

An Investigation to Understand the Need for Financing Small and Medium Enterprise in Afghanistan

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Abstract

Small business firms are important and integral part of any economy. They generate employment and income when they do business and tend to expand. With fast growing globalization trends, new opportunities and threats for small business are opening. But there are some perceived and actual threats for survival of micro and small firms. These include cutthroat competition, aggressive marketing, reach to credit and global linkage with foreign firms. Largely the small and micro scale units are concentrated in all over Afghanistan. The units located hear complete for the share of the local market for different type of business. Hence, there is a sort of cluster in this geographical area which is important for employment generation as well.

Keywords: *Financing, Enterprise, Investigation, Afghanistan, Capital invested*

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Introduction

The small & medium scale industrial sector plays pivotal role in industrial development of Afghanistan because it employs less fixed capital investment, generates more employment opportunities, uses indigenous technology and raw material, and helps reduce urban migration. Its share in GDP is 4.7 percent and employs about 80 percent of industrial labor force. Its share in manufacturing sector export is 30 percent whereas contribution to the industrial value added is 27 percent. (Small & Medium Enterprise Development Authority). Each country uses different definitions for various sizes of enterprises. The Afghanistan official definition of SMEs is based on both employment and asset size: Units up to 25 workers and assets (excluding land) of up to 2 million are defined as small enterprises. A deeper analysis of social and behavioral aspects of entrepreneurship is required for identifying the barriers to growth of Small enterprises. With due weight age of cultural variables a more effective and feasible strategy can be outlined for up gradation of seemingly stagnant units but desirous to further their business concerns. This report presents a framework to explain the financial needs of small enterprises in the Afghanistan.

Problem Statement

In research the focus will be on the financial needs of small enterprises of Afghanistan. Finance plays a vital role in business and it is one of the factors of production. Lack of financial capability prevents an organization from growth. Financing helps existence, survival and expansions. Here in this report we will see what financial needs of small enterprises are, what financial products are provided to them by various financial institutions? Which sources are available to them to finance their businesses as it is expected that the startup such enterprises take place through informal financial arrangement such as friends, relatives and business partners. Which source is the best according to them? As financing is the most important problem for such enterprises.

Significance of the Research

The area under concentration is, finding the needs of small enterprises specially financing needs which should be related only to Afghanistan Small enterprises play an important role in the economy of a country. Small enterprises have made an excellent performance towards promoting economic development, expending international trade, creating job opportunities and raising nation income. But these enterprises face some problems which prevent them from their excellent performance. These limitations can be lack of finance, relevant training institutions, infrastructures and the expertise and experience necessary to successfully operate in competitive market. They can get financial help from many sources such as external, internal and debt financing. What the researcher has to find is what small entrepreneurs of Afghanistan want and what is basically provided to them especially by commercial

banks and other MFI's. This research will help to minimize the distance between Afghanistan's entrepreneurs and financial institutions to boost these small industries. But due to the time limitation and lack of experience with research study there may be some area remains uncovered.

Research Objective

As the aim of this research is to find out their financing needs, so the scope of research is closely related to it. Furthermore, the research objectives are as following:

- To understand how small and medium enterprise will improved by financial support.
- To understand the need for capital management for SMEs in Afghanistan.

Research Questions

1. What are the main constraints in getting financial help from MFI's?
2. What are their financial requirements for their business?
3. What are their expected sources of finance?
4. What are the main sources from where they expect the financial help
5. How do they perceive the financial services being offered by the financial institutions in their target area?

Literature Review

A major problem encountered in a discussion of small enterprises is that of a suitable definition. Both quantitative definitions such as number of employee's capital invested, or sales turnover and qualitative definitions such as being owner-managed, independent and lacking stock market quotation are used (Agarwal 1979). The extent of the contribution of small enterprise to the economy can be debated, but it is considerable and in recent years has been growing (Acs and Audretsch 1990). Galbraith (1957) summarizes both the definitional aspect and the contribution of small enterprises succinctly.

