

Financing Small and Medium Enterprises in Afghanistan

Kardan Journal of Economics
and Management Sciences
2 (4) 97–111

©2019 Kardan University
Kardan Publications
Kabul, Afghanistan

[https://kardan.edu.af/Research/
CurrentIssue.aspx?j=KJEMS](https://kardan.edu.af/Research/CurrentIssue.aspx?j=KJEMS)

Alimadad Rasoli
Aimal Mirza

Abstract

The objective of this study was to investigate Financing Small and Medium Enterprises in Afghanistan. This thesis has been completed with a detailed research result with a set of findings and recommendations for the key stakeholders - Banks, SMEs and the Government. The research included surveys, visits and meetings with owners of SMEs, SME lending banks and financial institutions that lend to SMEs. The data was collected via a questionnaire through Google Forms. SME owners were the main target group for data collection. 385 was selected as sample size because the exact number of SMEs is not determined by GIROA in Kabul city. Over 400 SMEs were approached and requested for giving their opinions, 327 responses were received. In addition of SMEs, survey with 6 banks and financial institutions was also conducted. According to findings of this study, in Afghanistan, sources of financing SMEs are personal investment, loan from relatives, loan from banks/financial institutions and loan from donors. The survey results show that around 89% of the SMEs need finance for their businesses while only 16% (of 89%) of them have really accessed loans. 63% SMEs responded that financing is critical or very important for their businesses. Banks, financial institutions, donors' programs and some NGOs are providing loans to SMEs in Afghanistan. High rate of interest (21.2% average), lack of support from government, lack of policy/regulation from Da Afghanistan Bank for banks and financial institutions, lack of Islamic loans and SMEs' low capacity in loan processing are the main challenges of SMEs financing in Afghanistan. SMEs are facing lack of access to finance and only a low percentage of them have access to loans.

Keywords: SMEs, access to finance, loan, financial institutions, banks

Mr. Alimadad Rasoli is MBA Alumni, Kardan University, Kabul, Afghanistan.

Mr. Aimal Mirza is Thesis Coordinator at Kardan University, Kabul, Afghanistan.

Introduction

Almost every developed and developing country depends on its private sector (Beck & Demirgüç-Kunt 2006), very few, if they do not, have natural resources like oil, minerals or tourism (Ghatak 2010). According to researchers like Zulkifli-Muhammad (2015), Char (2006), (Bin Yaso, 2004) and Hassan (2009). The private sector in many countries players are the main job creators, they pay taxes and maintain the economy. The private sector includes all the people doing an activity for earning profit for their livelihoods. They differ in size (Rao, 2006) capital (Varma, 2017), employability (Ghatak, 2010), coverage and ownership (Parto, 2007). The section with the most influence on the economy is the range of small and medium enterprises. In this paper afterword, we will call them SMEs. Though economies are generally comprised of a big number of micro-businesses however, they are being too tiny and not mainly given attention. Big corporations are also a crucial part of the private sector, but the number of corporations is few in each economy, especially in Afghanistan. The Small and Medium Enterprises (SMEs) influence the economies by employing, contributing to exports and forming a major portion of export and tax revenues. As the SMEs perform for the economies, they encounter many challenges including but not limited to capital, human resources, policies and procedures by governments, markets, technology and infrastructures. The challenges differ from context to context.

SMEs are playing a crucial role in the Afghan economy as well. SMEs are a vital component of the nation's economic development plan, since companies with fewer than 100 employees constitute 80 to 90% of all Afghan businesses, generate 50% of the GDP, and employ 75% of the labor force (MoCI of Afghanistan). It is also important to bring up the challenges that need attention and we believe solving many of them is possible with the available resources and opportunities within the Afghanistan context.

Afghan economy in the post-Taliban era, mostly depended on the aid money. The aid money through donor community was injected without a concrete plan. This money was not efficiently used to strengthen manufacturing and exports; instead they were spent on imported consumable items mostly. There has been a need and opportunities for the donors and the government to focus on serving the SME sector to start-up, build, produce, export and grow. Currently, access to finance is still difficult, where there is a significant need of funds for doing business and a good amount of funds is available in the financial market of Afghanistan through aid money, people's deposits and idle capital of other enterprises which could be efficiently utilized and spread across the SMEs.

