

Evaluation of Factors Affecting Small and Medium Enterprises Growth in Afghanistan

Kardan Journal of Economics and
Management Sciences
2 (4) 17–30

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Kardan Publications
Kabul, Afghanistan

DOI: [10.31841/KJEMS.2021.42](https://doi.org/10.31841/KJEMS.2021.42)

<https://kardan.edu.af/Research/CurrentIssue.aspx?i=KJEMS>

Waqas Khan
Khalid Adel

Abstract

The main purpose of this study is to explore the internal and external factors affecting Small and Medium Enterprises (SMEs) growth in Afghanistan. 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. To find out those factors, this study uses Exploratory Factor Analysis (EFA) technique. A sample of 150 SMEs' employees including top level and middle level managers were chosen for the study through a structured questionnaire. Management of SMEs, use of technology, marketing the products, skilled labor, and structure and size of the businesses are the internal factors affecting SMEs' growth. Role of government, education curriculum and SMEs knowledge, access to finance, loyal customers, and competition from foreign companies are external factors affecting the SMEs' growth. The study signifies the role of government, use of updated technology, investment on development of labor for SMEs growth. It is important that SMEs spend more resources on marketing their products, utilize updated technology, maintain and increase their customers' base, and be involved in productive competition.

JEL Classification Code: L30, L31

Keywords: Exploratory factors analysis, small and medium enterprises, access to finance, government role, technology.

Introduction

Small and Medium Enterprises (SMEs) make up around 85% of the private sector in Afghanistan, and it is regarded as the backbone of the growth of economy (ACCA, 2010). SMEs are considered as the important component in the economic structure of both developed and developing countries (Govori, 2013). SMEs have a crucial role in bringing prosperity, innovation (partially via partnership with large corporations) and economic growth to a country. SMEs in European Union makes 99.8% of all the firms and provide employment to around 76 million people, which is 67.4% of the total employment in 2010 (Ayyagari et al., 2010). In India, according to ministry of small and medium enterprises, there are 13 million SMEs operating around the country in 2008, this makes 80% of the country's total businesses (Ghatak, 2010). So it can be inferred that SMEs are responsible for inclusive economic growth of a country (Amaradiwakara & Gunatilake., 2017; Bayati & Taghavi, 2007). The inclusive growth is for both manufacturing and service sectors. When service sectors are growing in proportion to overall production in an economy, it signals the making of a more developed and formalized economy (Lake et al., 2010).

Schlogl (2004), stated that SMEs lead in contribution to both employment and number of companies but still their full potential is not realized yet. Despite such contribution and significance to economy, SMEs across the globe and in Afghanistan faces many challenges and obstacles which hinder the performance of these businesses. The challenges, in Afghanistan, are increasing with each passing day because the country's economic, political, and security situation is becoming complex and dynamic. According to Khan et al., (2018), there is lack of government support, over the counter illegal transactions, informal markets, money laundering, lack of public awareness about financial knowledge and limited types of financial institutions are key challenges faced by businesses in Afghanistan. But they also stressed that despite all these challenges, there are potential opportunities for growth because of low competition, huge chunk of unserved market, and underdeveloped SMEs in the country. So SMEs have potential of meaningful contribution to GDP and reduction of unemployment in the country.

Despite such important role and contributions, failure rate of SMEs is very high throughout the globe (Fang, Yuli & Hongzhi, 2009) and Afghanistan is not an exception in this case. Failure and success of SMEs in Afghanistan is because of many factors which are not researched till recently. So given the state of SMEs in Afghanistan, it is pertinent to find factors of both success and failures for improving the SMEs performance and sustainability. This study tries to explore those factors by categorizing them as external and internal factors. Categorizing the factors as external and internal helps the organization in the management of those factors accordingly. Government, regulatory body, and SMEs' leadership can potentially use the findings of the study to develop laws, regulations and strategies for the development of the SMEs performance.

