Not many SMEs are really looking into hiring more employees to do the jobs done. This generally reflects the fact that people cannot manage employees specially the ones that they do not know. There's a lack of a system to hire and deploy the employees that are not friends or relatives. In so many SMEs, it has been witnessed that the employee has turned to be disloyal, robbed, or leaked out company's information and confidentiality. In some other cases, the business owners believe that the employees after learning about their business well, start their own businesses and compete back with them.

Table 2

#### *Nature of Business by Category*

Nature of businesses	Number	Percentage
Handicrafts	40	40%
Manufacturing	25	25%
Service providers	20	20%
Trade, imports, & exports	10	10%

Table 3

#### *SMEs Employee Size*

Number of employees	Number of businesses	Percentage
01-09	50	50%
10-24	20	20%
25-49	10	10%
50-100	10	10%
100+	5	5%

### Asset Size

SMEs are classified based on the size of their assets. Different sizes of SMEs were questioned and recorded during this survey. The asset size of more than half of these SMEs is less than \$20,000. Many SMEs believe that investing less money and assets to generate more revenue is less expensive and more profitable. Some of the SMEs who were interviewed have extra cash in their homes that they use occasionally.

As a result of the lack of capital in the market, SMEs are more likely to buy on credit from suppliers rather than spending their own money. A significant number of SMEs prefer to act as service providers, which need fewer assets. Online stores, food distribution, brokerage, commission companies, and virtual businesses are only a few examples of service-based businesses that don't have a lot of assets or don't expose their assets to the public or markets.

Table 4

#### *SMEs Category by Asset Size*

Amount	Number of SMEs	Percentage
\$5,000-19,000	50	50%
\$20,000-49,000	20	20%
\$50,000-99,000	20	20%
Above \$100,000	5	5%

### Monthly Sales Volume

The SMEs were also asked to consider their monthly average sales volume as part of the survey. The figures chosen are near close/estimates of the truth. The reported statistics and facts could not be checked by looking at sales records. The majority of the SMEs who participated in the survey have estimated monthly revenues of \$1,000 to \$4,000, accounting for at least 40 percent of all SMEs. The SMEs that were contacted, as well as those who contributed, were both relatively new.

Around 40% of these SMEs are either fresh or have chosen to be between the ages of one and two years. Monthly earnings for new businesses are likely to be lower. SMEs with a smaller monthly sales volume feel that they do not have consistent sales and that they need a larger number of customers to increase their sales.

Table 5

#### *SMEs Monthly Sale Range*

Monthly sales	Number of SMEs	Percentage
\$1,000-\$4,000	40	40%
\$5,000-\$19,000	30	30%
\$20,000-\$39,000	10	10%
\$40,000-\$49,000	10	10%
Above \$50,000	5	5%

### Source of Financing for SMEs

It is always important to be aware of the sources of funding for SMEs while we are discussing them. Based on the results of this study and interactions with financial institutions and SMEs, it was discovered that SMEs have a variety of financing options. A large number of SMEs have their own personal resources, such as money from their families, to start a company. However, a small percentage of SMEs receive donor funds or supplier loans to start their businesses without using their own assets or resources.

The researcher also asked SMEs about their sources and methods of funding when it was most important to their companies. Typically, the majority of people spend their own money; but, on a more long-term basis, SMEs obtain financial assistance from immediate or distant family members or friends, which is normally free of charge. What usually stays in the company for a long time is their own money, capital from other firms, individual or corporate shareholding, and capital infused by selling land, property, or a higher-valued vehicle.

According to the results of the study, 60% of SMEs have their own investments in their companies. 40%/60% of these individuals rely solely on their own income and do not rely on any other sources of assistance. They also included their own sources or personal savings, as well as reaching out to other sources for funding when it really counts, according to 36%/47% of the responses received. The SMEs polled had the option of choosing from a variety of funding options. Just 7 of the 100 SMEs surveyed said they had taken out loans from banks or other financial institutions. In reality, access to finance continues to be a difficult task for SMEs, for a variety of reasons (Ayyagari, Demirgüç-Kunt, & Maksimovic, 2010).