In Afghanistan, SMEs face a series of challenges and access to finance is one them. Given the importance of financing SMEs in Afghanistan, it is worth researching, discussing and analyzing the gap between the necessity, demand and the possibilities of the available opportunities for financing. For instance, what sources of financing are available and what source is mostly used by SMEs?

It is always wise and better to reflect on the possible solutions rather than discussing only the problems. The difficulties and challenges the SMEs face in their day-to-day businesses to access finance is the core of this research. Wide-ranged possibilities, opportunities, solutions and practices are referred to in the main document to serve the SMEs get easy access to finance or financing.

1.1 Research Objectives

The objective of this research “Financing SMEs in Afghanistan” is to research and study sources of financing for SMEs, the need and importance of finance for SMEs, the current challenges, barriers and road-blocks present and also explore the opportunities, solutions and supports available in the financial market.

1.2 Research Questions

Limited research is conducted in the field of financing SMEs in Afghanistan and this research focus is mostly on:

1. What sources of finance are available for SMEs?
2. How is financing important for SMEs?
3. What challenges SMEs face in financing and what opportunities are available?

2. Literature Review

2.1 SME Definition

There is no universally accepted definition of an SME. In some countries, the definition is based solely on the size of the labor force (Ibrahim,2012). In some studies, the definition incorporates financial variables, such as turnover (Batsaikhan,2015) or assets (Xueyuan 2011). Furthermore, in some studies, such as Wang (2010), Robson, and Freel (2015) different definitions apply in different sectors. Also, different organizations defined SMEs differently based on their contexts, but the number of employees is one of the key criteria for the SME definition in a global context. For instance, the current World Bank Group definition is “as encompasses enterprises with up to 300 employees and total annual sales of up to US\$15 million”. The European Union has defined an SME as a legally independent company with no more than 500 employees. World Bank has also differentiated between micro, small and medium enterprises and defined micro, small and medium enterprises as below:

Micro-enterprise: up to 10 employees; total assets/total annual sales of up to US\$100,000; turnover must be more than US\$400,000, and tangible assets more than US\$200,000; Small enterprise: between 10 and 50 employees; total assets/total annual sales between US\$100,000 and US\$3 million; Medium-sized enterprise: between 50 and 300 employees; total assets/total annual sales between US\$3 million and US\$15 million.

Ministry of Commerce and Industry of Afghanistan defines SMEs based on the Afghanistan context.

Microenterprise: up to 5 employees, a total investment of 2.5 million AFs in manufacturing and 1 million AFs in the service sector. Small enterprise: between 5 – 19 employees, total investment of 2.5 – 5 million AFs in manufacturing and 1 - 2 million AFs in services. Medium enterprise: between 20 – 99 employees, total investment of 5 – 10 million AFs in manufacturing and 2 – 5 million AFs in services. So, SMEs include enterprises with 5 – 99 employees and 2.5 – 10 million AFs investment in manufacturing and 1 – 5 million AFs investment in services.

2.2 Role of Banks in Financing SMEs

A major challenge to the growth of the vital Indian SME sector is its lack of adequate access to finance (Tsai, 2017). The major issues in the financing of SMEs' context are the information imbalance facing banks and the efficacy of measures such as credit scoring for SMEs (Khalique, 2014); whether transaction lending would be adequate to address the information issues or would lending have to be based on a relationship with the SME (Khan, 2015), using both 'hard' and 'soft' information; and whether the size and origin of the bank affect the availability of credit to SMEs" (Ashok Thampy, 2010). In recent years, while the world's economy has been growing at a smaller rate (Shamsuddin, 2017), (Sarkawi, 2018), (Jaafar, & Rahim, 2017). the production from micro, small and medium enterprises has been growing at over 11% between 2002 & 2003 and 2007 & 2008 in many developing countries like India (Ashok Thampy, 2010) and China (Xuegona & Xueyuan 2011).

