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The Role of SMEs in the Socio-Economic Development of Afghanistan

**Dr. Muhammad Fayaz
Abdullah Emran**

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Dr. Muhammad Fayaz
Abdullah Emran

Abstract

The contribution of small and medium-sized enterprises (SMEs) and informal enterprises constitutes about 70% of the GDP of developing nations. In Afghanistan, SMEs are independent entities that employ at least 250 individuals and possess a paid-up capital of at least 250 million Afghanis annually. They play a major role in the recovery and development of Afghanistan. This study used structural analysis based on secondary data available from the websites of regulatory bodies and past literature on this topic. The study's findings show that SMEs play a crucial role in contributing to GDP, fostering local entrepreneurship, and promoting innovation despite facing obstacles such as insufficient infrastructure, political instability, restricted access to financing, and regulatory challenges. The study underscores the necessity of implementing policy reforms, establishing financial support systems, and initiating capacity-building programs to empower SMEs, thus enhancing their contribution to sustainable development and recovery in post-conflict scenarios. There is a need to strengthen the SME sector through capacity-building programs, supportive policies, and improved market access. Such steps can strengthen Afghanistan's economic resilience and self-reliance.

Keywords: Small and Medium-sized Enterprises (SMEs), Entrepreneurship, GDP, Economic Growth, Development

1. Introduction

SMEs have an important role in a nation's modern economic and social development (Neagu, 2016). They also make a major contribution towards the overall global economy and support the GDP, which affects the population's standard of living in general (Herr & Nettekoven, 2018). Developed countries attribute 80% of their organizations to SMEs, which are regarded as a cornerstone of their overall economic growth and financial development (Dobrovic et al., 2018). As per the report by the Trade Commission of the United States (2020), its economy is considering a contribution of over 65% to the overall nation's GDP (Petrunencko et al., 2021). They effectively leverage available resources under favourable terms and conditions, facilitating the optimal use of assets and contributing to economic growth. SMEs are pivotal in generating jobs and creating employment opportunities (Herr & Nettekoven, 2017).

SMEs are essential to the economic advancement of Afghanistan, particularly in light of the nation's distinct challenges, including political instability, security issues, and inadequate infrastructure (Barinova & Zempsov, 2019). They are instrumental in generating employment, alleviating poverty, and encouraging entrepreneurship, creating avenues for local development and innovation (Stanisławski, 2021).

1.1 Sectors-wise SMEs in Afghanistan

Table 1

Types of SMEs	Sector	Areas
Manufacturing	Textile Production, Handicrafts, Construction	Carpet weaving, Brick production
Construction	Contractors, Builders, Suppliers	Construction firms, Building material suppliers
Trade and Export	Wholesale, Retail, Import/Export	Cross-border trade, Local shops
Transport	Logistics, Courier Services, Freight Forwarding	Delivery services, Trucking companies
Education & Training	Educational institutions, Vocational training centres	Language schools, Skill development centres
Technology	IT Development, Mobile Apps, E-commerce	Software development, Online businesses
Finance	Microfinance, Insurance, Lending Services	Micro-lending institutions, Insurance brokers
Services	Retail, Hospitality, IT Services, Healthcare	Restaurants, Call centres, Physiotherapy clinics

Source: Based on the literature review

1.2 The Contribution towards Exports

According to the Afghanistan Chamber of Commerce and Investment (ACCI), SMEs play a significant role in the country's exports, specifically textiles, handicrafts, and agriculture (Abdullah, 2021). During 2021, the total exports in Afghanistan were around \$900 million. The major ratio of the exports is from small-scale producers of the agricultural sector, like dried fruits, nuts, almonds, pistachios, saffron, and herbs (Elagin, 2020). Their presence in the agriculture sector contributes about 80% of Afghanistan's exports. Afghanistan is one of the world's largest exporters of dried fruits, particularly raisins, mainly produced through firms (Ganji & Joshi, 2021). During 2020, the country exported dried fruits worth approximately \$200 million.

Handicrafts are considered one of the renowned products of Afghanistan, specifically woollen products and carpets, which came from SMEs (Fakhar, 2022). The carpet industry contributes about \$100 million annually in total exports. Over 1 million jobs are generated from the carpet industry, maximum of which are from small-scale producers and local export activities (Khatib et al., 2021). The saffron industry in Afghanistan has grown significantly in recent years. Approximately 80% of Afghanistan's saffron exports come from SMEs (Khatib et al., 2021). Small enterprises can change niche agricultural products towards lucrative export items.