It was thought that many SMEs had access to donor funds or loans via donor-funded projects. That is why the issue of whether "SMEs have any links to donor funds" has been included. However, only 7% of 100% get funds from donors, according to the findings. The majority of them, 70% of SMEs, reported receiving financial assistance from immediate family members or associates, which is a common practice in Afghanistan's various communities. According to interviews with some SMEs, financial support from family members is also

difficult; they claim that their families and friends will not be able to support them in their businesses for the time being.

The SMEs have replied well to the question of how important financing is for companies. Almost 80 of the 100 SMEs surveyed said that financing is crucial or very important to their operations. It is critical to have fair, simple, and affordable access to financial resources when they are needed. Some companies prefer funding only when they are in a successful season, while others need continuous financial injection to retain the most creative and up-to-date goods or services for their businesses.

Table 6

*SMEs Source of Finance*

Source	Number of SMEs	Percentage
Personal investment + other sources	50	70%
Loan from other businesses	5	5%
Loan from banks	7	7%
Loan from family members	20	20%
Loan from donor	13	13%
Other	5	5%

### Research Discussions

The findings of this study's research questions reveal current issues and new management perspectives in the growth of SMEs in Afghanistan, which are important to know for both SME owners and governmental and non-governmental organizations.

First of all, based on findings of this research, since unemployment and illiteracy rate is high in Afghanistan, the Afghan government has to attract more international organizations, such as ACEBA, GIZ, NRS, ILO, and so on and so forth in order to train SMEs owners on the most up-to-date management issues.

Secondly, the findings of this study show that SMEs in Afghanistan face numerous challenges and problems, including a lack of resources and opportunities, a lack of government support, and the complexity of government procedures and documentation, as well as political, economic, and security instability, all of which have an impact on their productivity and development. Thus, government should support SMEs and try to take some measures to help them grow, such as easing government procedures and documentation, assisting them in exhibiting their inventions and ingenuity to the business world, and helping them improve their personal and professional capacities and capabilities.

Furthermore, the study summarizes a broad range of variables influencing the efficiency and development of SMEs in Afghanistan, which are further defined as internal and external variables. Internal determinants of SMEs growth include management, technology, product marketing, skilled labor, and the structure and size of companies. External factors influencing SMEs' growth, on the other hand, include the role of government, curriculum, access to finance, loyal customers, and competition from international companies.

However, SMEs' management is recognized as one of the most significant factors in their development and long-term viability. As a matter of fact, a significant cause of SMEs failure is a lack of management skills. Efficient management skills will prove to be a competitive advantage for SMEs in Afghanistan's unpredictable market climate. Moreover, in today's technological environment, failing to provide advanced technologies for SMEs can have a negative effect on the business development process.

According to Arinaitwe (2006), the lack of access to technology or low technical capacities in developing countries is the primary cause of SMEs' development. Therefore, according to the findings of this research, SMEs in Afghanistan work on a more conventional manual system; yet, the use of updated technology can help SMEs in Afghanistan improve their operational performance.

Another factor found is marketing skills, which include identifying a relevant target market, selecting a selling strategy, delivering quality services, advertisement, public relations, e-commerce, competitor awareness, promotion, product creation, selling, and designing plans and strategies to achieve a competitive advantage and outperform the competition (Monk, 2000; Tustin, 2003). Reaching out to consumers in Afghanistan is a difficult task due to the public's restricted access to the internet and technology. In such circumstances, it is important for Afghan SMEs to increase their marketing expenditures.

What's more, skilled labor is described as a key factor in rising cost efficiency in the report. Today's market competitiveness is focused on cost containment, and skilled labor can be a key component in controlling and managing operating and production costs. Moreover, that smaller companies with minimal financial resources and access to capital are more likely to fail than larger businesses, and that the size of a business has a direct effect on its success (Hubbard, 1998).

However, one of the investigated external factors affecting the growth of SMEs is the government's position. Policymaking, tax relief, building confidence in the justice system, granting access to government assistance packages, access to public procurement projects, creating opportunities for SMEs to establish public-private partnerships, infrastructure, security and ease of doing businesses and so on are all important aspects of government's position.