"No agreed level of assets or sales divides the millions of small firms which are half of the private economy from the handful of giant corporations which are the other half. There is (however) a sharp conceptual difference between the enterprise which is fully under the command of an individual and owes its success to this and the firm which, without entirely excluding the influence of individuals could not exist without organization"

According to the Canada's business and consumer site created by Department of Finance Canada in 2002, this is working on small and micro business research and policy. This research paper highlights the basic concepts of SMEs and micro enterprises. According to this research micro enterprises are those started by low income individuals who have provided a very small loan called micro credit. (Micro-credit refers to small loans made to low-income individuals to sustain self-employment or to start up very small

businesses). Although there is no standard definition of micro-credit, in practice such loans are quite small, amounting to a few thousand dollars. Micro-credit is a loan under 25,000\$.

The review is, therefore, deliberately selective and compact. There has been a series of reports reviewing this area which has exhaustively discussed these issues. The review begins with a brief theoretical overview of the determinants of the financial structure of small and medium sized enterprises, which is designed to highlight the ways in which financing 'gaps' may emerge for these firms. This is followed by a brief overview of evidence relating to the 'riskiness' of investment in early stage and high-tech Small and Medium enterprises; the nature of venture capital investment in Small and Medium enterprises; the characteristics of personal or business angel investors in Small and Medium enterprises; and the provision of smaller sums of equity for growing Small and Medium enterprises. We then provide an overview of the financial structure of Small and Medium enterprises and evidence bearing on the nature and extent of financial constraints they may face. In doing so, we emphasize where the evidence permits differences between different risk classes of firm, in particular between hi-tech and conventional firms distinguished by the R&D intensity of their activity.

Financial Problems

SMEs need all type of finance from working capital to term finance to venture capital to leasing. Banks are weak and have very bad impression there because of inefficient products. Their products are just arrived from old system and they don't want to take any risk as well. Many SMEs complaint that banks simply do not react to credit submission. Also banks do not look beyond the collateral requirements and they are generally very cautious accepting collateral. The researcher has identified some common financial needs of SMEs in these three countries which are working capital, trade finance, supplier's credit and leasing etc. SMEs of these three countries and definitely all SMEs in the world have regular financial needs.

The three sources of external equity typically available to small firms are public equity market, the professional venture and the informal risk. The researcher has written that the first choice is not realistic option for small and medium enterprises and the amount which is generated from this source is above SMEs needs. The second one is more realistic option for small or rapidly growing oriented firms but the researcher has again focused on third option and says that due to the challenges many SMEs face in obtaining risk capital from both public equity market and the formal venture capital market both in term of value and investment.

Research Methodology

The objective of this chapter is to describe and argue the research methods and methodology used for

this research. This chapter will also present an evaluation of sources and identify methods used to increase reliability and validity.

Training and skills of Entrepreneurs

The Canadian department of finance stresses that SMEs support agencies should be properly regulated and they should be quite aware from the market. Training session should must be there periodically. They emphasize that when they don't know how they will achieve best results what are expected from them? According to the study of Asian development bank that because of short of skilled labor they delay productions so it affects quality and they don't bring products at right time to right place so training is an important task. Any entrepreneur wants to improve their technology but the lack of resources doesn't give permission.

A key feature of "Galbraith's" observation is the reliance of the small enterprise on individuals and their lack of formal organizational structure and management specialization. Promotion of self-employment is a major concern for most developing countries. This is mainly for the reason that it eases the governments of these countries from their social obligations of employment creation to a great extent. In this effort, technical training has been perceived as a short cut, which enables one to get self-employed. John Griesson, based on his substantial field research in developing countries, concludes that such governmental support is by no means, meaningful. To be meaningful, it is necessary to have a well-integrated scheme of enterprise promotion.

