Business Climate in Afghanistan

Afghan-American Chamber of Commerce (AACC)

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Introduction

As Afghanistan's rebuilding, through enormous assistance from the international community, slowly proceeds towards peace, stability, and prosperity, the emergence of a viable and vital private sector gains importance for ensuring the appropriateness and sustainability of such developments. In the light of recent experiences in other parts of the globe, the consensus is that democratic values and open-market systems are essential to achieving these goals. The Afghan-American Chamber of Commerce (AACC) was established in 2002 with assistance from the Center for International Private Enterprise (CIPE) to serve as a catalyst in the development of the Afghan private sector. Believing that open-market economies share a common feature (i.e., a competitive system where the rules are consistent for all participants), AACC launched its activities inside Afghanistan with the following goals in mind:

- Privatization should proceed openly and with an adequate pace;
- Corruption should be weakened and transparency and accountability**,** strengthened;
- Rule of law should be respected;
- Property rights should be protected;
- Corporate governance mechanisms should be created, implemented and monitored;
- Enterpeneurship, particularly for women, should be encouraged;
- Laws and institutions necessary for open, market-oriented economy are developed;
- Participation of business groups in the day-to-day process of government decision making should be fostered;
- Access to business and economic information necessary for informed decision making should be expanded; and

- Trade between Afghanistan and other nations of the world, particularly the U.S.A., should be expanded.

Given the recent patterns of economic and social developments, it is an opportune time to explore the business climate in Afghanistan and to identify barriers and obstacles to business development. The survey conducted by AACC in the second half of 2003, is unique for the following reasons:

1. Survey questionnaire items were developed on the basis of preliminary information collected in business roundtables held by AACC;
2. Entrepreneurs were randomly selected to participate in the survey;
3. Survey instrument were administered in person based on a face-to-face interviews; and
4. A large sample size (i.e., around 1,000 entrepreneurs) was involved, thereby enhancing the stability of survey estimates and reducing survey-sampling errors.

The results of the survey make it possible, for the first time, to explore the profiles of business entrepreneurs in Afghanistan and to provide baseline data on important business activities and characteristics.

Developing the Survey Instrument

The design and development of the survey instrument entailed the following steps:

1. Identification and delineation of goals and objectives of the survey;
2. Identification of relevant survey topics;
3. Identification of survey items for each topic;
4. Small-scale pilot test; and

5. Revision and finalization of survey items, format and directions.

Given the scarcity of locally used survey instruments, attempts were made to look for survey items in comparable studies in countries similar to Afghanistan. Therefore, with input from CIPE, a few items included in a recent survey by USAID in Iraq were identified, modified and included in the survey instrument. The final instrument consisted of five parts. Table 1 summarizes the survey components and the number of items for each component.

Table 1. Survey Components and Number of Survey Items

Survey Component	**Number of Items**
General information regarding the business	7
Capitalization	6
Revenue and expenses	2
Expectations and opinions regarding current and future economic conditions in Afghanistan	3
Barriers and recommendations	3
Total	21

To facilitate standardized administration of the survey instrument, both general and item-specific directions were developed and highlighted. The issue of confidentiality of the survey responses was stressed in the general direction of the instrument. During the administration of the instrument, our field operators were required to convey to the respondents the message that the responses will be strictly confidential and no attempt would be made to identify respondents and/or link specific responses to particular respondents.

Sample Selection

Sample selection was a challenge because the sampling frame for the population of interest (i.e., business entrepreneurs in Kabul) was not available and could not have been constructed given the paucity of available information. Therefore, strict multi-stage probability sampling technique, so common in other parts of the world, could not have been employed in this case. Even though strict adherence to multi-stage probabilistic approaches was not feasible, nevertheless, we tried to optimize the random selection of respondents by applying a three-stage sampling procedure. In the first stage of our sampling, we selected geographical clusters within Kabul. The second stage of our sampling involved identification and selection of city blocks within each cluster. The third stage of sampling involved random selection of business enterprises within the city blocks. To optimize sampling efficiency, we made attempts to reduce cluster effects by: (a) increasing the number of clusters; (b) increasing the number of city block within clusters selected; and (c) reducing the number of sampling units within each city block. To produce survey estimates with low sampling errors, we targeted the size of the sample to be around 1,000 enterprises. Our final achieved sample (i.e., 1,002) was very close to this target.

