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VOICES FROM  
THE FIELD  
POLICY BRIEF

## Afghanistan's Willing Entrepreneurs *Supporting Private-Sector Growth in the Afghan Economy*



By Jake Cusack and Erik Malmstrom

Headlines paint a bleak picture of Afghanistan. Among a host of seemingly intractable problems, the country faces rising insecurity, endemic corruption, and a struggling international effort to end what is now a decade-long war. Many see significant cause for concern and little reason for hope. Yet, as the United States, its NATO allies, and its partners in Afghanistan grapple to build a foundation for that country's long term stability, there is potential for positive change within an area often neglected in the public discourse: The private sector.

While the relationship between economic growth and security is complex, private sector development will undoubtedly be critical to the long-term viability of the Afghan state.<sup>1</sup> Business formation and growth can provide a desperately needed source of sustainable tax revenue for a country that relies more heavily on foreign aid than any other country in the world.<sup>2</sup> It can also drive job creation and income growth for a population that is concerned as much about unemployment and poverty as security.<sup>3</sup>

In the post-Taliban era, efforts to develop Afghanistan's private sector have been inadequate. From an extremely low baseline, Afghanistan's gross domestic product (GDP) more than tripled in less than a decade. Afghanistan has also made progress in building critical infrastructure, such as road and telecommunication networks, and in providing basic services, such as health care and education.<sup>4</sup> However, it continues to derive 40 percent of GDP from official development assistance, register an annual trade deficit of more than 4 billion dollars and rank at the bottom of the World Bank Ease of Doing Business Index in most categories.<sup>5</sup> All too often, billions of aid dollars have benefitted foreign contractors and Afghan elites at the expense of the population.

In response, critics have challenged the international community's approach to development in Afghanistan and advocated a model that emphasizes entrepreneurship.<sup>6</sup> According to this line of thinking, entrepreneurship can be an engine of growth, jobs, goods, services and tax revenue, while growing "a class of people with a vested interest in stability and order."<sup>7</sup>

To inform this debate, we conducted more than 130 interviews with businesses and economic stakeholders in the Afghan cities of Kabul, Kandahar, Jalalabad, Mazar-e-Sharif and Herat.

To better gain perspective from the people who matter most – Afghans themselves – we traveled without security and maintained no organizational affiliation. Our central goal was to understand the narratives, challenges and opportunities of Afghan business people in order to inform a more effective strategy to empower them. Our findings, distilled here, will be the subject of a December 2010 report published by the Kauffman Foundation, which will present qualitative research that complements quantitative business surveys conducted by the World Bank and Center for International Private Enterprise.<sup>8</sup> Our desire to conduct this study stemmed from our experience as combat veterans of Afghanistan and Iraq, where we saw personally the importance of investing in the long-term economic growth and human potential of those societies.

We argue that there is tremendous potential to nurture an entrepreneurial economy in Afghanistan. Firsthand field research revealed five major characteristics of the Afghan business environment that have implications for policymaking:

- Afghan businesses are responding rationally to economic incentives in a highly distorted economic environment.
- Uncertainty and unpredictability, not physical insecurity, are the fundamental obstacles to business.
- Businesses are adapting through strategies such as vertically integrating, pursuing short-term trading over long-term enterprises and “buying” security in multiple ways.
- Many business people believe that the Afghan government not only fails to provide basic services but also engages in corruption that directly threatens their businesses.
- International actors distort the business environment in ways harmful to Afghan businesses.

## Afghanistan's Business Environment

Afghanistan's business environment features challenges common to a developing country but also challenges unique to a conflict zone. Afghan businesses do continue to operate, and even grow, by adapting in a variety of ways.

### *Afghan businesses respond to economic incentives.*

Despite Western perceptions of Afghanistan as a near economic wasteland, businesses are functioning, some even thriving, in a highly distorted environment. Beyond Roshan Telecom and Moby Group – which have powered the robust telecommunications and media sectors – and other nationally notable companies, regional small- and medium-sized enterprises have identified entrepreneurial opportunities and created profitable firms.<sup>9</sup> In Afghanistan, as in Iraq and other conflict zones, the indigenous population responds rationally to economic incentives so long as violence remains low enough to make conducting business still possible. Thus, the same key lessons that have informed economic progress in Africa, Asia and the West remain relevant in the Afghan market.

*Uncertainty, not insecurity, is the fundamental problem for business.* In national surveys, insecurity ranks at the top of the most serious concerns of Afghan businesses.<sup>10</sup> However, discussions with local business owners revealed a critical qualification to this finding. Surprisingly, Afghans were more concerned with the uncertainty of the business environment than with physical insecurity. In Kandahar, which is considered one of the most dangerous areas of the country, conversations with business people highlighted uncertainty about the quality and timing of the power supply, about supplies flowing in through the border crossing of Spin Boldak, about the local/national government, about financing, about American force posture and about the sanctity of obligations should political power shift – more than security issues. In Kabul, two manufacturers noted that they had received seven-year tax break

## Zarang Motorcycle Company

The Zarang Motorcycle Company defies conventional expectations of the business potential of Afghans who have only a high school education. Based in Herat, the Zarang family began a simple motorcycle import business before deciding to assemble its own lines of three-wheeled rickshaws. Lacking local manufacturing capacity, one sibling traveled to China, videotaped the assembly process and returned to Afghanistan to teach a select group of mechanics. Subsequently, the company grew from 15 employees in 2005 to 200 in 2010, with eight regional branches across the country. An innovative marketing strategy includes locally televised promotions by Afghan celebrities, lottery giveaways, promotional calendars and billboards. Despite the entrance of other Afghan competitors, the company continues to turn a profit and Zarang motorcycles can be seen on roads throughout the country. As of August 2010, the company had purchased more land and was constructing a factory to fabricate its own parts.