Information Problems

A publisher of National newspaper Sunday 18 December and magazines has said to have really struggled to obtain information on financing option for SMEs, including the finance they sought for themselves he is interested to publish periodically on finance so that awareness can be created which will help in what the market offers and what SMEs look for. Only %14 of Afghanistan's SMEs approach the formal lending sector for financial assistance. SMEs perceive that high risks and high costs are associated with Bank's financing services. There is lack of accurate information on Banks and borrowers alike. SMEs are short of sound collateral and abilities to present bankable business plans. Despite this and no collateral SMEs are still have low default rate from large-scale productions. The concept of information asymmetry helps to explain problems faced by both large and small enterprises. In the case of large organizations, managers may well have information that shareholders do not and may use this to their advantage, although it may not always be the case that agents know more than principals (Waterman and Meier 1998)..

Research Methodology

Data Collection

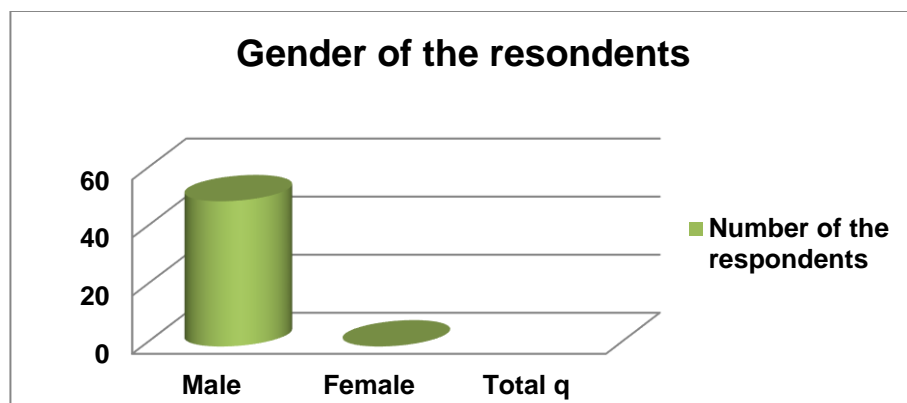
For conducting this research study, there was different ways of data collection. It depends upon the situations and research issue to select the way of data collection. It is a series of written questions for which respondents provide answers and well-designed questionnaire motivate the respondents to provide complete and accurate information. Data regarding the financial needs of SMEs were needed so by the help of questionnaire the primary data collected form the respondents and interpreted.

Population and Sampling

Non-probability convenient sampling method is abed in completion of the thesis. The random sampling technique was used to collect data from the respondents, Collecting data and other relevant information for writing a research report is the most important step, in the given study the major sources of information is the questionnaire. Every effort has been made to collect data and information about the financial needs of the SMEs however; the following data collection methods have been mainly used for the compilation of this report. The sample size is 100 people, which include the member of the ministry of finance and other think tank persons.

Data Analysis & Interpretation

Demographics



The above graph shows that 100 percent of the entrepreneurs were male because in Afghanistan region the cultural constraints do not allow the Women entrepreneurs to do Business.

There is no clear distinction that can be made in the association of financial needs assessment and Gender. (Small & Medium Enterprise Development Authority SMEDA).