2. Creation of Employment Opportunities

Such organizations create many job opportunities in Afghanistan, specifically where large-scale organizations are developing. As per the International Finance Corporation (IFC) reports, 80% of Afghanistan's workforce is occupied through them. The contribution comprises numerous sectors, i.e., retail, agriculture, services, and manufacturing (Haqbin et al., 2023).

They are instrumental in Afghanistan in creating employment for marginalized groups, specifically youth (Mohammadi, 2024). Such setups empowered women by promoting small-scale businesses and supported many women to become participants in boosting the economy. Afghanistan's handicrafts and carpet weaving support about 1 million people in urban and rural areas. They offer employment to a major share of the workforce (Khalid, 2020). As per the World Bank report, they face vital problems with access to finance. The 2019 survey disclosed that only 12% of such businesses in Afghanistan have access to formal credit, which shortens their ability to increase production or enhance export capacity (Khalid, 2020).

The Afghan government and international donors work to assist such entities. The Afghanistan Investment Climate Facility (AICF) gives training and helps build capacity for them, which makes it easier for them to reach markets and get financing. The World Bank supports their development through microfinance, training programs, and legal reforms. Additionally, the Afghan government and international organizations have implemented various initiatives to promote exports (Mirza & Baharudin, 2024). The Afghan Export Development and Promotion Agency (AEDPA) assists small enterprises in marketing Afghan products in regions such as the Middle East, Europe, and North America.

2.1 Contribution of SMEs to Afghanistan's GDP

Table 2

Sector	Contribution to GDP	Role of SMEs
Agriculture	25-30%	This sector comprises numerous small agriculture, agribusiness, and food processing enterprises. These small businesses significantly contribute to exports, including dried fruits, nuts, and saffron.
Services	40-45%	SMEs are important in retail, hospitality, education, and transport. The service sector is mainly powered by small businesses, especially in cities.
Manufacturing and Industry	15-20%	Small-scale manufacturing, encompassing sectors such as textiles, crafts, and construction materials, plays a crucial role in the economy. Small and medium enterprises (SMEs) are at the forefront of these industries, exemplified by Afghanistan's renowned carpet industry.
Trade and Commerce	10-15%	SMEs are important in local and global trade, including selling agricultural and craft items abroad.
Other	5-10%	SMEs add to areas such as building, tech, and services for professionals.

Source: Based on the literature review

Their Role in Contributing to GDP

SMEs are vital to Afghanistan's economy, accounting for roughly 50% to 60% of the country's GDP (Hemat & Rahman, 2023). This contribution includes small business entities across various sectors, such as agriculture, manufacturing, services, and trade. In agriculture, they are essential, generating approximately 80% of the total agricultural output, which corresponds to a contribution of around 25-30% to the national GDP. The services and trade sectors are also witnessing significant growth, primarily driven by such setups, especially in urban and semi-urban areas (Nasseri & Singh, 2024).

2.2 The Role of Small and Medium Enterprises in the Socio-economic and General Economic Growth of Afghanistan

In Afghanistan, they are important for both socio-cultural and economic development. They greatly help in employment creation, poverty reduction, and the enhancement of the economy (Frozan & Matolia, 2019). In Afghanistan's business domain, Micro, Small, and Medium Enterprises (MSMEs) comprise about 80% of the business activity, contributing around 50% to the country's GDP and employing over one-third of its labour force (Tahir, 2019). These are important in boosting the agriculture, industry, and service sectors, which are very important for the economic development of Afghanistan.

2.3 Socio-Economic Impact

Such ventures have a key role in increasing income equality and living standards through the promotion of innovation and entrepreneurship. They play a role in economic stability through the provision of one of a multitude of economic activities, of which the provision of basic economic activities is often overlooked (Kakar, 2020).

2.4 Recent Trends

There have been several spurns in growth in the Afghan economy, most of which are due to reductions in international aid and ongoing political instability (Yar & Hajinejad, 2023). Despite the various obstacles, they remain essential to Afghanistan's development plan, particularly in transitioning to an independent economy.

2.5 Government and Donor Support

Their promotion in development involves facilitating access to microfinance, training, and market access initiatives. Afghan SMEs must be supported to overcome obstacles and become part of the global economy through these initiatives (Shah & Solangi, 2019). These businesses play a vital role in Afghanistan's quest for economic independence, supporting job creation and helping to establish stability despite persistent difficulties. Investment must be sustained in developing SMEs to achieve sustainable growth and advance socio-economic conditions (Muhammadi et al., 2023).