Conducting the Survey

We trained our field operators (n=5) in sample selection and interview techniques prior to data collection. Given that our sample size target was 1,000 responses, the average yield per field operator was estimated to be around 200 cases. Based on our small-scale pilot test, we had estimated a completion rate per case, including travel time and time to establish rapport with individual respondents, to be around two hours. Therefore, our estimated yield was around four to five cases per day per field operator.

The estimated completion rates were quite accurate in practice. Due to attrition (i.e., one of our field operators left in the middle of data collection activities), holidays, and other AACC related activities (e.g., seminars), our data collection activities were completed within a four-month period (i.e., August to November, 2003).

Data File Creation

Completed survey instruments were edited and keypunched. We developed special software for keypunching the responses. To ensure accuracy, we double checked every entry by an independent office staff. To avoid delays, keypunching and database creation was completed concomitant to data collection activities.

Results

<u>General Business Information</u>: Vast majority of business enterprises (i.e., 74%) were sole proprietorships and only a quarter of businesses were corporations.

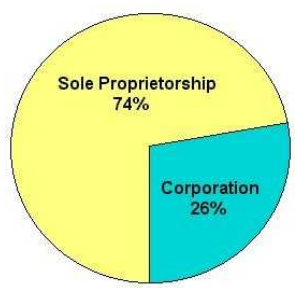

Figure 1: Type of Business

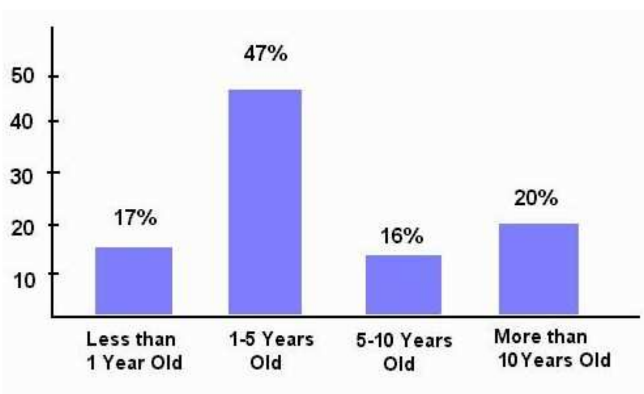

Figure 2: Age of Business

Majority of business enterprises (i.e., 64%) was less than 5 years old and only 20% of the business enterprises were more than 10 years old.

The businesses were more evenly distributed in terms of the type of business activity. Specifically, commercial activities in food, consumer goods and production each reported approximately 25%, while commercial activities in agriculture and construction accounted for 11% and 13%, respectively.