In fact, in Afghanistan, where the small and medium business sector is struggling, government assistance in all of the aforementioned areas is desperately needed. To attract entrepreneurs, the government must develop business-friendly regulations. At both the college and university levels, the government must support incubation centers and develop updated business curriculum. It is the government's duty to broaden funding options, which are the backbone of doing business. Because of the high risk of default, low profitability, and the high collateral requested by banks, SMEs in developing countries find it difficult to receive loans from banks (Haron, 2013).

Similarly, as financial markets become more complicated, financial institutions are becoming more cautious in loan processing and approval, making it more difficult for SMEs to obtain funds (Haron, 2013). In Afghanistan, there is only one microfinance bank that has made a small contribution to SMEs growth because the loans are interest-based, and the majority of people do not prefer to take interest-based loans due to their religious conservatism.

SMEs must be competitive in terms of creativity, industry awareness, prudent investment, company processes, cost control, customer satisfaction, and management performance in order to thrive. In Afghanistan, the sense of competition for SMEs is different, with revenue and market share being the only factors that matter, while these two factors are dependent on being competitive in cost control, consumer loyalty, productive operations and management, and creativity (Singh, 2010).

## **Conclusion**

### **Main Findings**

In all around the world, Small and Medium-Sized Enterprises (SMEs) are considered as the engine for

economic growth of a country, especially for developing countries. However, comparing to developed and most of the developing countries, SMEs in underdeveloped countries like Afghanistan can play a crucial role for the employment and overall economic growth of the country, and that's because of two main reasons. On the one hand, establishing SMEs, particularly in the case of Afghanistan, doesn't require and need high skill and technology, rich business knowledge—at least at the beginning—as well as huge investment. On the other hand, Afghanistan, as an underdeveloped and economically unpredictable country, lack highly qualified individuals, high technology, and huge capital. Therefore, SMEs are the most ideal, effective, and efficient method for the economic growth of the country.

However, in Afghanistan, SMEs have not been prioritized by the government for a long time. Yet, in Afghanistan's turn to market economy after the US invasion in 2001, the private sector, 85 percent of which are made up of Small and Medium Enterprises (SMEs), was defined as the engine for growth; yet, the Afghan government's current SME strategy, was finalized in 2009 and it took almost two years to implement these strategies within the concept of Afghanistan.

Moreover, during the time since 2009, Afghanistan's Small and Medium Enterprises development projects have initiated—which overall cost almost 114 million dollars in the economy—for the purpose of development of SME's in Afghanistan. As a result of these, more than one hundred thousand jobs have been created and more than 1,300 or 1,400 SMEs benefited from them. In fact, SMEs have brought a good change in the employment and self-employment opportunities. For the time being, contribution of SMEs for GDP is 30% to 40% and 35% employment for the economic are made of SMEs' employees as well as 85% private sector is made of SMEs.

According to interviews which the researcher had with some of the SMEs' owners in Afghanistan, most of them were not satisfied with the government's plans and supports of the SMEs. Most of them have complained about limited access to finance, sustainable energy (water and electricity), and standard business environment. They also complained about government's tax policy which, according to them, is not fair, especially this is true with medium-sized enterprises because according to the Ministry of Commerce and industry's law in Afghanistan, the medium-sized enterprises and large businesses have to pay the same tax although they are not comparable.

Also, according to the authorities from the Chamber of Commerce and Investment of Afghanistan, insecurity and government's failure to support investors with their basic needs like water and electricity have not only reduced investment significantly in the last few years, especially 2019, but it has also made a lot of investors to take their capitals out of the country. In most recent case in 2020, 1,400 businesses most of which were SMEs left the country due to the worst insecurity.

Younus Momand, deputy head of the Chamber of Commerce and Investment said, "During the past one or two years, investors and businessmen, considering the unstable situation in the country, went to Turkey, and the move has had a negative impact on the country. Security threats were among the major challenges" he added, "private sector has become a good source of revenue for corrupted individuals in the government, kidnappers, robbers, insurgents and so on, and annually private sector or simply most of the businesses in the country spend more than 25% of their incomes in security of themselves and their families."

