Small and Medium-sized Enterprise (SME) Profiles for Financial Institutions

Prepared for: Promote, Women in the Economy (WIE) and Afghanistan Banks Association
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EXECUTIVE SUMMARY

Study objective

In discussions with WIE Private Sector Development (PSD) staff, financial institutions identified lack of sufficient information about their market as an issue. The survey aims to:

- Identify characteristics of small- and medium-sized enterprises in the WIE target market
- Provide financial institutions with information about SMEs in their target market

SMEs are defined as businesses with between 5 and 99 employees (small: 5-19, and medium 20-99). This is the adopted definition as per the Afghan Ministry of Commerce and Industries (MOCI).

Scope of Study

WIE carried out 500 semi-structured interviews with SME owners and senior managers across 12 sectors in five cities of Afghanistan (Kabul, Jalalabad, Mazar-e-Sharif, Hirat and Kandahar). It sought to interview businesses with female owners or 10% or more female employees, since this is the target business criterion for WIE. In two cities—Kandahar and Jalalabad—there were fewer than 100 SMEs in targeted sectors that met either criteria, so some businesses in these two cities did not meet the critieria. The resulting sample had 34% female business owners.

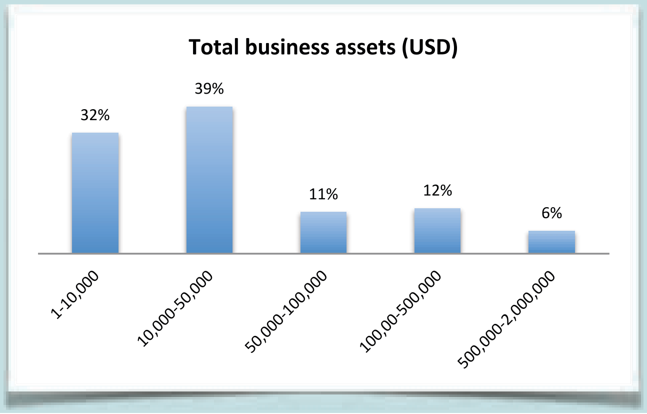
Businesses interviewed by sector: manufacturing (172 businesses), trade (89), education (73), services (44), agriculture (43), ICT (25), health (19), transportation (12), telecoms (10), construction (6), minerals and mining (5), and financial services (2).

General Business Profiles

- The majority of businesses interviewed were registered with AISA (60%), the municipality (19%), the Ministry of Commerce and Industry (14%), followed by other ministries (7%).
- Of those that provided revenue information (one-third of businesses), the majority in 2014, 2015 and 2016 reported revenues in the 10,000-52,000 USD range.
- Most businesses did not own the building where their business operates (77%). A total 19% owned buildings outright (no loan), and 4% owned their building with a loan.
- Businesses were asked to select the factor that they perceive to be the most significant in limiting their growth. The main factors identified were general economic outlook (41%), the security and political situation (28%), limited demand in the local market (16%), high competition (9%), and other (6%).

Just 2% of respondents said that access to finance was the most significant factor that limited growth.

The majority of SMEs reported assets of less than $50,000 USD and average annual revenues between $1,000 and $52,000.



Sectors with larger assets were minerals and mining (100% over $500k) and construction (100% over 50k).

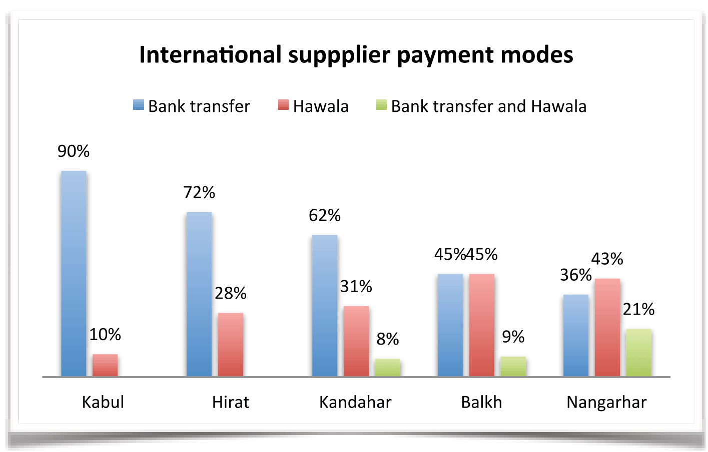
Sectors with smaller assets were services and trade (94% and 78% with 50k or less, respectively).