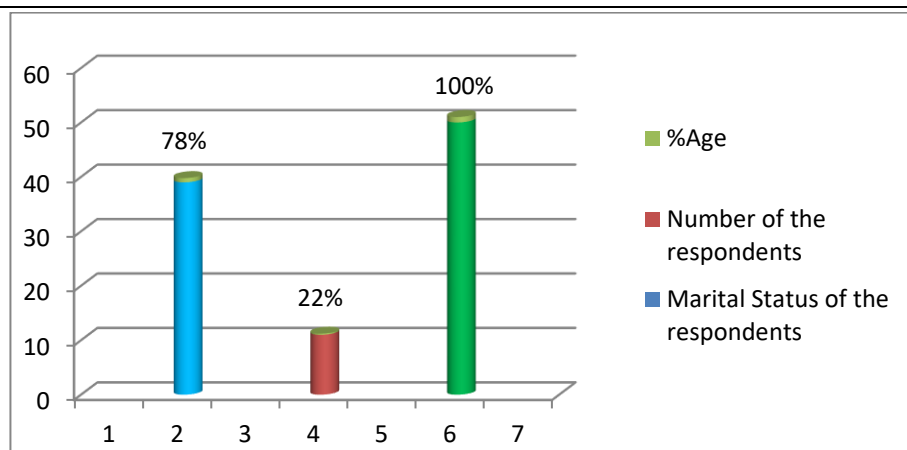


Figure 3.2 shows that 78 percent of the total entrepreneurs surveyed are married while 22 percent of them are un-married. There is no clear distinction that can be made in the association of financial needs and Marital Status.

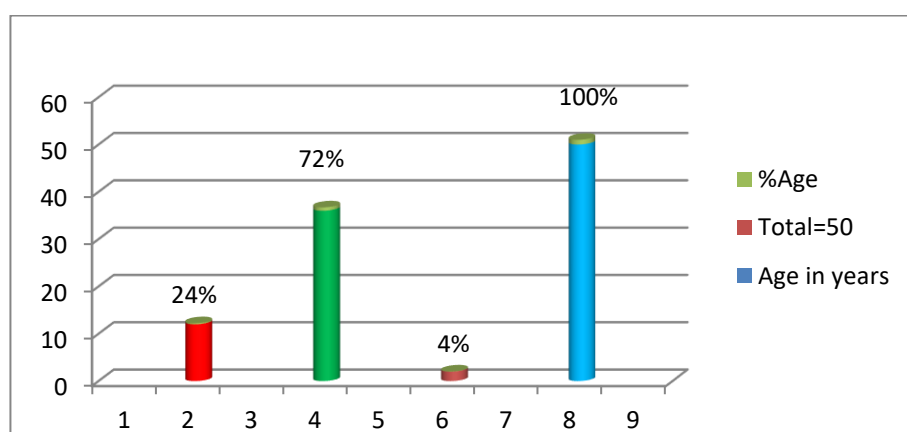


Figure 3.3 shows that 24 percent of the total entrepreneurs are in the range of age up to 25, 72 percent are in the range of 26-50 years of age which means that majority of entrepreneurs are young, the table show that only 4 percent of the total sample are above 51 years of age which is very low and shows that less entrepreneurs of age more than 51 are undertaking small business.

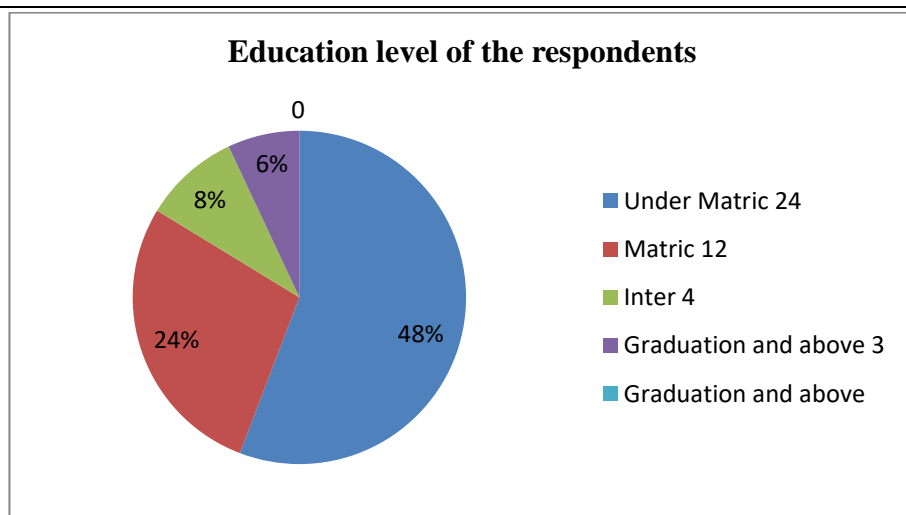


Figure 3.4 show that 88 percent of the total entrepreneurs are educated while the remaining 14 percent are uneducated.(The phenomenon of no education does not necessarily mean no education at all, because education (literacy) can be acquired from informal means as well.), the level of education of educated people is explained in table 3.5.