2. Literature Review

Defining SME is quite challenging, because different scholars have defined it differently all around the world (Sitharam & Hoque, 2016). According to Baumbach (1983), definition of SMEs differs from employees' number, size of the enterprise, type of industry, and country. Jasra et al. (2011) 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". Alarape (2008) defined SMEs as "an enterprise comprising 11-100 employees or a total cost more than N50 million, including working capital but exclusive of cost of land While Arowomole (2000) defines it "an independently owned and operated business which is not leading in its field and meets the criteria of the SME business administration". The definitions of Alarape and Arowomole suit more the small businesses only because Darren et al., (2009) defined medium enterprises as "an enterprise which employ up to 249 employees in UK, up to 250 employees in European Union, up to 200 employees in Australia, while up to 500 employees in U.S.A". 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 (World Bank, 2011).

There is an ample literature available about the performance of SMEs (Chittithaworn, 2011; Zulkifli, 2015). These studies identified factors which effect the performance of SMEs across the globe. Some studies divided these factors as internal and external factors. Jahur & Quadir (2012) identified ability to enter international markets, good customer relationship, and good supply chain system as the main external factors effecting the performance of SMEs while managerial qualities, technology, and lack of skilled labor are identified as internal factors effecting the performance of SMEs by Noreen & Junaid (2015) and Clegg (2018).

Among the external factors, competition is believed to be one of the important determinants of SMEs growth (Lind, 2009; Singh et al., 2010; Gunasekaran et al., 2011). Nkwabi & Mboya (2019), Wang (2016), Nichter & Goldmark (2009), Dalberg (2011), Mazanai & Fatoki (2012) and Haron et al. (2013) consider access to finance as a main obstacle for SMEs' development, particularly in developing countries. Government regulations can be an important factor effecting SMEs. With changing regulations, it is difficult for small firms to bear the compliance cost (Christian, 2003). Fielden et al. (2000), Ligthelm & Cant (2002), Ligthelm & Cant (2002), Luiz (2002), and Clover & Darroch (2005) consider support of the government policies as pivotal for the growth and sustainability of SMEs. Okpara & Kabongo (2009) argued that infrastructure of a country can be one of the leading factors for the success or failure of an SME. Weak infrastructure within judicial system may lead to corruption which negatively affect the growth of SMEs (ADB, 2005). Corruption and red tape can increase the business costs and may make the product uncompetitive in the market (Obeng & Piaray, 1999). Afghanistan is ranked 172 out of 180 countries in 2018 (Transparency

International - Afghanistan, 2018). Such a worse corruption scenario makes it really difficult for the SMEs to survive in Afghanistan.

Wasilczuk (2000), Hisrich & Drnovsek (2002), Ibrahim & Soufani (2002), Markman & Baron (2003), Mughan et al. (2004), Martin & Staines (2008), Alattar, Kouhy & Innes (2009) and Abdel, Rowena & Robyn (2010) all consider effective managerial skills are must for the success of SMEs. For SMEs to gain competitive advantage, besides managerial skills, SMEs need to have access to appropriate and updated technology (Rogerson, 2001; Clover & Darroch, 2005; and Arinaitwe, 2006). 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 et al., 1999). Al-Mahrouq & Maher (2010) argue that the significance of marketing is universally accepted and recognized for all businesses, especially for small and medium-sized businesses.

Botha (1999) defined creativity “as the process of developing and creating new and workable concepts, commodities and ideas”. Mansfield et al. (1971) and Ridderstrale & Nordstrom (2003) consider creativity and innovation as the backbone of entrepreneurship and growth. 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 (Leburic and Krneta, 2004; and Tan & Smyrniotis, 2011). All the mentioned studies do not have any contribution from Afghanistan as the literature on SMEs in Afghanistan context is very limited. This study tries to fill the gap and add to the body of knowledge by exploring the factors effecting the performance of SMEs in Afghanistan.

3. Methodology

The study tries to explore the factors affecting the performance of SMEs in Afghanistan, so the study follows Exploratory Factors Analysis (EFA). EFA seeks “to uncover the underlying structure of a relatively large set of variables”. EFA starts with a correlation matrix which presents the inter-correlations of the variables studied (Field, 2000). The highly inter-correlated variables measure another underlying variable called “Factor”. The study targeted SMEs’ stakeholders ranging from owners, employees, policy makers, and regulators. A total of 160 questionnaires were distributed out of which 150 were collected back as complete responses. The response rate was 93.75%. The study used random sampling technique for data collection. For data collection, the study utilizes questionnaire consisted of a total of 43 close ended questions.