Beside insecurity, corruption is one of the other main challenges with which SMEs have been facing since 2001. In fact, because of high corruption rate, Afghanistan ranks in the first position when it comes to corruption. Most of the governments' supports and incentives will be given mostly to those businesses which

have a close relationship with the governments' authorities. Even, lends are given mostly to those business which are in one part with the government. Thus, most of the SMEs owners prefer not to register their business in Afghanistan.

Moreover, according to most of the SMEs, the government only reaches out to them when it's time to get the tax. For instance, most of the SMEs in Afghanistan don't have stable electricity, and thus they use their own generators in order to produce electricity and ultimately run their businesses. Hence, this increases their expenditure. As a matter of fact, according to most of the SMEs with whom, the researcher had interview were claiming that the government strategies, plans, supports, and incentives are not comprehensive, inclusive, and they are not easy to access by all SMEs.

Therefore, this can also be one of the main reasons why most of the SMEs in Afghanistan don't want to register and get license. Even some of those who register and get license, after sometimes cancel their licenses because of not getting their needed supports from the government.

In short, SMEs in Afghanistan have been facing several challenges. Findings of this research show that limited access to sustainable finance is the most current and big challenge of SMEs in Afghanistan. Finance is considered as the life line of the SMEs and without enough finance we can't extend and sustain. The problem with SMEs in Afghanistan is that most of them are dependent on financing sources from parents and families which are not enough. It can be helpful at the start of the business but in the long run from sustainability and growth perspective that's not enough.

The total financial inclusion of the country is only 15%. 85% of the population directly or indirectly, is not in-touch with the formal financial system like banking institutions, micro credits and so on. In fact, SMEs owners are out of this financial system. The problem with these financial institutions is that they mostly put more interest or charge interest rate, and other demands which are out of the ability of SMEs or they can't afford. Thus, most of the SMEs owners don't refer to those institutions. Furthermore, when it comes to financing, financial intuitions like banks also focus more on corporate interest instead of national interest.

Moreover, based on findings of this research in Afghanistan, businesses in general and SMEs in particular, don't have a good connection with each other and they don't trust each other, and thus there is not a good B2B between those companies. In other words, one small business is not supported by another small business; similarly, one medium-sized enterprise is not supported by other medium enterprises. Also, according to the findings of this research, the government itself doesn't trust SMEs so that it can give them contracts.

Findings of this research also show that the service and the e-commerce sectors, they are making great advancement comparing to manufacturing sector. Part of the reason is that service sectors are competing with domestic enterprises or competitors while manufacturing sectors not only compete domestically but internationally.

What's more, according to findings of this research, Afghanistan has a great opportunity for e-commerce. In 2020, Afghanistan had 7.6 million people using internet which is more than 18 percent of the population. However, in 2010 this was around 4 percent. So in 10 years, there is a huge improvement in the number of internet users in Afghanistan. Besides, if we look at the number of social media users, it has 3.6 million which is 2.5 million more than 2010. That means that more and more people are actually choosing internet and usage of internet.

Similarly, the price of the internet has been reduced and they are coming down in Afghanistan. In 2015 and 2016, 3G Internet was introduced, but now Afghanistan has 4G Internet which is similar to our neighboring

countries. In 2018, a study shows that Afghanistan adopted the 4G technology before Tajikistan, Uzbekistan, and Turkmenistan, and that means that Afghanistan is moving rapidly towards adoption of technology, internet, and the access of people to the internet. That's why, nowadays, more and more businesses are using from internet, especially social medial for their marketing which have been useful greatly so far.

As a matter of fact, online stores in Afghanistan have been improved rapidly since 2018 and 2019. SMEs in Afghanistan are referring to online stores so that they can avoid being taxed by the government, or getting licenses or getting into whatever the government proposes as obstacles of SMEs. However, Afghanistan does have some challenge for example using internet or using applications for most of the population is one of the biggest challenges. Also internet connectivity in some areas has also deprived those people of the access to internet and e-commerce services.