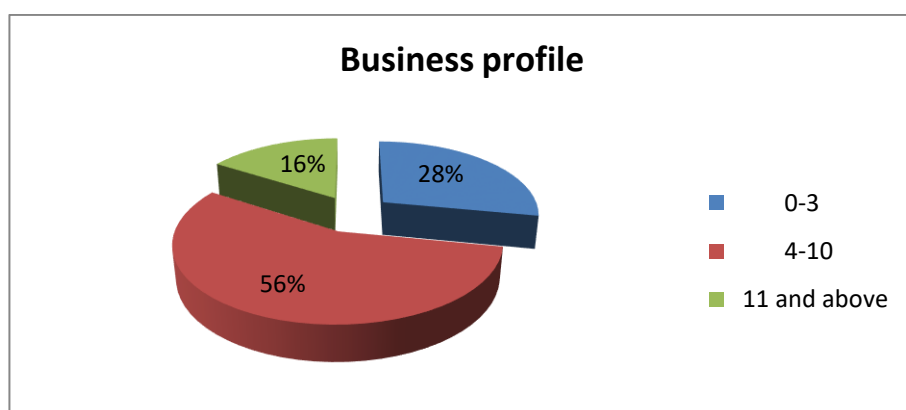
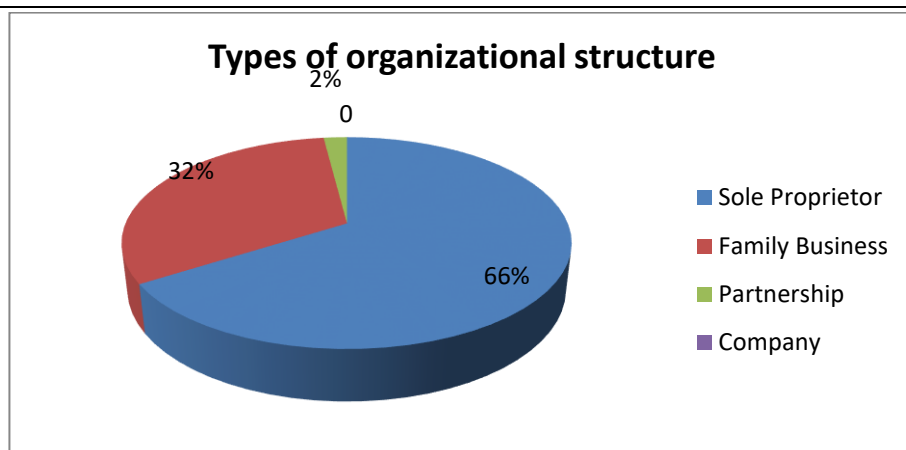


Figure 3.14 shows the age wise distribution of small-scale enterprises. It suggests that 28 percent of the firms are 0 to 3 years old; while 56 per cent of the firms are 4 to 10 years old; 16 percent of the firms are 11 and above years old.

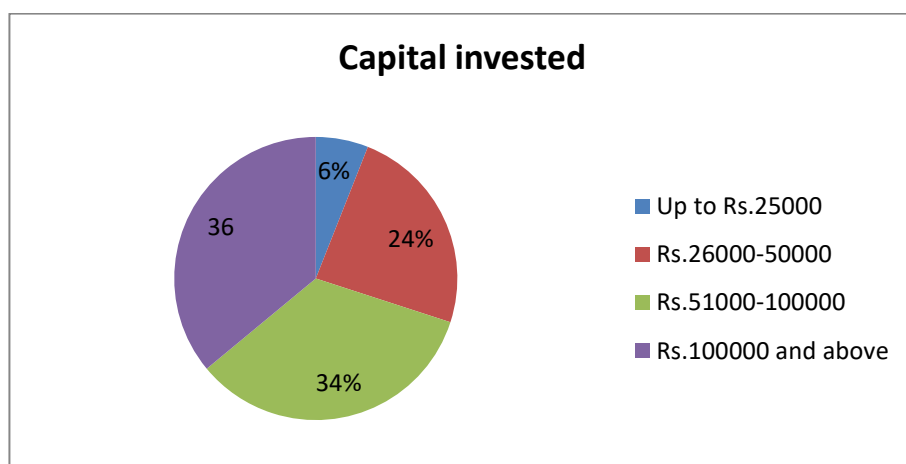
In other words, approximately 80 per cent of the firms are relatively new firms in the market, while the survival rate of the firm diminishes, as they become old firms. Hence, 16 percent of the firms had an age of more than 11 years. The rest of the units were established during the last twenty years.