2.3 Role of Financial Institutions in Financing SMEs

According to a World Bank survey in 2015 formal SMEs contribute to 60% of employment and 40 % of GDP in developing economies globally and about half of the formal SMEs do not have access to credit. Throughout the world SMEs rely on other sources of financing like informal finance, online peer to peer platforms, registered non-banking financial institutions and underground financiers. (Netease Finance, 2014). Based on literature and previous research, the following reasons are the main causes of lack of access to bank credits. The first cause is the political concerns about supporting public sector and maintaining social stability (Ibrahim, 2012). Second cause is the developmental priority of national and local government (Tahi, 2011). The third cause/reason is the organizational and technical capacity of central banks to serve non-state actors/enterprises (Batsaikhan, 2015). The fourth cause/reason is ideological and political sensitivity to supporting capitalist enterprises because of socialist governments (Xueyuan, 2011). The fifth reason is financial depression and based on government policy, central banks should provide subsidy to state-owned enterprises (Freel, 2015).

2.4 Financing SMEs in Afghanistan

In 2014 Coffey International conducted a research for DFID (Department for International Development) on "Scope of the Need for Improved Access to Funding, Advisory Support and Business Skill

Development for SMEs in Afghanistan”. Coffey findings show that it is logical for donors to support services for SMEs in Afghanistan. Because the banking system is under-developed, narrow and fragile and the government does not have a system for funding SMEs. So, it is a task for the donors to continue supporting SMEs in Afghanistan. The research findings show the major Afghan firms do have constraints in access to finance and a very limited portion of Afghan SMEs has access to formal finance and loans. To improve the financial sector of Afghanistan and have a better platform for financing SMEs and sustained financial system. The Coffey research suggested the following points for consideration.

1. Capacity development of new and existing institutions providing private sector development, financial sector development and business enabling environment supports.
2. Capacity support to Da Afghanistan Bank, with a focus on supervision and regulation of the financial sector.
3. Policy implementation facility to enact financial sector improvements for SMEs.
4. Strengthening the business environment to encourage investment and SMEs’ responsiveness.

2.5 Banks & Financial Institutions Financing SMEs in Afghanistan

Banks, financial institutions and donors provide fund for SMEs. Private banks like Afghan United Bank, Ghazanfar Bank First Micro Finance Bank and Afghanistan International Bank, are given loan to SMEs in Afghanistan. Financial institution like FINCA, Muthahid Development Finance Institutions, Afghan Rural Finance Company and OXUS are providing loan to SMEs. Beside banks and financial institutions NGOs and donors like USAID, GIZ, Hand in Hand Afghanistan, Afghan Women Council, hope for Life and Exchanger Zone providing loans to SMEs.

2.6 SMEs Financing by MISFA Afghanistan

The Microfinance Investment Support Facility for Afghanistan (MISFA) was set up in 2003 at the invitation of the Afghan government, to get donor coordination right from the start and avoid the counter-productive efforts that have emerged from conflicting donor objectives in other post-conflict situations. It was established as a vehicle through which the Afghan Government and international donors could channel technical assistance and funding to build Afghanistan’s microfinance sector. MISFA was the first facility of its kind, pooling diverse donor funding mechanisms and converting them into streamlined, flexible support to microfinance institutions in Afghanistan, tailored to local priorities and accompanied by technical assistance and strong performance monitoring. In March 2006, MISFA registered as a limited liability non-profit company whose sole shareholder is the Ministry of Finance of the Islamic Republic of Afghanistan. MISFA Ltd is an independent apex organization with several implementing partners on the ground. In most cases, MISFA functions as either the exclusive or primary provider of funds to its partners. The legal status of MFIs has been transformed from NGOs to that of non-profit companies

registered with the Afghanistan Investment Support Agency (AISA), as permanent institutions under the laws of Afghanistan. (MISFA, Afghanistan. (2018, December). *SME Sector Update*)

MISFA's Small and Medium Enterprises (SME) lending program was initiated in October 2006, with the financial cooperation of USAID's ARIES Project. Under this program, MISFA is developing SME lending by partnering with local bank and non-bank financial institutions (Microfinance Institutions etc.). MISFA since then has provided technical assistance, whole-sale loans and credit guarantees to a big number of financial institutions. As per MISFA typically SME loan amounts range between AFS 250,000 to AFS 5,000,000. MISFA's SME program has provided training on the basics of SME lending to more than 310 loan officers, managers and employees of the partner financial institutions on SME lending techniques in Afghanistan and how to successfully manage SME loan portfolios.