Yet, there are some methods which can be learned and used by Afghanistan from its neighboring countries in order to improve this situation. First, the banks should work harder along with central bank of Afghanistan to increase the financial inclusion and this can be done by giving prizes for people so that they can trust the banking system. Also, the universities can play an important role to educate young professional entrepreneurs which in fact are doing for the time being in Afghanistan.

Last but not least, according to findings of this research, the COVID-19 is also one of the hot issues of SMEs and it has affected SMEs in Afghanistan to a large extend. As a matter of fact, the brand new virus, the Coronavirus, has turned everything upside down and inside out. It has not only affected people by taking their lives but also impacted their economies greatly. In other words, COVID-19, has not only affected global health but also global economies.

In fact, less or more, the COVID-19 has affected every country across the globe. However, since the capital market and supply chains are globally integrated, any remarkable measure taken by one of the countries in the world, especially super powers like USA, China and so on, can have effect on many other countries. The Coronavirus has affected all sorts of businesses ranging from micro, small, and medium-sized enterprises, and some of the large companies. It has also affected self-employed greatly. Yet, MSMEs and self-employed were among those which have been impacted greatly. This is true in almost all of the countries in the world including Afghanistan.

As a matter of fact, SMEs in Afghanistan, during this global pandemic, have been affected more than SMEs of any other countries since most of the SMEs in Afghanistan, among other challenges, have limited access to sustainable finance, and that means when there are financial crises, natural disasters, global pandemic, or anything like them, they barely can survive. Indeed, most of them will fail and collapse since very few of them have access to sustainable finance.

Another remarkable reason behind the worst effect of the COVID-19 on SMEs in Afghanistan is that the government couldn't support them to the extent that it should have supported them, and that was mainly because it had more important task to do and that was saving people live from the COVID-19. As Waheed Omer, presidential adviser said, "Fighting the coronavirus is a top priority for the Afghan government". In fact, the government has allocated a lot of resources to fight against COVID-19. That's why the SME's were not paid attention the way they should have.

Therefore, the Coronavirus has affected many SMEs in Afghanistan greatly. Affected here means, hundreds of SMEs have collapsed and thousands of workers lost their jobs which had a great impact on economy of the country, and ultimately helped insecurity in the country. In fact, one of the main reasons of

insecurity in Afghanistan is unemployment. When people lose their jobs, they either join insurgents or work as a robber. Therefore, the COVID-19 has led to unemployment and this led to insecurity. So, that's how the Coronavirus pandemic affected the country at both ends.

However, the government should seriously support all businesses, particularly SMEs by providing comprehensive and inclusive supports and incentives, establishment of industrial parks, providing SMEs basic needs like stable water and electricity, easy to access to resources, making it easy to import machines, standard infrastructure, making it easy to pay the tax, making it easy to enter to the market and exit from the market and other relevant and needed requirements.

According to Shubham Chaudhuri, World Bank Country Director for Afghanistan, "Improving the business environment is essential for Afghanistan to stimulate domestic investment and create jobs. Given the exceptional challenges of conflict and violence in the country, the government's resolve to improve the business climate for private enterprise is doubly commendable" he added, "We look forward to continuing to record Afghanistan's successes in years to come."

### **Recommendations**

- SMEs need a long-term funding source. Microcredits and micro institutions, for example, may come up with good strategies for SMEs' growth by providing some source of public financing.
- When it comes to taxation and licensing, SMEs are treated as large businesses. In other words, they have to go through all procedures that a large company should pass-although ministry of industry and commerce recently come up with a new licensing for Startups which is a good sign. Thus, the government should differentiate rules of different businesses and also digitalize the public services to the SEMs, especially when it comes to registration, tax firing, customer procedures and so on since it can mainly save cost and time for the SMEs.
- According to some statistics, 400,000 university graduates annually joined the labor force. So the government should provide them job or internship opportunities so that they can be well-equipped with the business knowledge in the future.
- According to findings of this research, there is lack of differentiation, innovation, and creativity which are major problems of SMEs in Afghanistan. In fact, whenever people see a business going well, they copy pretty much everything of that business. Therefore, the government should reward who are the initiator of a business and should implement copy rights rules strictly.
- SMEs should work on promoting and encouraging their employees, the culture of innovation and rewarding those who innovate or create something good should be promoted. Also the employees should be equipped with required skills and knowledge.
- Base on the findings of this research, more than 80% of the SMEs in Afghanistan fail in the first year of their establishment. And in the second year this number becomes 95 percent. Hence, only 5 percent will remain. In fact, failing is in the nature of SMEs in every part of the world but SMEs fail mostly in Afghanistan rather than other countries because most of the people who come to the SMEs are illiterate people. They don't have business literacy. So, both government and universities should work to educate entrepreneurs, especially SMEs' owners. In fact, government should strengthen the training program, especially programs that can improve the entrepreneurship and managerial skills of entrepreneurs which are very important. Universities, on the other hand, should offer more courses and add more departments related to business like BBA, MBA, Finance, international business and so on.