Table 3

Category	Contribution
Share of Total Businesses	Small and medium-sized enterprises (SMEs) represent around 80% of the total number of businesses in Afghanistan.
Employment Share	They play a vital role in agriculture, manufacturing, and services, creating employment opportunities in rural and urban settings.

Category	Contribution
Sectoral Contribution	SMEs are important in manufacturing, agriculture, and service areas, creating employment opportunities in urban and rural regions.
Gender Inclusion	Many SMEs, specifically textiles and handicrafts sectors, produce more job opportunities, with relatively limited available data.
Youth Employment	Furthermore, SMEs serve as a crucial source of employment for young individuals, helping mitigate the high unemployment rates.
Economic Impact	They account for nearly 50% of Afghanistan's gross domestic product (GDP), highlighting their importance in maintaining the workforce.

Source: Based on the literature review

Their contribution to reducing unemployment, improving income distribution and fostering economic stability is significant in Afghanistan. Investment in this sector is essential to sustain and augment employment opportunities. Hence, the table below displays their contributions in Afghanistan, accompanied by statistical data.

Table 4

Region	SME Contribution	Key Figures
Kabul (Central)	A significant centre for commerce, services, and manufacturing, attributed to its robust infrastructure and demographic advantages.	Houses account for over 40% of SMEs, contributing significantly to national GDP.
Herat (West)	It emphasizes trade relations with Iran, particularly in textiles and agricultural processing.	Fifteen per cent of small and medium-sized enterprises (SMEs) are situated in this area, a prominent region for exporting dried fruits and carpets.
Mazar-e-Sharif (North)	The region is a pivotal trade nexus with Central Asia, concentrating on logistics, agriculture, and small-scale manufacturing.	This region comprises approximately twelve per cent of SMEs, demonstrating significant cross-border trade value.
Kandahar (South)	The region is a pivotal trade nexus with Central Asia, concentrating on logistics, agriculture, and small-scale manufacturing.	Agricultural SMEs play a crucial role in Afghanistan's fruit export sector; however, regional SMEs encounter considerable risks.
Jalalabad (East)	It excels in agricultural production, notably pomegranates and grapes, alongside small-scale trading activities. A vigorous cross-border trade with Pakistan features prominent small and medium-sized enterprises in food processing and packaging.	This area accounts for ten per cent of SMEs and is vital for imports and exports via the Torkham border.
Bamiyan and Central Highlands	Handicrafts and small-scale agriculture primarily characterize the economic landscape, although they face limitations	Less than five per cent of SMEs are present here, primarily concentrating on local markets

due to infrastructural challenges and and handicrafts aimed at geographic seclusion.	tourism.
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Source: Based on the literature review

With its advanced infrastructure and a concentrated consumer market, Kabul is an attractive location for such activities. Comprehensive information regarding their contributions to employment categorized by income group in Afghanistan is limited. However, general trends can be deduced from the characteristics of this sector and the socio-economic environment of Afghanistan. Below is a summarized table:

Table 5

Income Group	SME Contribution to Employment	Key Figures/Insights
Low-Income Individuals	Small and medium-sized enterprises (SMEs) are crucial in generating employment within labour-intensive industries such as agriculture, textiles, and handicrafts.	Small and medium-sized enterprises (SMEs) represent over 33% of national employment, predominantly low-income workers in these sectors.
Middle-Income Individuals	They create job opportunities in skilled trades, retail, and small-scale manufacturing, thereby facilitating income mobility for individuals.	Middle-income individuals mainly work in manufacturing and service SMEs in urban centres such as Kabul.
High-Income Individuals	While the direct employment opportunities may be limited, higher-income individuals are often more likely to be owners or investors in these SMEs.	In contrast, high-income individuals tend to be involved in entrepreneurial leadership roles rather than traditional wage-based employment.