Table 1: MISFA Afghanistan's Portfolio in SME Lending Through Financial Institutions

Key Indicators	December 2018
Active SME borrowers	1,438
Total number of loans disbursed (cumulative)	35,991
Total value of loans disbursed (cumulative)	AFN 16.6 billion
Loan outstanding	AFN 1.8 billion
SME Loans by Sector	per cent
Trade and Service	60.1 percent
Handicrafts & Manufacturing	18.2 percent
Agriculture and Livestock	19.9 percent
Housing Loans and Others	01.8 percent

Source: MISFA 2018 report

2.8 Gaps in SMEs Financing in Afghanistan Based on Literature

The private sector is very young and new in Afghanistan and the government does not have a proper supporting policy for the private sector. Despite big contribution of SMEs to employment and GDP but still government is failing to support the SMEs and have a pro – SMEs policy. Government of India approved a law for SMEs and Reserve Bank of India have a proper policy for supporting SMEs.

In Afghanistan, donors are supporting SMEs with different projects, but it is not enough and sustainable. There is a need for government policy to involve and force banks and financial institutions in giving loan to SMEs. Based on literature review and desk research following gaps and issues exist in financing SMEs in Afghanistan.

1. Lack of government policy/regulation specially non - existence of regulation in the Afghanistan central bank (Da Afghanistan Bank).
2. Young financial institutions and banks.
3. Traditional management style of SMEs and lack of professional business.
4. Weak and young private sector.
5. High rate of interest for loans.

3. Research Methodology

Based on literatures and previous research in access to finance for SMEs in Asian context, mixed strategy/methodology used for this research. Based on research findings from Ministry of Commerce & Industry, number of SMEs are not determined in Kabul and there is no exact figure. Indefinite sample size method is used for SMEs and 385 was the sample size for this research. Questionnaires shared with over than 400 SMEs in Kabul and 327 SMEs providing Feedback. Response rate compare to sample size is 85%. Six banks and financial institutions also interviewed in Kabul to have information and idea of loan providers as well. The research included interviews and questionnaire from the SMEs and Banks. For questionnaire, Google Form is used and data is downloaded from Google Form in excel format for analysis and findings. Questionnaire used for SMEs were reflecting on the needs for finance of SMEs, available opportunities of financing in the country, facilities available for financing the SMEs, gaps in demands and supplies with regards to financing, unserved facilities for SMEs, perceptions of SMEs for Banks and financial institutions and their financing facilities, other financial sources than the banks, policies & procedures etc. The financial institutions and SMEs were approached via personal visits for face-to-face interviews, hard-copy survey form was used to question the SMEs appearing in classroom/events where a good number of SMEs were present, Google Form questionnaires were spread through personal and friends networks, lists of SMEs were received from the MoIC Afghanistan and some other governmental departments, donor funded Programme “A Bright Future of Afghanistan” assisted in accessing over 50 beneficiaries who were SMEs and some financial institutions in Kabul allowed to meet their SMEs and interview regarding the financial access and facilities by the banks and financial institutions.

The SMEs and Financial institutions that were questioned and interviewed were mostly in Kabul. Some SMEs that responded to the survey questionnaires were from other major provinces of Afghanistan like Mazar-e-Sharif, Herat and Kandahar. The banks and non-bank financial institutions that interviewed and supported in reaching out the SMEs were all in Kabul.

4. Data Analysis and Findings

The SMEs that filled questionnaire are 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 have need accessed loans, donor funds, loans from other personal sources and have included a good amount of capital from their other personal businesses.

Trade businesses generally require bigger amounts of capital and stocks, the market is less trending towards the trade, import/export businesses given the less favorable conditions in the economic context of Afghanistan. During the survey, we came across very few of the trading

businesses. This fact in the table 2 reflects to a finding that less investors are inputting capitals in a business activity in Afghanistan. Entrepreneurs prefer to work without or with less capital. A good number of manufacturing business gives 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 2: Overall Information About Data Collection

Number of SMEs that questionnaire was shared	400+
Sample size	385
Number of SMEs that responded to questionnaire	327
SME response rate to questionnaire	85 per cent
Number of financial institution and banks that questionnaire was shared	7
Number of financial institutions and banks responded to questionnaire	6