The researchers believe that due to overall reduction in economic growth rate and non-availability of jobs both in the private and public sectors, people have tended to start their own business.

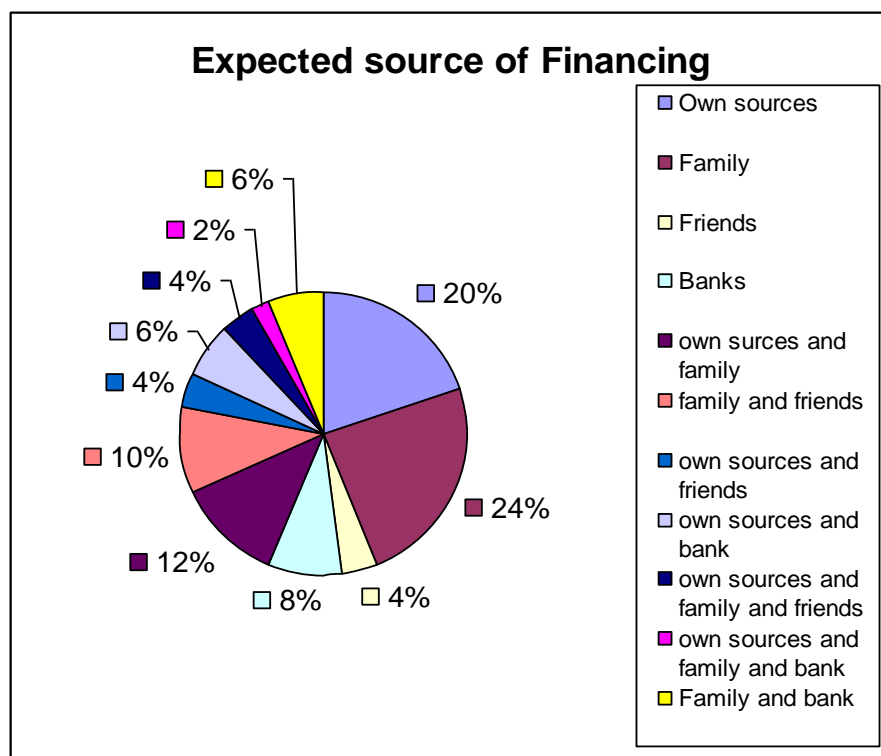


Most of the small Entrepreneurs (66 %) were sole proprietors of their own business, followed by family ventures (32%) and partnerships (2%).

The common views that most of the firms in the small enterprises are family ventures, has turned out to be wrong. But currently the major part of this sub sector comprises of sole proprietors, followed by the family ventures and partnerships. Sole proprietorship can also be termed as self-employment, but not exactly.



Of the total sample 36 percent had invested Capital of Rs.101, 000 & above, followed by 34 percent who invested Rs.51, 000-100,000. 24 percent have the invested capital of Rs.26, 000-50, 000 while 6 percent of the total sample had an investment up to Rs.25, 000 thereon.



If the majority of the sample has not used financial institutions, then the investment has to come from other sources, 24 percent of the total sample expect their family resources to Finance their business needs, while 20 percent expect financial help from their own sources (savings, and property) other 12 percent rely on both own sources and family, just 8 percent expect finance from banks. Financial help from their own. Why they are not thinking of other than their own, because they lack the information of getting finance from others such as banks NGO's MFI's and other financial institutions.