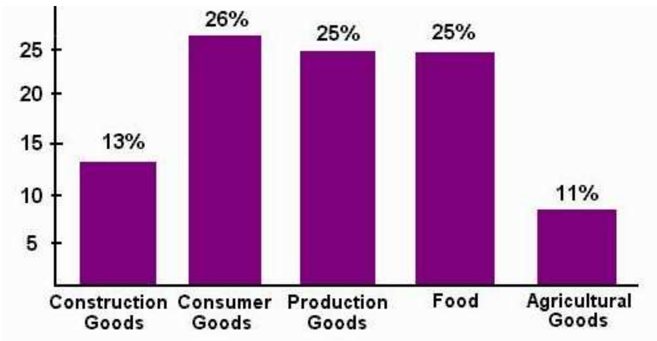

Figure 3: Type of Business Activity

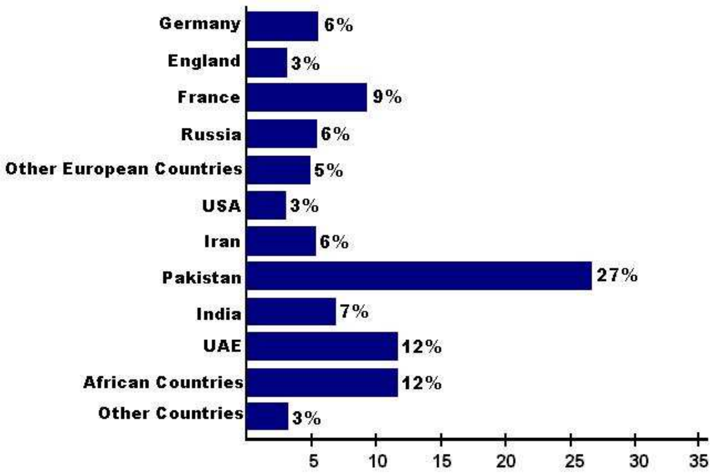

Figure 4: Country and Region of Business

Commercial activities by country and region were as expected. Commercial activities with Pakistan were the highest (27%) followed by UAE (12%). The European countries, as a whole, accounted for almost 30% of commercial activities, while the U.S. accounted for only 3% of commercial activities. India and Iran accounted for 9% and 6% of commercial activities, respectively, while the African countries accounted for 12%. The figures relating to the commercial activities between Afghanistan and the U.S. are discouraging. Every effort needs to be made to expand the trade between these two countries. Vast majority of business enterprises (i.e., 71%) reported to be engaged in imports only, while only 8% of businesses reported to be engaged in exports only, and 21% of business enterprises reported to be engaged in both imports and exports.

Figure 5: Type of Business Activity

This is also discouraging. The Government of Afghanistan, the business community, business associations, trade unions, and the international community all need to work together to develop programs to remedy this huge imbalance between imports and exports.

Capitalization: The majority of business enterprises (i.e., 90%) reported that their initial capitalization was less than $4,000, while only 10% reported initial capitalization of more than $4,000. The findings here indicate that the overwhelming majority of businesses are small businesses. While this fact could be discouraging, there appears to be some good news. First, it appears that the Afghan Government could enormously increase the number of small businesses with limited capitalization, thereby greatly expanding the bases of the business pyramid. Second, with limited additional assistance, some of these small businesses could be transformed into medium and large businesses.

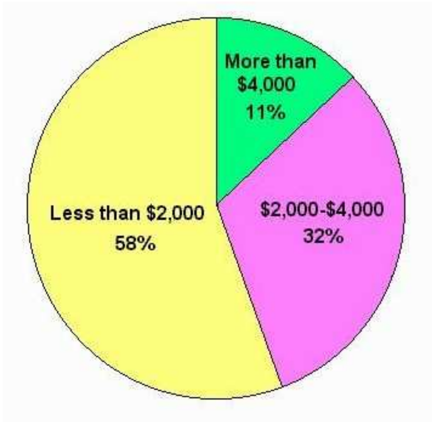

Figure 6: Initial Capitalization

Almost all businesses (i.e., 99.5%) reported that their initial source of capitalization was personal funds. The contribution from government and banks for establishing businesses in Afghanistan appeared to be nonexistent.