Source: Computed based on collected data

4.1 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 (55%) have less than 10 employees including the owners, friends and family advisors and supporters. Not many SMEs are really looking into hiring more employees to do the jobs done. This generally reflects to 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 3: Nature of Business by Category

Nature of Businesses	#	per cent
Agriculture and Livestock	13	4 per cent
Construction	24	7 per cent
Manufacturing	111	34 per cent
Others	12	4 per cent
Services Provider	151	46 per cent
Trade, Imports & Exports	16	5 per cent
Total	327	

Source: Computed based on collected data

4.2 Asset Size

SMEs are generally differentiated based on their asset size. During this survey the sizes of SMEs have been questioned and reported. More than a half of all these SMEs have asset sizes less than \$20,000. So many SMEs find it less risky and more profitable to input less capital and assets to make more revenue. Some SMEs that were interviewed have spare cash or stock at homes that are being used for utilizing on casual and eventual basis. Such a

situation creates a shortage in capital in the market where the SMEs tend to buy on credit from the suppliers rather inputting their own money in business. A big number of SMEs prefer doing service providing business which requires less amount of assets. Online Shops, Food delivery, brokerage, commission agency and virtual businesses are some examples of service providing businesses that either do not involve a lot of assets or the assets are not exposed among the public and markets. 4% of the SMEs that took part in survey preferred not to reflect on their company's asset sizes.

Table 4: SMEs Employee Size

Company Sizes (# of Employees)	#	per cent
01 - 09	180	55 per cent
10 – 24	98	30 per cent
25 – 49	38	12 per cent
50 – 100	11	03 per cent
Total	327	100 per cent

Source: Computed based on collected data

4.3 Asset Size

SMEs are generally differentiated based on their asset size. During this survey the sizes of SMEs have been questioned and reported. More than a half of all these SMEs have asset sizes less than \$20,000. So many SMEs find it less risky and more profitable to input less capital and assets to make more revenue. Some SMEs that were interviewed have spare cash or stock at homes that are being used for utilizing on casual and eventual basis. Such a situation creates a shortage in capital in the market where the SMEs tend to buy on credit from the suppliers rather inputting their own money in business. A big number of SMEs prefer doing service providing business which requires less amount of assets. Online Shops, Food delivery, brokerage, commission agency and virtual businesses are some examples of service providing businesses that either do not involve a lot of assets or the assets are not exposed among the public and markets. 4 per cent of the SMEs that took part in survey preferred not to reflect on their company's asset sizes.

Table 5: SMEs Category by Asset Size

SMEs by Asset Size	#	per cent
\$5000 - 19,000	176	54 per cent
\$20,000 - \$49,000	80	24 per cent
Above \$100,000	39	12 per cent
\$50,000 - \$100,000	19	6 per cent
No Response	13	4 per cent
Total	327	

Source: Computed based on collected data

4.4 Monthly Sales Volume

The survey also required the SMEs to reflect on their monthly average sales volume. The figures selected are closer/estimates of the facts. The figures and facts that are reported could not be verified through checking sales documents. Most of the SMEs attended the survey fall in the basket of

sales range \$1,000 to \$4,000 which makes at least 61 per cent of the SMEs that have below \$4000 average monthly sales. The SMEs that were approached and those who contributed were relevantly new. Around **56 per cent of all these SMEs are either newly established or they chose their age to be between 1-2 years**. New companies can be expected to have lower monthly sales. 23 SMEs prefer not to disclose their monthly sales volume making 7 per cent of all the responses. SMEs with lesser volume of monthly sales believe that they do not have reliable sales, they feel that they need a greater number of customers to have enhanced sales.

Table 6: SMEs Monthly Sale Range

SMEs by Monthly Sales	#	per cent
\$ 1,000 – 4,000	199	61 per cent
\$5,000 - \$19,000	72	22 per cent
\$20,000- \$29,000	23	07 per cent
\$30,000 – \$39,000	5	02 per cent
Above \$40,000	5	02 per cent
No Response	23	07 per cent
Total	327	