4. Analysis

For EFA, the study first conducted correlation analysis where none of the coefficients has a value greater than 0.9 and also the determinant value is also less than 0.000, this signifies that there is no multicollinearity and singularity problem in the data collected. Which applies that we can advance

to KMO and Bartlett’s Test to check the feasibility of the exploratory factor analysis.

To check whether the data is feasible for exploratory factor analysis, the study tested the given hypothesis:

H_0 : Factor analysis is not appropriate

H_1 : Factor analysis is appropriate

Table 1: KMO and Bartlett’s Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.479
	Approx. Chi-Square	1845.585
Bartlett’s Test of Sphericity	Df	903
	Sig.	.000

Source: Author’s compilation

The KMO value of sampling adequacy is .479 which is a great range of adequacy and it also shows that data is adequate. Bartlett’s test of Sphericity significant value is .000 rejecting the null hypothesis and signifying that ‘Factor analysis is appropriate’. On the basis of KMO findings we can advance to next step of EFA i.e. extracting value of ‘communality’. After extraction of variance in first statement in communality statement, the value is 57.5%. Total variance of the first few statements demonstrates much of the variance and so on. It helps in locating that all these factors are a quite equivalent and they are important in explaining the problem at disposal.

4.1 Variance Explanation

From the below Table 2 out of the 43 statements, the Eigen values explain the amount of variance, like component 1 has 2.963 variance and total 16 factors are there which have the variance above 1. The total percentage of variance explained by these factors is 68.539% as indicated in extraction sums of variance loadings, thus confirming the feasibility of these factors as the important in explanation of SMEs growth in Afghanistan. So based on the cumulative percentage of variance, the study expects 16 variables which can possibly affect the performance of SMEs.

Table 2: Total Variance Explained

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative%
1	2.963	6.892	6.892	2.963	6.892	6.892
2	2.875	6.686	13.577	2.875	6.686	13.577
3	2.634	6.126	19.703	2.634	6.126	19.703
4	2.42	5.627	25.33	2.42	5.627	25.33
5	2.139	4.975	30.305	2.139	4.975	30.305
6	2.074	4.824	35.129	2.074	4.824	35.129
7	1.911	4.444	39.573	1.911	4.444	39.573
8	1.718	3.996	43.569	1.718	3.996	43.569
9	1.678	3.902	47.471	1.678	3.902	47.471
10	1.54	3.582	51.053	1.54	3.582	51.053

11	1.462	3.399	54.452	1.462	3.399	54.452
12	1.325	3.082	57.534	1.325	3.082	57.534
13	1.277	2.97	60.504	1.277	2.97	60.504
14	1.256	2.92	63.424	1.256	2.92	63.424
15	1.121	2.608	66.031	1.121	2.608	66.031
16	1.078	2.508	68.539	1.078	2.508	68.539
17	0.969	2.253	70.792			
18	0.935	2.175	72.967			
19	0.905	2.106	75.073			
20	0.85	1.977	77.05			
21	0.834	1.94	78.99			
22	0.754	1.754	80.744			
23	0.738	1.716	82.46			
24	0.694	1.615	84.075			
25	0.648	1.507	85.583			
26	0.623	1.45	87.033			
27	0.593	1.379	88.411			
28	0.535	1.244	89.655			
29	0.469	1.09	90.746			
30	0.446	1.037	91.783			
31	0.426	0.991	92.773			
32	0.408	0.949	93.723			
33	0.361	0.841	94.564			
34	0.35	0.814	95.377			
35	0.309	0.718	96.095			
36	0.283	0.658	96.753			
37	0.247	0.575	97.329			
38	0.238	0.555	97.883			
39	0.23	0.535	98.419			
40	0.218	0.506	98.925			
41	0.185	0.43	99.355			
42	0.153	0.357	99.712			
43	0.124	0.288	100			