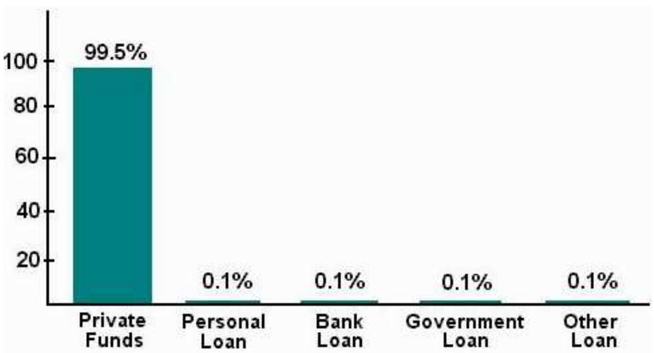

Figure 7: Source of Initial Capitalization

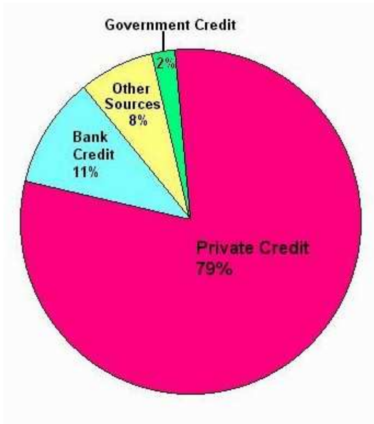

Figure 8: Credit Last Year

Vast majority of businesses (i.e., 79%) indicated that last year the source for their credit was personal assets, while bank credit and government credit sources accounted for only 11% and 2%, respectively. Last year, almost all businesses (i.e., 98%) conducted their business on a cash basis and only 2% of business reported that they used the banking system to conduct their business. This is understandable since banks were not fully operational last year.

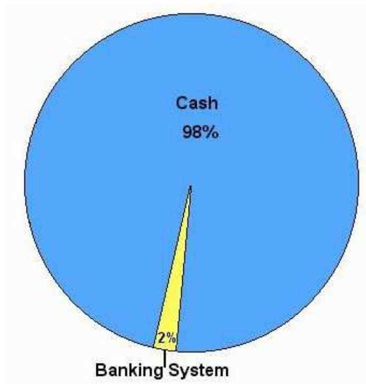

Figure 9: Payments Last Year

It was encouraging to note that most businesses reported they had plans to expand their businesses. Specifically, 62% of business reported that they had plans to hire additional staff, 25% reported that they had plans to buy new machinery, and 14% reported that they were planning to purchase land or property for their business.

Figure 10: Six Month's Plan

In terms of their current capitalization, the vast majority of business (i.e., 84%) reported that their current capital to be less than $4,000, while only 16% reported that their current business assets were estimated to be more than $4,000. A comparison of initial capitalization and current business

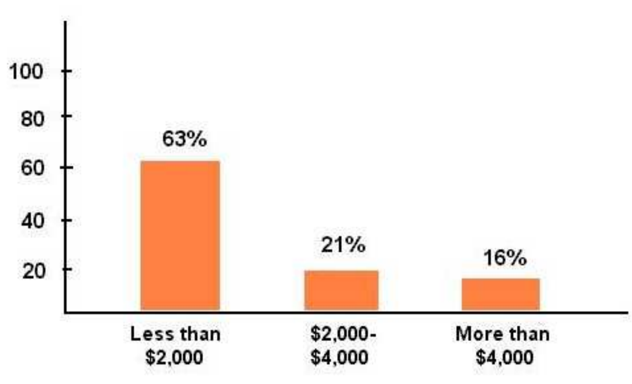

Figure 11: Current Capitalization

assets shows a slight increase in business capital. Given that most business were not old, it is not surprising to find a very slow growth in business assets.

The majority of businesses (i.e., 72%) reported that their annual business gross income was less than $2,000 last year, while 14% reported income levels between $2,000 to $10,000, and 13% reported business gross income between $10,000 and $40,000. Given the initial and current business capitalization, the income levels are high. It appears that business enterprises are operating on large profit margins thereby making the cost of goods and services prohibitively high for consumers. The business community needs to be educated to reduce profit margins thereby increasing the buying power of the people. The dramatic increases in business volume will most likely increase the total profits for the business community.

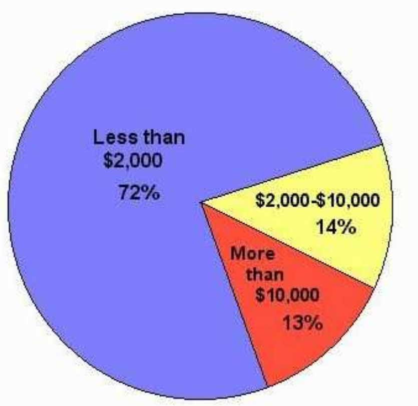

Figure 12: Revenues Last Year

As expected the business community did not allocate resources for advertising, marketing, improvement of goods, or staff training. AACC will conduct seminars to raise awareness of the business community with regards to these important factors for improving the general business climate in Afghanistan.