Source: Computed based on collected data

4.5 Source of Financing for SMEs

It is always worthy to know the sources of the financing for SMEs while considering them into our discussions. Based on our findings and interaction with the financial institutions and SMEs, it was found that SMEs everywhere have various sources of financing. Some big number of SMEs have their own personal capital to start a business. A smaller portion of the SMEs get any donor funds or supplier loans to initiate their business without involving their own assets or capital. This survey also asked the SMEs about their sources and means of financing when it really matters for their businesses. Usually, majority of the people included their own capitals, later, on eventual basis, the SMEs get financial supports from immediate or far family members or friends which generally doesn't cost any interest. What mostly remains in the business for long time is their own capital, capital from their other businesses, shareholding by individuals or companies and often capital injected by selling a land, property or a bigger valued vehicle. Through the survey, it was found that 57 per cent of the SMEs have their own investments in their businesses. 31 per cent /57 per cent of these people have only their own sources of income and do not take supports from any other sources. 26 per cent /57 per cent of the responses collected shows that they have included their own sources or personal investments as well as they reach out to other sources for financing when it really matters. The SMEs that were surveyed could chose more than one financing sources. All the 327 SMEs have responded and a total of 486 responses have been selected by all (1.8 options were selected per SME on average). It has also been reflected that only 53 SMEs responded that they have accessed finance from a bank or financial institutions 11 per cent only. "Access to finance is still a challenging job for the SMEs in Afghanistan, there are many reasons behind it".

It was assumed that there are a lot of SMEs that have access to donor funds or loans from donor projects. That was the reason that the question if “the SMEs have any access to donor funds” is included. But finding shows that only 3 per cent out 327 are received fund from donor. 20 per cent of the SMEs responded that they receive financing supports from immediate family members or friends which is a common practice across Afghanistan’s all communities. The financial supports by family members is also difficult as per interviews from SMEs, they believe that now a day their families and friends cannot support them in their businesses. In the response that how financing is important for the businesses, the SMEs have responded well. 63 per cent of 327 SMEs responded that financing is critically or very important for their businesses. It really matters to have equal, easy and less expensive access to financial resources when it is needed. Some businesses go for a financing option when only it is a good season for them, some others require continuous financial injection in their businesses to keep the most innovative and up-to-date products or services for their companies.

Table 7: SMEs Source of Finance

Sources of Financing (all responses, multiple responses were allowed and included)		
Personal Investment + other sources	275	57 per cent
Loan from other Business	31	6 per cent
Loan from Banks	53	11 per cent
Loan from Family Members	98	20 per cent
Loan from donor	17	3 per cent
Loan from Hawala Dealers	5	1 per cent
Others	7	1 per cent
Personal Investments Only	151	31 per cent
Personal Investment + Other sources	124	26 per cent

Source: Computed Based on Collected Data

4.6 Ratio of Access to Finance and SME Needs

The survey asked a question and further information from the SMEs that either they accessed finance from Banks for their businesses in recent years. 18 per cent of the (59/327) SMEs reflected that they have accessed bank loans whereas 19/327 SMEs access bank loans more than 1 time. The SMEs that accessed loans believe that the process of taking loans is simple but takes a lot of time, documentations and long history in business. This reflects to the performance and efficiency of credit front line employees and credit administration of banks and SME lending institutions.

Generally, people have the perception that the getting a loan from banks is either very difficult or it requires personal references, some other believe that they may not fulfill all the requirements to access loans from banks. Whereas, the banks and financial institutions believe that they created great platforms, trained well their credit processing staff and improving their process of loan giving every day. A big number of SMEs (18 per cent of 327) believe the bank loans are expensive where their businesses are not that profitable to cover loan interest expenses and at the same time leave behind some ransom for themselves.

4.7 Suggestions of the SMEs Regarding “Access to Finance” Facilities in the Country

The survey where included a detailed background information of the SMEs, their needs, sources of finance for their business, importance of financing for the businesses and available options, it also included many “Open Ended” questions that allowed the SMEs to write anything they face in running and maintaining their business operations. The SMEs have made valuable suggestions, recommendations and concepts that can be considered by financial institutions/banks, the central bank of Afghanistan and as well as for the Private Sector/SMEs. The suggestions including with the findings of interviews and meetings with the SMEs has been categorized to make it countable and possible for analysis and reporting. The table below reflects on all the categories including the number and ratios compared to the full number of SMEs. The survey allowed the SMEs to extend their recommendations, 117 SMEs (out of 327) (36 per cent) had a recommendation at the end of their survey. The survey had an open box for SMEs to write their recommendations in Dari/English narrations. The recommendations and narrations were listed and their recommendations were manually counted and categorized. May SMEs that have included recommendation have included more than 1 recommendation. On an average, the response rate per SME is 1.8 (meaning that every SME had at least 1.8 recommendations).