Source: Based on the literature review

Table 6

Category	SME Contribution	Key Figures
Employment Generation	Offers employment opportunities in agriculture, handicrafts, and manufacturing.	Over 33% of national employment
GDP Contribution	Serves as a crucial participant in economic activities across various sectors.	Represents 50% of the Gross Domestic Product
Exports	A significant contributor to trade revenue through products such as carpets and dried fruits.	A substantial portion of exports is derived from industries led by small and medium-sized enterprises.
Regional Trade	Promotes cross-border trade, particularly in border areas like Herat and Jalalabad.	Facilitates regional integration with Iran and Pakistan
Rural Economy Support	Leads in agriculture and small-scale industries	Aids low-income families, especially in rural regions
Entrepreneurship	Fosters entrepreneurship and innovation.	Encourages entrepreneurial ventures across various sectors

Source: Based on the literature review

With the fabric of Afghanistan's economic system, the very essence of catalytic growth enablers, we must also build on their potential capabilities with better infrastructure, greater financial inclusion and a smart set of policy reforms.

2.6 Afghanistan's GDP Data for the years 2019 to 2023

Afghanistan's GDP has been significantly impacted by political instability, the economic consequences of COVID-19, and differences in global support. The GDP was around \$18.8 billion in 2019, reflecting a lack of economic activity due to ongoing conflict and reliance on international aid. Aside from the pandemic, there was a slight increase in 2020 to \$19.96 billion, which was supported by some recovery programs and the agricultural sector. Additionally, in 2022, the GDP fell to \$13.06 billion due to rising isolation and worsening humanitarian conditions.

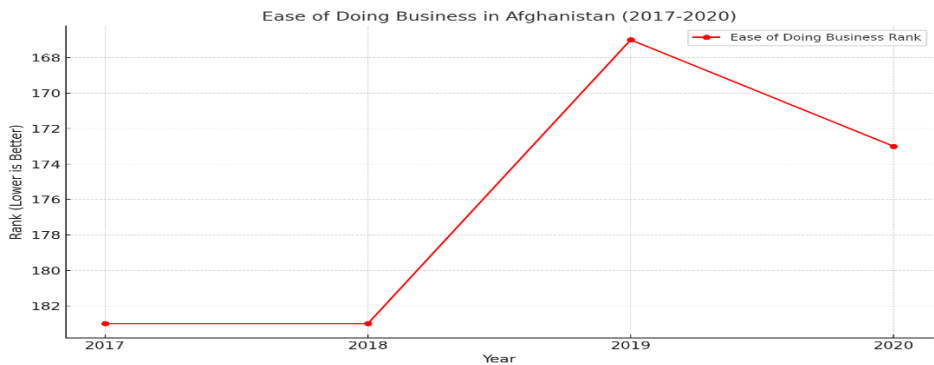
Table 7

Category	Contribution	Key Figures
Employment Generation	Offers substantial employment prospects in essential industries. Crucial for the economic productivity of Afghanistan.	More than 33% of overall employment is represented in this sector.
GDP Contribution	A primary source of export income is essential commodities.	Contributes to 50% of the Gross Domestic Product (GDP).
Exports	Promotes economic integration via cross-border trade activities.	Holds a substantial portion of the exports of carpets and dried fruits.
Regional Trade	Promotes economic integration via cross-border trade activities.	This sector is crucial in the trade routes connecting Herat to Iran and Jalalabad to Pakistan.
Agriculture and Industry	Leads in the agricultural and small-scale manufacturing sectors.	Bolster's local economies and enhances food security.
Poverty Reduction	Supports the livelihoods of low-income and rural communities.	Having a notable effect on income distribution and the reduction of poverty

Source: Based on the literature review

Such enterprises heavily influence the economic growth of Afghanistan. Their influence on employment, GDP, and trade demonstrates that policies that support, promote financial inclusion, or enhance infrastructure are essential to unlock their potential. Afghanistan's position in the World Bank's Ease of Doing Business rankings from 2017 to 2020 is depicted in this graph. It measures the regulatory frameworks that support business operations in different countries. The ranking of Afghanistan 183 out of 190 countries in 2017 revealed significant obstacles in terms of business establishment, credit accessibility, and contract enforcement.