<u>Expectations and Opinions Regarding Current and Future Business Conditions</u>: It was encouraging to note that the vast majority of businesses (i.e., 79%) indicated that within the next six months the overall business climate will improve as compared to current conditions, while 12% indicated that the situation will remain the same, and only 9% indicated that the

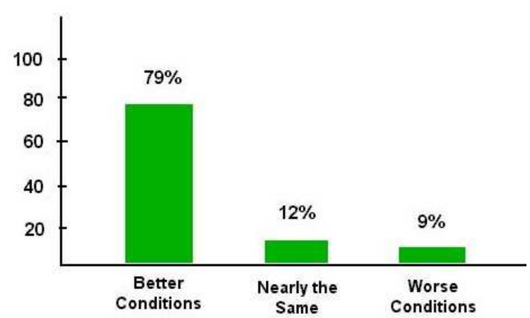

Figure 13: Expectations & Opinions
Next 6 Months Economic Situation in the Country

situation will deteriorate.

The majority of businesses (i.e., 68%) reported that currently their business was at an average condition, while 26% reported that currently their business was at an excellent condition and only 6% reported that currently their business condition was bad.

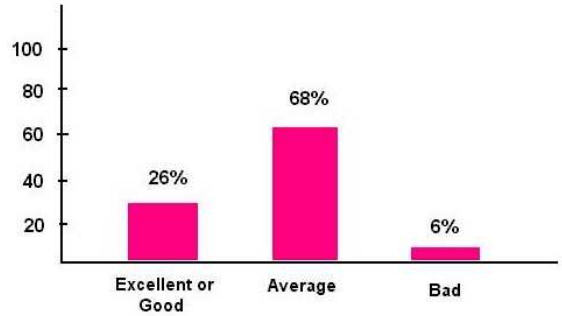

Figure 14: Current Condition of Business

As compared to current conditions, the majority of businesses (i.e., 67%) reported that their business would improve, while 28% reported that the conditions would remain the same, and only 6% reported that the conditions would deteriorate.

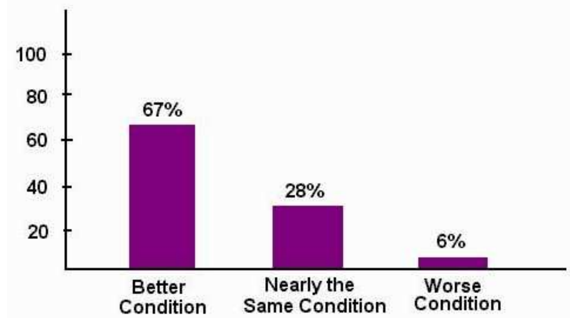

Figure 15: Next 6 Months Condition of Business

Recommendations and Barriers: Businesses reported that the five most important factors in improving their business were: (1) better overall security (26%); (2) availability of adequate business capital (26%); (3) better exports (9%); (4) better business rules and regulations (9%); and (5) availability of land and building for businesses (8%).