Discussion

Almost all entrepreneurs had not received any management training to improve the operation of their units. Where the rate of informal training, which was on the job training is high which shows that there is lack of formal training in the entrepreneurs which does not allow them to grow faster. On account of the low level of skills and lack of information about modern techniques these entrepreneurs suffer from a low level skill trap. Such low-level skill trap results in lower productivity and inefficient use of resources. Also, the lack of management ability and training often acts as a barrier to take initiatives for expansion of their businesses and modernization of technology. They also lack the capability or capacity to handle their book- keeping accounts of sales, or record of inventory etc. in a modern manner.

It is widely claimed that, relative to large firms, Small Enterprises are more labor intensive; that is, they employ more labor relative to capital than large enterprises producing similar products. It has been noticed that the price of labor is playing a vital role in small business sector. At the end of afghan war most of the afghan labor has migrated to their homeland so, as a result the labor available is becoming

short so the labor at present is demanding huge wages & salaries. There has been a significant increase in the oil prices which caused serious increase in the prices of the inputs has used by small businesses.

Most of the small-scale entrepreneurs (% 66) were sole proprietors of their business, followed by family ventures (% 32), and partnerships (% 2). If the partnership business is encouraged instead of sole proprietorship there would be no financial barriers in the way of development of small business sector. The majority of the sample has not used financial institutions, so the investment has to come from other sources, 55 percent have used personal resources while 35 have used household savings or family resources, 10 percent of the total sample had financed their business by borrowing from their friends. In looking at this sourcing, at the firm level, we find small firms are using not only family and personal savings but are also accessing other sources of capital other than banks.

Conclusion

Through the results obtained from the questionnaire it is clear that the major problem faced by the small business sector is of finance. The majority of small sector businessman is not taking finance through banks or MFIs. They are doing so because of two reasons, firstly the small sector entrepreneurs are not taking external finance because they don't have the adequate information & secondly they are afraid of high interest rates. The Government should play a strong hand in the development of micro finance institutes. The Government must clearly define the small business sector & it should deal the small sector with a positive approach. The small sector should be treated as a strong part of the economy. This research explores that how the financial needs of SMEs in Kabul will be full filled smoothly to enhance the efficiency of them. The reports encompass many aspects of the SMEs to enhance their activities in Kabul. The report also discusses the feedback from customers and analyses their results and take the corrective steps to satisfy their needs accordingly. The main hurdles have been found out their removal procedures are also identified.

Recommendations

No policy is neutral. Every policy creates winners and losers. So any policy designed for small enterprises should not be formulated in isolation of other sectors of the economy. Present government has formulated an action plan for the development of micro, small and medium enterprises but it needs to be more targets specific.

Based upon our survey and research we suggest following policy recommendations:

- First of all a due care should be taken in defining and differentiating the micro and small scale units, although the differentiating line can be very thin. The financial institutions providing special assistance and products to MSEs or SMEs should take care when defining the target group.

- Although the government is using micro finance, micro credit and SME finance based on the available information and it has linked it with poverty alleviation goals. We suggest that instead of making a general policy for all players in MSE group the government should make sector and even sub-sector specific policies to effectively achieve its targets of employment creation and poverty reduction.
- Furthermore the MSE or SME policy should have a due notice of rural and urban dimensions of cultural fabric in which these units are closely knitted. It also needs to take a due opinion of the stake holders in the MSEs and SME sector to formulate a framework of operation of the policy.
- The Government should offer incentives to financial institutions to lend to SMEs. This approach would be more effective than sinking the funds into the assistance schemes which not many SMEs are aware of. The incentives should be substantive enough to cover the risks involved in lending to SMEs.
- The attitudes of entrepreneurs in different sectors are not alike because of cultural, behavioral and integration experiences. So, any policy designed for up gradation and development of MSEs should also address the agricultural and industrial background of the specific target group.

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