Extraction Method: Principal Component Analysis

Source: Author's compilation

4.2 Analysis of Factors Responsible for SMEs Growth in Afghanistan

From Table 2, it is clear that Eigen values for factors are above value of 1 and we expect 16 exploratory factors effecting the performance of SMEs in Afghanistan. Following Table 3 is developed based on the rotated component matrix's factor loadings values. Table 3 defines the factors responsible for the growth in SMEs in Afghanistan. On the basis of the factor loadings the factors have been merged to get the resultant factor. Thus the naming of the factors on the basis of factors loadings are explained in the Table 3:

Table 3: Factors Affecting SMEs Growth in Afghanistan

No.	Statement	Factor Loading	Name of Factor	Related to
1	Not having a strong marketing team leads	0.494		

	your business to failure.			
	I should learn more about managing SMEs.	0.315	Managing SME	Internal Factors
	One reason that I am successful is that I am very good at networking.	0.316		
	I am not a best manager.	0.369		
	I think using machineries cost much electricity.	0.388		
2	Foreign SMEs have better technology and good products.	0.317	Technology	Internal Factor
	I have little experience of using technology.	0.402		
3	Not having a strong marketing team leads your business to failure.	0.478		
	Knowing more people means more people know your business.	0.35		
	More people think you try to deceive them when you advertise.	0.332	Marketing	Internal Factor
	Consumers do not like what they have not tried before.	0.412		
	Spending money on ads is illogical.	0.345		
	Marketing is the main factor for SMEs success.	0.51		
4	Type of business.	0.374		
	The bigger the size of firm the more profit it makes.	0.351	structure and Size of Business	Internal Factor
	Type of business ownership.	0.595		
	You have to spend a lot to train a new employee.	0.441		
5	Most of SMEs staff do not SMEs knowledge.	0.323	Skilled labor	Internal Factor
	You can hardly find educated labor.	0.309		

	Experience of the employee.	0.468		
	If you have good relation at govt. level, you rarely run into legal problems.	0.41		
	Getting a new license will get years.	0.402		
	I worry that govt. bureaucracy will stop SMEs development.	0.498		
6	My friends say that if you don't bribe government officials they won't issue a license.	0.427	Role of Government	External Factor
	Bribing officials is an issue that must be addressed.	0.404		
	Government should review tax issues.	0.324		
	I should learn more about managing SMEs.	0.565		
	School system is outdated and has nothing about SMEs.	0.467		
7	Adding topics on SMEs in school curriculum will be a big help for SMEs.	0.331	Curriculum and SMEs knowledge	External Factor
	You can hardly find educated labor.	0.309		
	Learning books on entrepreneurship is interesting to me.	0.548		
	Banks do not lend a money that you really need.	0.422		
	The loan system are very complicated in Afghanistan.	0.549		
8	Banks charge a very high rate of interest on loans.	0.441	Access to Finance	External Factor
	Funding business can be done only through friends or family.	0.429		
	Financial institutions do not trust SMEs to provide them loans.	0.444		

	Launching a new product is a big risk.	0.639		
9	Loyal customers do not want to see any changes in the products.	0.543	Loyal Customers	External Factor
	Consumers do not like what they have not tried before.	0.412		
	Foreign SMEs have better technology and good products.	0.317		
10	Foreign SMEs produce good quality products.	0.365	Foreign SMEs Competition	External
	All good employees are hired by foreign SMEs.	0.378		

Source: Author's compilation

5. Discussion

Based on the factor loading, Table 3 summarizes a total of ten variables which are further categorized as internal and external variables affecting the performance and growth of SMEs in Afghanistan. Management of SMEs, use of technology, marketing the products, skilled labor, and structure and size of the businesses are the internal determinants of SMEs growth. Role of government, curriculum and SMEs knowledge, access to finance, loyal customers, and competition from foreign companies are external factors affecting the SMEs' growth.

Management of SMEs is considered as one of the important factors for the growth and sustainability of SMEs (Hisrich & Drnovsek, 2002). Martin & Staines (2008) finds lack of managerial skills a major cause of SMEs failure. Considering the uncertain business environment of Afghanistan, effective managerial skills can be proved as a competitive edge for SMEs. Clover & Darroch (2005) argue that failure to have advanced technology at start-up can negatively impact the business development process in today's world of technology. Arinaitwe (2006) believe that the primary cause for SMEs growth in developing countries is the lack of access to technology or their low technological capacities. SMEs in Afghanistan operate more in a traditional manual system, use of updated technology can increase the operational efficiency of SMEs in Afghanistan.