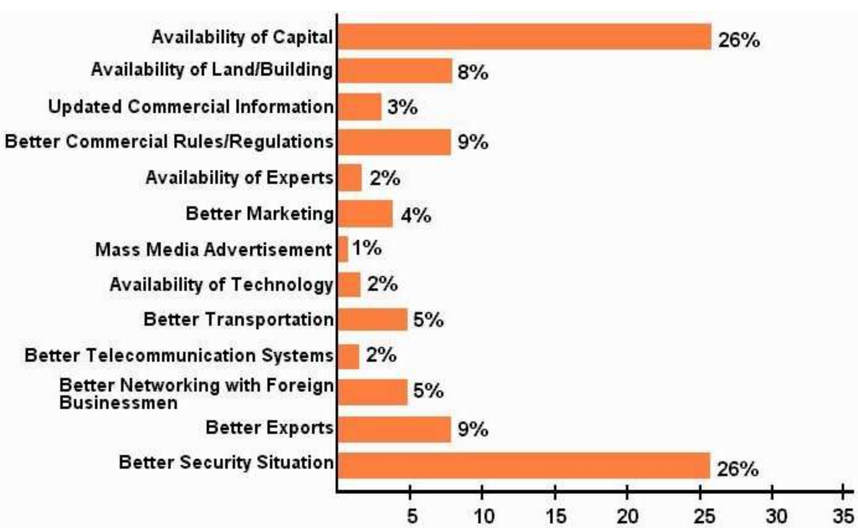

Figure 16: Factors to Improve Business

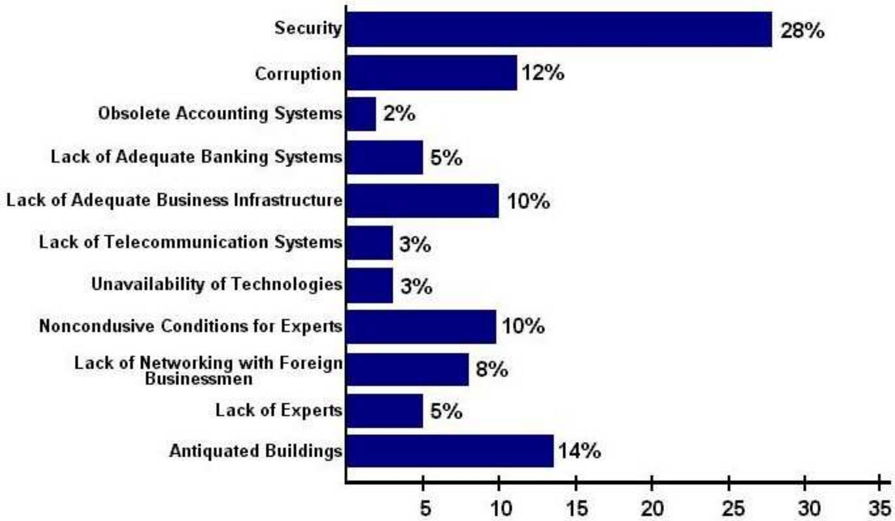

Figure 17: Barriers to Business Development

Businesses reported that the five most important barriers to their business growth are: (1) security (28%); (2) antiquated and run-down buildings (14%); (3) corruption (12%); (4) non-conducive conditions for exports (10%); and (5) unavailability of adequate business infrastructure (10%).

Conclusions

The encouraging news is that the business community has spoken loud and clear regarding major barriers to open-market economy. However, to tackle these challenging issues, immediate, extensive and coordinated action is required by key players (e.g., the Government of Afghanistan, Afghan business community, Afghan Chamber of Commerce and Industry, AACC, other business and trade associations, academics, think-tanks, international donor nations, etc.). A detailed plan of action is needed in order to meaningfully channel these efforts

AACC is willing and ready to take a lead role in developing a national business agenda, which will highlight key efforts and will provide a map for the arduous journey ahead. Experience has shown that failure to incorporate democratic governance as an integral part of the economic and commercial reform gravely jeopardizes the reform agenda itself. In partnership with the Government of Afghanistan, AACC and the

Afghan business community will ensure that as Afghanistan moves to establish a democratic system and open-market economy the rules of the system are open, transparent and fair for all.

The security, safety, stability and prosperity for all Afghans are closely related to the development of an open-market economy and a strong and viable private sector. Every job created through the private sector will directly benefit, on the average, about 8-10 persons who belong to the immediate family of the jobholder. Aside from the direct benefits, the ripple effects on the economy will be even greater. The job market developed by a strong and viable private sector will also have positive impacts on the educational system of the country. The educational system of Afghanistan will need to be responsive to the job market and offer graduates who are highly qualified and are ready to occupy the necessary high-level job openings.