30 per cent of the recommendations reflect that the bank loans are expensive, they preferred lower interest rates. Based on interviews, the SMEs believe that the Government should intervene either by giving subsidies in loans for SMEs or put strict restrictions for financial institutions to keep their interest rate as minimum as possible. Some SMEs reflected that the banks have hidden charges, 2 per cent of the loan amount is taken as the admin cost or loan processing cost which increases the rate of expenses even more. It was surprisingly seen that 11 per cent of the responses from the SMEs reflect to the need of donor funds, while this question was never asked in the questionnaire. SMEs prefer more projects; more donor funds as grant and as free of interest loans. The donors in the past have been giving out a huge amount of free money as grants and some donor funded financial institutions have given out free of interest loans. This has put a high expectation impact for the SME and many other sorts of entrepreneurs. 14 per cent SMEs wished to get loans on Islamic terms and conditions or get loans that suit startups. There are several Islamic loan products at multiple banks but unfortunately less people either know about them or they do not entertain the people/SMEs they don't know. Startups find it difficult to follow bank loans with regular on-time repayments. Startups mostly need longer term loans with lower amounts of repayments and at the same time, they wish for less expensive loans. Among the recommendations, majority of the responses (78 per cent of all the responses) in a way or in another reflect on the improvement of loans, loan conditions, lower interest rates, faster processing duration,

new/customized loan products, easily accessible facilities and better customer services by the financial institutions/banks

Table 8: SMEs Suggestions on Access to Finance

Suggestions of SMEs on Access to Finance		
# of SMEs that have Suggestions	117	36 per cent
Recommendations rate per SME	1.8	
Need Bigger Loans	4	2 per cent
Need Donor Funds	23	11 per cent
Lower Interest Rates	62	30 per cent
Easy Collateral Policies	6	3 per cent
Easy Loan Process to be in place	32	15 per cent
Quick Process	6	3 per cent
Suitable Loans, Startup Loans	10	5 per cent
Islamic Loans Preferred	19	9 per cent
Long Term Loans Preferred	24	11 per cent
Need Projects	2	1 per cent
Private Investors Preferred	4	2 per cent
Don't Need Loans	18	9 per cent
Total Responses	210	
No Suggestions	171	
Responses	# of Responses	
Improved Quality and Conditions of Loans	163	78 per cent
Donor Funds, Private Investors, New Projects are requested	29	13 per cent
Don't Need Loans or other financial supports	18	9 per cent

Source: Computed based on collected data

5. Conclusion

In Afghanistan sources of financing SMEs are personal investment, loan from relatives, loan from banks/financial institutions and loan from donors. The survey results show that around 89% of the SMEs need finance for their businesses while only 16% (of 89%) of them have really accessed loans. 63% SMEs responded that financing is critically or very important for their businesses. Banks, financial institutions, donors' programs and some NGOs are providing loan to SMEs in Afghanistan. High rate of interest (21.2% average), lack of support from government, lack policy/regulation from Da Afghanistan Bank for banks and financial institutions, lack of Islamic loans and SMEs low capacity in loan processing are the main challenges of SMEs financing in Afghanistan. SMEs are facing lack of access to finance and only low per cent age of SMEs have access to loan.

It is recommended that the central bank of Afghanistan should interfere and come up with regulations on streamlining the interest rate and collateral acceptance across all the financial institutions. The Central Bank of Afghanistan (the DAB) should be aware of and has a control on the lending process of the financial institutions. The banks and financial institutions should not be allowed to charge hidden costs/charges on processing loans which prevents the SMEs to access further funds. It is also recommended that banks and financial institutions should provide

awareness raising and training/coaching for SMEs in loan processing. Because SMEs sector is not professionally managing in Afghanistan.