- According to the findings of this research, the government regulation in Afghanistan has made the environment so tough that most of the people are establishing SMEs in black markets which are illegal. Thus, the government should provide an ideal entrepreneurship ecosystem for SMEs' owners like having lab and required and needed staff. The government should also make entry and exit to the market very easy. Especially, the government should make exit from the market easy to the SME because nowadays, entry to the market is very easy and anyone can get a license in two days while exit can take three years. So most of the people think of this as a trap. Like putting them in a situation form which they can't walk out easily.

- Based on findings of this research, Afghanistan doesn't have technical support when it comes to the SME. So the university and other organizations should work corporately with SMEs for technical support to help them sustain or at least reduce the number of their failures.

- The government should support more and work more with SME's in order to encourage them and also help their sustainability. Government should also extend its supports of SMEs in rural or far remote areas of Afghanistan because 70% of Afghanistan's SMEs, according to a research, are located over there.

- Universities should pave the way for their professors and students in order to have in-depth research about SMEs which can help to find out needed information about SMEs in Afghanistan, and ultimately will be useful both for SMEs' owners and governmental as well as non-governmental organizations (donors, international organizations).

- Include women: Policy-making bodies such as the Afghanistan Investment Support Agency and the Afghanistan Chamber of Commerce and Industry are entirely devoid of female business leaders. Female-owned small businesses are struggling, and public recognition of women who work outside the home is dwindling. The participation of women in decision-making bodies may lead to the formulation of policies that make it easier for women to succeed in business.

- According to the findings of this research, the most successful SMEs are those, especially for the time being in which the amount of people who have access to the internet, especially social media, are dramatically increasing, which, besides marketing methods, uses from social medial like Facebook, Instagram, and so on in order to promote their businesses. Thus, SMEs should try to use the most out of internet, especially social media, in order to promote their businesses efficiently.

### **Implication of This Study**

The main implications of this research for SMEs' owners and governmental and non-governmental organizations are concerned with issues and new management perspective to improve their knowledge of these issues.

### **Limitations of the Present Study and Suggestions for Further Research**

Although the researcher tried to make this research as comprehensive and authentic as possible, unfortunately owing to some unavoidable problems it could not succeed to do so. Those challenges are:

Insecurity: Primarily researcher aimed to cover SEMs of six major provinces in Afghanistan, but unfortunately because of insecurity, he could only travel three of those six provinces such as Faryab, Balkh and Kabul. In the remaining three provinces, since the researcher could not go and have in-person interview with SMEs' owners which would be very helpful. However, he still had some virtual interviews with some of SMEs located in these remaining provinces such as Herat, Kandahar, and Nengarhar.

As a matter of fact, the survey of this research was conducted in only six provinces of Afghanistan; thus, it may not reflect the views and practices of SMEs in other provinces. There is a need for large scale survey to identify whether findings of this research are valid or applicable for all SMEs in Afghanistan or not.

Moreover, in Afghanistan, there were no central databases or information points dedicated to SMEs research that could provide fast access to pertinent data. There was also a lack of accurate data on SMEs outside of major cities.

So keeping in mind all above points, it is obvious that effects resulting from the fundamental nature of Afghanistan's political, economic, and financial system need a better understanding before a credible policy on SMEs can be developed; future research can examine the nature of problems faced by SMEs in greater depth.

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