Reported Use of Bank Accounts

- The majority **(70%) of businesses reported using bank accounts.**
  - Of these, a very large majority held current accounts (94%); remaining 6% were savings or deposit.
  - AFN-only accounts held by 59%, followed by AFN & USD accounts (30%), and USD-only (11%).
  - Main reasons for bank account use: Bank transfers (59%), Check/debit/credit card services (46%), Vendor payments (7%), Payroll (6%).
- 30% of SMEs don't have bank accounts
  - Lowest: Nangarhar province (49%); highest: Kabul (79%).
  - By sector, those least likely to have bank accounts were in education (52% without), trade (36% without), small-scale manufacturing (33% without) and health (26% without).

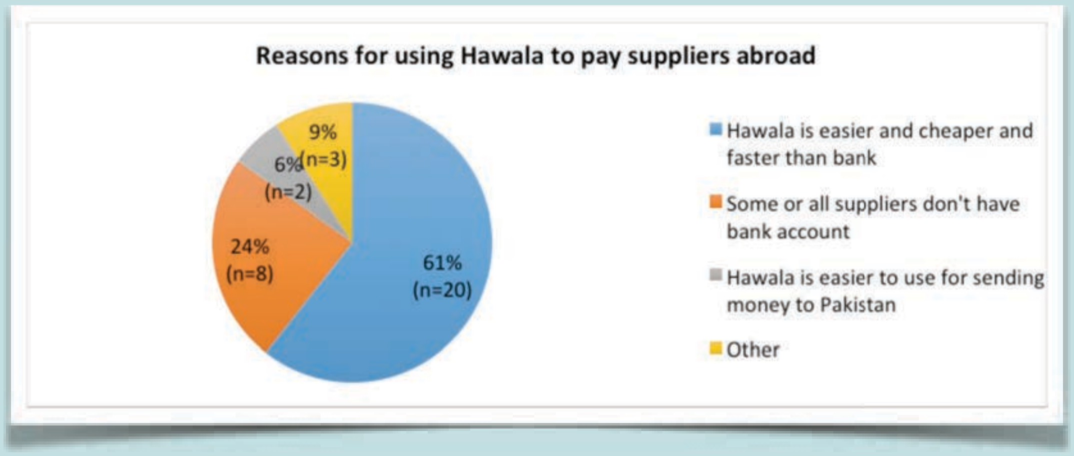
Reported use of formal sector for supplier payments

- The vast majority of businesses (80%) reported that they pay local suppliers exclusively in cash. A small percentage reported using exclusively bank transfer (9%) or Hawala (1%).
- 21% of businesses reported using suppliers abroad
- Of these, 68% percent pay their suppliers with bank transfers, 27% use the Hawala system, and 5% use a combination of bank transfers and Hawala.



The vast majority of businesses (80%) reported that they pay local suppliers exclusively in cash. For businesses with suppliers abroad, 68% use bank transfers and 27% use the Hawala system.

Why use Hawala?



Reported Use of Accounting System

- About one-fourth (27%) use electronic record keeping
- One-third (34%) use paper based record keeping
- Another 13% use a combination of paper and electronic
- 15% (1 in 6) do not have formal record keeping
- For those reporting electronic records, the majority use either MS Excel (55%) or Quickbooks (39%).