References

- Abe, M., Troilo, M., & Batsaikhan, O. (2015). Financing small and medium enterprises in Asia and the Pacific. *Journal of Entrepreneurship and Public Policy*, 4(1), 2-32.
- Baker, H. K., Kumar, S., & Rao, P. (2017). Financing preferences and practices of Indian SMEs. *Global Finance Journal*.
- Beck, T., & Demircuc-Kunt, A. (2006). Small and medium-size enterprises: Access to finance as a growth constraint. *Journal of Banking & finance*, 30(11), 2931-2943.
- Coffey International. (2014). Scoping the Need for Improved Access to Funding, Advisory Support and Business Skills Development for SMEs in Afghanistan, DFID.
- Ghatak, S. (2010). Micro, small and medium enterprises (MSMEs) in India: an appraisal. *Journal of Technology Management & Innovation*, 6(1), 66-76.
- Ibrahim, N. (2012). The model of crowdfunding to support small and micro businesses in Indonesia through a web-based platform. *Procedia Economics and Finance*, 4, 390-397.
- Khan, M. W. J., & Khalique, M. (2014). An overview of small and medium enterprises in Malaysia and Pakistan: past, present and future scenario. *Business and Management Horizons*, 2(2), 38.
- Khan, S. (2015). Impact of sources of finance on the growth of SMEs: Evidence from Pakistan. *Decision*, 42(1), 3-10.
- Kumar, S., & Rao, P. (2016). Financing patterns of SMEs in India during 2006 to 2013—an empirical analysis. *Journal of Small Business & Entrepreneurship*, 28(2), 97-131.
- Mashal, M. (2014). Small and medium enterprises development and regional trade in Afghanistan.
- MISFA, Afghanistan. (2018, December). SME Sector Update. Retrieved from <http://misfa.org.af/sme-sector-update/>
- Moorthy, M. K., Tan, A., Choo, C., Wei, C. S., Ping, J. T. Y., & Leong, T. K. (2012). A study on factors affecting the performance of SMEs in Malaysia. *International Journal of Academic Research in Business and Social Sciences*, 2(4), 224.
- Parto, S., Paterson, A., & Karimi, A. (2007). The operating environment for small and median enterprises in rural Afghanistan: enabling or disabling. Background paper to the Enabling Environment Conference: Effective private sector contribution to development in Afghanistan.
- Pei-Wen, T., Zariyawati, M. A., Diana-Rose, F., & Annuar, M. N. (2016). Impact of Microfinance Facilities on Performance of Small Medium Enterprises in Malaysia. *World Applied Sciences Journal*, 34(12), 1845-1849.
- Rao, P., Kumar, S., Gaur, V., & Verma, D. (2017). What constitutes financing gap in Indian SMEs—owners' perspective. *Qualitative Research in Financial Markets*, 9(2), 117-131.
- Shamsuddin, J., Sarkawi, M. N., Jaafar, A. R., & Abd Rahim, N. F. (2017). Malaysian SMEs Performance and the Government Business Support Service: The

- Moderating Effects of Absorptive Capacity. *International Journal of Supply Chain Management*, 6(4), 326-331.
- Tahi Hamonangan Tambunan, T. (2011). Development of small and medium enterprises in a developing country: The Indonesian case. *Journal of Enterprising Communities: People and Places in the Global Economy*, 5(1), 68-82.
- Thampy, A. (2010). Financing of SME firms in india: interview with ranjana Kumar, former CMD, Indian bank; vigilance commissioner, central vigilance commission. *IIMB Management Review*, 22(3), 93-101.
- Tsai, K. S. (2015). Financing Small and Medium Enterprises in China: Recent Trends and prospects beyond shadow banking.
- Tsai, K. S. (2017). When shadow banking can be productive: Financing small and medium enterprises in China. *The Journal of Development Studies*, 53(12), 2005-2028.
- Wang, J., Robson, P., & Freel, M. (2015). The financing of small firms in Beijing, China: exploring the extent of credit constraints. *Journal of Small Business and Enterprise Development*, 22(3), 397-416.
- Xuedong, S., & Xueyuan, L. (2011). Small and medium enterprises' access to finance in china. Small and medium enterprises (SMEs) access to finance in selected east Asian economies, 1.
- Zulkifli-Muhammad, M., Char, A. K., bin Yaso, M. R., & Hassan, Z. (2009). Small and medium enterprises (SMEs) competing in the global business environment: A case of Malaysia. *International Business Research*, 3(1), 66.