Figure 1



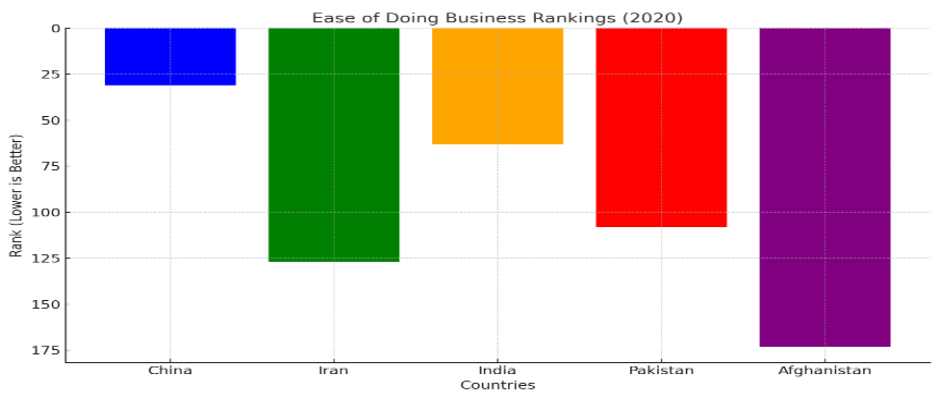
Source: Ease of doing business index

The chart shows the World Bank's 2020 Ease of Doing Business rankings, specifically for China, Iran, India, Pakistan, and Afghanistan. This index indicates the quality of the legal framework for starting and running a business.

China: Rank 31, showing significant progress due to reforms in areas such as compliance, taxation, and international trade. India Rank 63, showing improvements in doing business, debt settlement, and debt repayment. Pakistan: - ranked 108th, with little progress in building permits and electricity supply. Iran: - ranked 127th, showing difficulties in registering property, international trade and compliance.

Afghanistan: Ranked 173rd, faces significant challenges, including political instability, poor infrastructure, and difficult governance. China appears to be the leader in creating a favourable business environment compared to other countries surveyed. India has made significant progress in recent years. In contrast, Afghanistan lags far behind, emphasizing the need for comprehensive reforms to encourage investment and entrepreneurship.

Figure 2



Source: Ease of Doing Business, World Bank

2.7 Prosperity Index Afghanistan

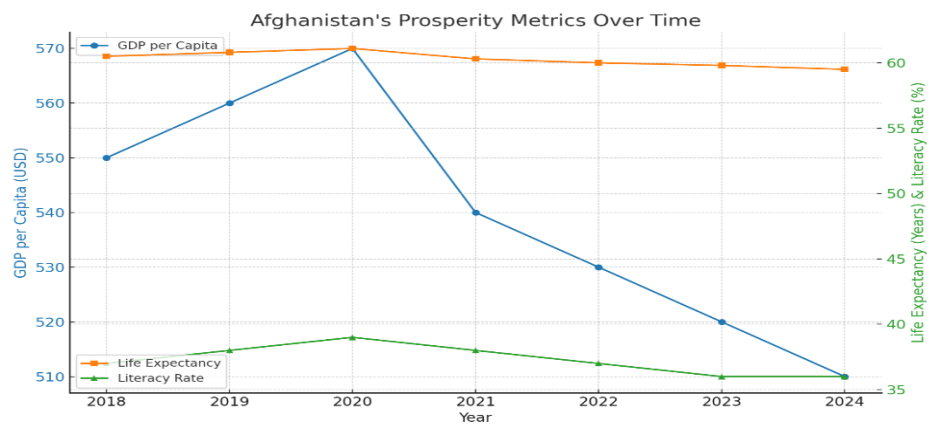
Afghanistan's ranking in the Global Prosperity Index reflects its high impact in many areas. In 2024, the country was ranked low in economy, health, education and

governance, including being the world’s smallest country. The country is suffering from poverty, with the majority of the population living below the poverty line. High unemployment remains high, and persistent insecurity and underdevelopment hamper economic growth. Afghanistan’s life expectancy is low, and access to health services is limited, leading to conflict and inadequate health care. Educational indicators are relatively flat, particularly among women and the availability of educational resources.

2.8 Afghanistan Development Indicators

The chart below shows the evolution of Afghanistan's development indicators from 2018 to 2024, focusing on key indicators such as GDP per capita, life expectancy, and literacy rate. This view provides a comprehensive picture of the country's progress and the challenges it faces in terms of economic and human development.

Figure 3



Source: World Bank

2.9 Prosperity Index of Afghanistan in Relation to Neighboring Countries

Compared to neighbouring countries, Afghanistan ranks low on the prosperity index, mainly due to problems in governance, security, education and health. The comparative analysis based on recent developments of the Afghanistan Excellence Awards Global ranking (2023) showed the 10 least developed countries in the world. Progress on security, governance and living conditions has been slow due to political instability and humanitarian crises.