Reported Formal Credit Knowledge and Utilization

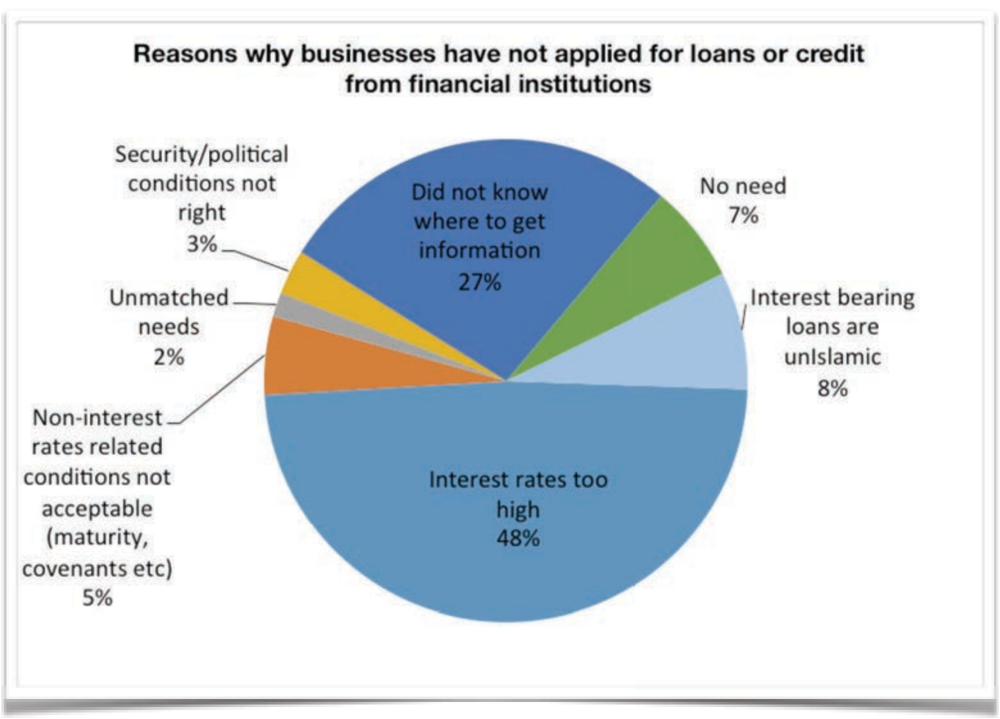
Afghanistan SMEs reflect an environment with low formal credit knowledge and utilization.

- More than one-third of business (36%) reported **no knowledge** of formal/institutional financial credit services available to them.
- 83% said that their business start-up capital came from a single personal source (either self or family)
- 17% identified start-up capital from multiple sources.
- **Only 3% identified a bank or microfinance loan as the startup capital** for their business, alone or with another source.

Three out of five businesses had never sought credit or loans from any source. The main reasons businesses don't access formal capital are perceived high interest rates (48%) and a lack of information (27%).

Need for Past Capital

- A total of 40% of businesses reported that they needed outside credit at some point in the past for their business, while 60% said they had never sought credit from any source.
- Of those accessing credit, a total of **53% approached formal financial institutions (35% banks and 18% microfinance institutions),** while others approached friends and family (44%) and then other sources (6%).
- The average size of loans obtained was 16,275 USD, the median size was 4,545 USD.
- The major reasons to seek loans were for financing specific equipment/machinery and working capital needs.
- Only 2% reported their formal loan application was declined; reasons were unsatisfactory terms, non-paying bribe and unknown. As collateral is often a stumbling block for businesses, these results suggest that businesses without collateral do not seek formal loans.