Another factor identified is marketing skills which is about finding your relevant target market, choosing a selling strategy, providing quality services, Advertising, public relations, e-commerce, competitor knowledge, promotion, product development, selling and developing plans and strategies to gain competitive advantage and surpass the competition (Monk, 2000; and Tustin, 2003). Reaching out for customers in Afghanistan is a challenging task considering the limited access of public to internet and technology. In such cases, it is very important for SMEs in Afghanistan to

invest more on marketing their products. The study find skilled labor as an important factor for increasing cost efficiency. Today's market competition is based on cost controlling and skilled labor can be an important factor to control and manage the operational and production costs. Hubbard (1998) believe that smaller firms with financial capital and limited access to finances are more prone to failure against the large sized firms and this size of business directly affect the growth of business (Hussain, 2003).

One of the explored external factors which affect the growth of SMEs in role of government. Role of government is important from different dimensions like policy making, providing tax relief, building trust on judicial system, granting access to government aid packages, access to public procurement projects, providing opportunities for SMEs to build public private partnerships, infrastructure, security and ease of doing businesses (Fielden et al., 2000; Clover & Darroch, 2005; and Harvie, 2005; Okapar & Kabonga, 2009). In case of Afghanistan, as the small medium enterprise sector is struggling, support of government in all the mentioned areas is direly needed. Government must come up with business friendly regulations to encourage entrepreneurs. Government must facilitate incubation centers and develop the updated curriculum of doing business both at college and university levels. It is the job of the government to increase the financing facilities which is the backbone of doing business. In developing countries, SMEs find it difficult to access banks for loans because of the high risk of failing to pay back, low profitability and the high collateral demanded by banks (Harvie, 2005).

At the same due to increasing complication of financial markets, financial institutions are becoming more careful in loan processing and approval, making it more difficult for SMEs to access finances (Haron et al., 2013). In Afghanistan there is only one microfinance bank with limited contribution in SMEs development as the loans are interest based and being a religiously conservative society, majority people do not prefer taking interest based loans. Walley (1998) argued that competition helps the SMEs to find competitive advantages that significantly affect the success of the enterprise. For the survival of business, SMEs must be competitive in innovation, market knowledge, prudent investment, business operations, cost control, keeping loyalty of customers, and management efficiency. In Afghanistan, the context of competition for SMEs is different which only revolves around sales and market share while these two factors depend upon being competitive in cost control maintaining customers' loyalty, efficient operations and management and innovation (Singh, Garg & Deshmukh, 2010).

6. Conclusion and Recommendations

The objective of the study was to explore the factors affecting the growth of SMEs in Afghanistan. The factors were categorized as the internal (firms' associated) factors and external (market related) factors. As the SMEs in Afghanistan are struggling with survival and growth because of the multidimensional complex environment, it is important to find out those

possible factors which can affect the growth of SMEs in Afghanistan. The study used exploratory factor analysis to achieve the objective. The study found Management, use of technology, marketing the products, skilled labor, and structure and size of the businesses are the internal challenges of SMEs growth while role of government, curriculum and SMEs knowledge, access to finance, loyal customers, and competition from foreign companies are external factors affecting the SMEs' growth.

The study explored the diverse role of government ranging from regulations to providing financial security to the entrepreneurs. The findings also stress the use of technology to bring efficiency in operations of the business and to reach out to more customer base across the country. Development of incubation centers is important to facilitate SMEs and create more public awareness about the SMEs and entrepreneurship. To be competitive in the market, it is necessary that enterprises invest on the development of labor force, because skilled labor is a competitive tool for cost control and efficiency. Entrepreneurs face acute limitation of access to finance. Government, through public private partnership, can launch diverse nature of financing facilities. Access to such facilities must be made easier and 'Shari'ah' compliant so that majority of people can capitalize on such facilities. Confirmatory Factor Analysis is needed to confirm the explored factors of the study.

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