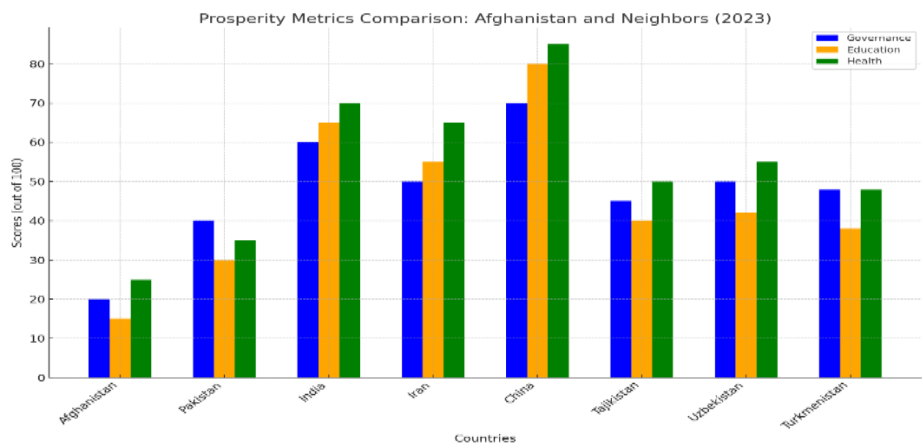
1. Pakistan: Higher than Afghanistan but faces governance and security issues. - Little progress has been made in health and education.
2. India: Obtained the highest level, which shows the organization's strength and the economy's quality. - Address issues related to regional inequalities and inequalities.
3. Iran: Performs strongly in infrastructure and education but still faces human rights and governance constraints.
4. China: They are doing very well in economic and infrastructure development. - Scores lower on human and political rights.

5. Tajikistan, Uzbekistan, and Turkmenistan are higher than Afghanistan but still struggling for governance and human rights. - Economic reforms help their scores improve.

2.10 Graphical Representation

Figure 4

Custom charts or graphs and specific metrics like governance, health, or education performance show these comparisons.

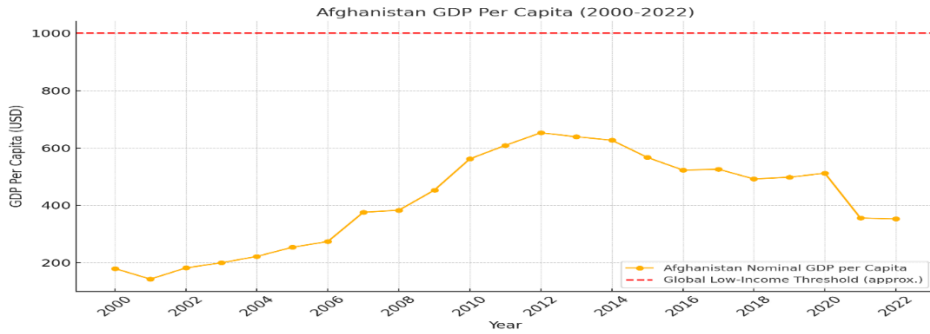


Source: World Bank

A bar chart compares Afghanistan's governance, education, and health scores with those of its neighbouring countries, utilizing scaled scores out of 100. This illustration underscores Afghanistan's comparatively lower performance in all three areas. In recent years, Afghanistan's per capita income has experienced significant fluctuations, indicative of the nation's political and economic difficulties. As of 2022, Afghanistan's nominal GDP per capita was approximately \$353 in current USD, a decrease from \$407.62 in 2021. This places Afghanistan among the countries with the lowest per capita income worldwide. However, the GDP per capita at purchasing power parity (PPP) for 2022 was estimated to be higher, at \$2,092.88, which considers adjustments for the cost of living. Economic reforms have contributed to a moderate improvement in their rankings.

2.11 Afghanistan's Per Capita Income Visualization

Graph that depicts Afghanistan's per capita income trends over the past twenty years to enhance visualization. This will provide insight into its performance in relation to global averages and trends.

Figure 5

Source: World Bank

To further elaborate on the analysis, we can investigate the following areas:

1. Comparison with Regional and Global Averages: - Examining how Afghanistan's GDP per capita stands in relation to its neighbouring countries (such as Pakistan and India) and various global income classifications (low, middle, and high income).
2. Key Economic Challenges: - A detailed assessment of the factors that have led to a decrease in GDP per capita, including issues related to conflict, inadequate infrastructure, and governance challenges.
3. Future Projections: - An exploration of anticipated trends based on projections from the IMF and World Bank regarding GDP growth and its potential effects on per capita income.
4. Sectoral Contributions: - An analysis of the economic contributions from different sectors (agriculture, services, and industry) to pinpoint potential areas for growth.