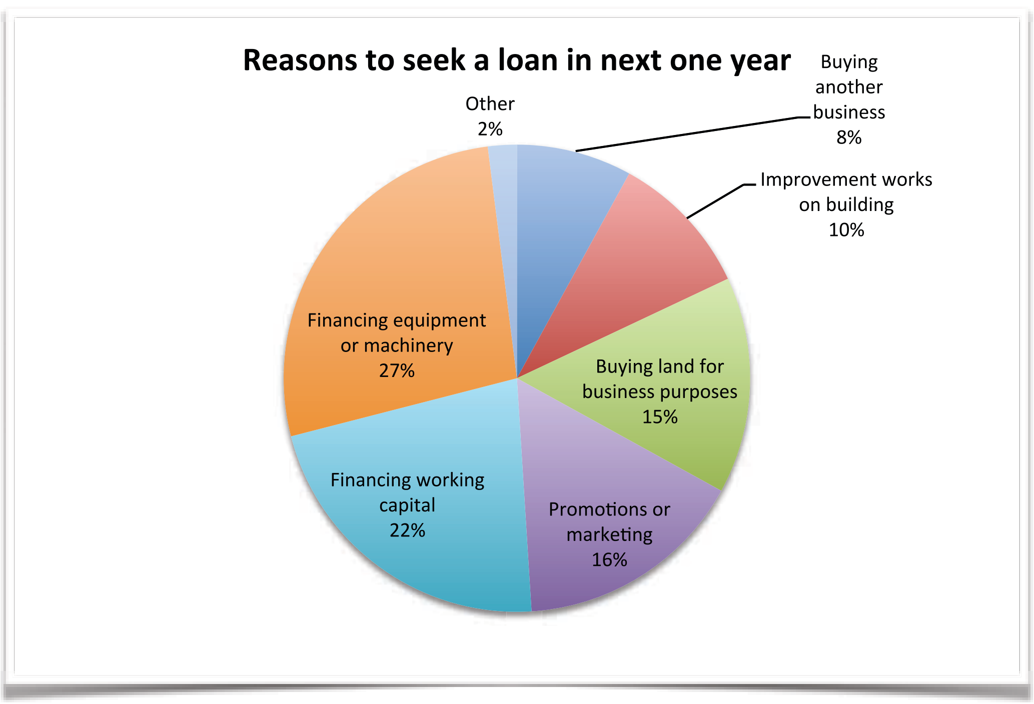


Half of businesses said they would only take a loan with "no interest," because high interest was seen to eat into the profit margins of businesses unnecessarily.

Banks need to educate customers, make the case for credit and show businesses how taking a loan can actually improve business profitability.

Reported Demand for Future Credit

- 70% of businesses said they would have need for credit in the next one year.
- The most popular ranges were: between 900-4,999 (28%), 7,500 – 9,999 USD (16%), and $30,000-49,999 (13%).
- Largest reasons to seek future credit include financing equipment/machinery (27%),working capital (22%), promotions/marketing (16%) and buying land for business (15%).



Recommendations

The survey results show that Afghan SMEs have adapted to a cash-based marketplace with low formal credit needs. Many have low-capital businesses that don't require formal credit and reflect short return-on-investment time horizons. Businesses are not averse to accessing credit per se, but rather the high cost of credit vis-à-vis their expectations of short capital recovery timelines.

Banking products therefore need to address the current low capital, short-term outlook of existing businesses. At the same time, banks can work in tandem with business service providers to help viable businesses develop longer-term, higher-capital business expansion strategies that require credit. For this, business owners must have higher tolerance for the longer time horizons needed to recover larger capital investments.

Specific opportunities:

- **Small, short-term credit lines.** Most SMEs require small amounts of capital, and do not require large loans to run their businesses. Banks can offer existing companies small credit lines. As these are paid back, the limits can be increased over time. Businesses can use these when they face temporary cash-flow issues. Vendor contracts or letters of guarantee from donors, investment partners or other banking customers with minimum cash balance can act as guarantors and make applying for a line of credit a fast application process. This also provides banks with information over time about the credit worthiness of businesses for larger capital needs.

- **Target companies without bank accounts to enroll, and provide small incentives.** 30% of SMEs interviewed reported not using a bank account at all, highlighting simple market expansion opportunities. As the largest bank service utilized by SMEs was transfers, a number of free transfers could be part of new account signup. This could be targeted at the following sub-groups: Nangarhar (where half of businesses did not have a bank account), education, trade, small-scale manufacturing and health care.

- **Partner with BDS providers to help businesses with expansion plans**. Without assisting businesses in their expansion plans, it is likely that the Afghan marketplace will continue to operate much as it is now: small-scale, with low need for formal credit. Therefore, banks can work in tandem with BDS providers that are vetting and assisting entrepreneurs in expanding their businesses. These should be entrepreneurs with an appetite for more risk, who are willing to lengthen time horizons to recoup their returns on investment. 2017 is also an optimal time with regards to the macro-economic environment: as the donor landscape changes and downsizes in Afghanistan, it is expected that more businesses will require capital through lending partners.

- **Target companies with international suppliers.** Because the vast majority of companies presently pay their local suppliers in cash, the 21% of businesses with international suppliers should be targeted for banking services, since this is where the demand is. Additionally, understanding why using Hawala in Jalalabad and Kandahar for sending payments to Pakistan is an area of further study that could yield market expansion opportunities if a comparable banking service could be provided. As it stands, market penetration for bank accounts in Jalalabad is just 49% of interviewed businesses.

- **As a mode of operation, consider creating more mobile sales forces.** As word of mouth is generally still a popular way to impart information in Afghanistan, mobile sales forces should be considered to raise awareness and reach potential customers in areas both covered and not covered by branches, especially for the various targeted sub-groups noted above. As 36% reported not knowing about credit opportunities and 30% still do not have bank accounts, there appears still to be ample opportunity in the market for such sales forces, especially in Nangarhar and Kandahar.

  This mobile sales team can also help with the task of educating customers, making the case for credit and showing businesses how loans can help improve profitability. As part of their pitch, professional products should be developed— for example, professional infomercials with interactive, real-world examples.