3. Research Methodology

The research is founded on data obtained from secondary sources, including websites, research articles, published theses, and various publications. It has conducted a literature review concerning the role of SMEs in Afghanistan's economic and socio-economic development. Additionally, the study compares the ease of doing business in China, Iran, India, Pakistan, and Afghanistan. It seeks to identify the factors driving industries in Pakistan to relocate to neighbouring countries.

Furthermore, the research discusses reports from the World Bank and other human development institutions. The Doing Business report provides targeted measures of business regulations and their implementation across 190 economies and selected cities at subnational and regional levels. Launched in 2002, the Doing Business project examines local small and medium-sized enterprises and assesses the regulations affecting them throughout their lifecycle. By collecting and analyzing extensive quantitative data to compare business regulatory environments across economies over time, Doing business encourages economies to strive for more efficient regulations, offers measurable benchmarks for reform, and serves as a resource for academics, journalists, private sector professionals, and others interested in the business climate of each economy (IBRD, 2017).

The study also evaluates prosperity reports published by the Legatum Institute. Prosperity fundamentally represents the opportunity for individuals to discover, achieve, and share their potential, enabling them to become the best versions of themselves while assisting others in doing the same. It encompasses wealth and well-being, ensuring no individual is left in poverty or social isolation.

4. Conclusion

The research determined that such entities are the primary driving force behind the global economy. They contribute significantly to output in developed nations and play a crucial role in enhancing the economies of developing countries such as Pakistan and India. The findings indicate that Afghanistan is grappling with significant educational and energy challenges. No educational institution from Afghanistan has ranked within the top 100 globally for an extended period. Additionally, the country is experiencing an electricity shortfall as well. This shortage prompts industries to relocate to neighbouring countries, adversely affecting Afghanistan's economic growth.

Furthermore, Afghanistan continues to contend with a high early mortality rate of 89 per 1,000 live births. According to the prosperity report, Afghanistan's socio-economic growth is comparatively lower than that of its neighbouring countries. The study also assessed the ease of doing business and found that establishing a business in Afghanistan is considerably more challenging than in neighbouring nations, attributed to factors such as inadequate financing, government policies, and a lack of interest among the youth in entrepreneurship. Despite SMEs providing employment to millions of individuals and generating a substantial volume of GDP, their contribution remains significantly lower than that of neighbouring countries.

4.1 Challenges and Solutions

Afghan SMEs face several challenges, such as a lack of financial capital, underdeveloped infrastructure, limited ability to access international markets, and lack political stability (Khadka, 2021). Moreover, they must contend with competition, outdated technology, and a shaky regulatory environment constraining their growth. Bureaucratic obstacles, low human capital, gender disparities and limited technology adoption further hinder their growth. Overcoming these challenges requires enhancing security, credit availability, improvement in infrastructure and supportive regulations. There is a need for capacity-building programs, efforts to improve trade facilitation market access and skills improvement. The government should support technology subsidies, e-business, and e-commerce initiatives to increase competitiveness.

5. Policy Recommendations

The government should launch a specialized program to foster the establishment of small-scale businesses.

1. The government must encourage the private sector to invest in new small-scale enterprises in Afghanistan.
2. Policies must be developed to provide support and relief to young entrepreneurs.
3. Specific initiatives should be introduced to assist young entrepreneurs in advancing and establishing new small-scale ventures.

4. Innovative and cost-effective transportation solutions for goods delivery should be designed to enhance their profitability.
5. The Small and Medium Enterprises Development Authority (SMEDA) should implement a legal framework for the registration of small-scale businesses to improve the ease of doing business.
6. Young entrepreneurs should receive training focused on enhancing the quality of their business products.
7. It is important to raise awareness among the public regarding the importance of investing in their social well-being to improve their socio-economic status.

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About the Authors

Dr. Muhammad Fayaz, Assistant Professor, Department of MBA, Faculty of Economics, Kardan University, Kabul, Afghanistan. <m.fayaz@kardan.edu.af>

Mr. Abdullah Emarn, Assistant, Department of Research and Development, Kardan University, Kabul, Afghanistan. <a.emran@kardan.edu.af> ORCID Id: <https://orcid.org/0009-0001-9115-6064>