Assembled motorcycles at the Zarang Factory.

(Photo by Jake Cusack)

guarantees from a minister of finance only to see them rescinded by his successor. This act understandably rendered the companies reluctant to make subsequent investments. In the absence of market predictability and protections, businessmen adopt a variety of hedging strategies in order to capitalize on short-term rent-seeking opportunities without committing themselves to risky long-term projects.

*Businesses adapt by integrating vertically, emphasizing short-term profits and “buying” security.* Businesses employ a number of common strategies to adapt to Afghanistan’s uncertain business environment. First, they seek to vertically integrate operations, generally within family and tribe, to minimize reliance on untrustworthy business partners and the government. “We have the most



## Zalmai Afghan Group

The Jalalabad-based Zalmai Afghan Group demonstrates a logical progression of Afghan firm formation and growth as well as the attractiveness of vertical integration to Afghan businesses. In 1996, Haji Zalmai Stanakzai, the company president, started a construction company with 25,000 dollars from personal savings and seed capital from a friend, two cargo trucks and a Toyota Corolla. Explaining why he began in construction, he said, "Construction has the highest margins." The company's portfolio included roads, bridges, clinics, retaining walls and schools, all contracted primarily by international organizations and

military forces. Growth was slow initially, but increased rapidly as the company strengthened its industry reputation and relationships. Stanakzai reinvested profits into the company, did not take out any loans and received no donor grants. Eventually, he created a trading subsidiary to secure cheaper, more reliable access to construction materials. Subsequently, he created a transportation subsidiary to eliminate the expensive middlemen whom he had been employing to transport construction materials from Pakistan to Afghanistan. Last year, he reported 650,000 dollars in revenues and a staff of 230

employees. In the next year, he hopes to find a foreign partner and expand his business to Pakistan and India. Security is a concern but he has adapted. His security measures include pricing security into his project budgets at a rate of 2 percent to 18 percent of the total cost, employing a full-time security manager, holding a *shura* with local elders before beginning a project and hiring as many local workers and security guards as possible. In the spirit of many Afghan entrepreneurs, he noted, "I will do business anywhere ... but if ISAF (International Security Assistance Force) leaves, I will shift my focus to trading."

corrupt government and people in the world. I don't like relying on people outside of my family if I don't have to," stated Mohammad Jalil Rahimi, General Manager of the Mazar-based Barakat Group, an import-export conglomerate. The process of vertical integration begins around a central business, often import-export, and grows to include supporting businesses, such as transportation and logistics. It can then grow to include other sectors such as construction, agriculture and light manufacturing.

Second, businesses seek to remain as flexible as possible in order to hedge against uncertainty, valuing short-term but dependable gains over developing long-term productive capacities. A Western official explained, "Afghans go to the highest-margin businesses that require the least amount of capital and that produce benefits in the least amount of time. This means that they often start in trade, then pick

productive business opportunities in services, agriculture and construction. But even then, people are loathe to invest in manufacturing versus trade because it is easier and quicker." Despite this adaptation, producers continue to face challenges from a variety of sources. For instance, a Mazar cable and wire producer was being put out of business due to competition from cheaper Iranian imports; a Jalalabad-based box manufacturer could not afford his onerous credit payments, was accumulating debt and was unable to sell his business; and a Kandahar beverage company could not convince needed Pakistani technical engineers to visit and repair manufacturing breakdowns.

We observed four primary strategies for managing physical insecurity: 1. shifting operations away from unstable areas; 2. negotiating with government or insurgent power brokers, often through payment of informal taxes and bribes; 3. allocating up to 20

percent of an operating budget to formal security costs, including a security director, guards, etc.; or 4. implementing community-based strategies in cooperation with local elders and staff. The choice businesses make depends on an individual business' toleration of risk, past experience and influence within society. An Afghan mining executive explained his predicament: "I can't complain to the police or the government because it will make the problem bigger. My only strategy is to negotiate directly with the Taliban. My last option is to pay them. But I don't want to pay them because it will make them stronger."

***Businesses feel threatened by the Afghan government.*** Many of the business people we interviewed felt frustrated by the Afghan government's incompetence and threatened by its corrupt and predatory behavior. These business people lacked confidence in the government's ability to provide basic services, implement pro-business policies and survive beyond the departure of the ISAF. Moreover, they were dubious of its integrity, its relationship to the insurgency and its proclivity for bribery, extortion and other suspect practices. Corruption is endemic. "Entrepreneurial" Afghans enter government to enable their personal business ventures, occasionally buying certain posts.<sup>11</sup> Others simply co-opt officials who can steer money to family enterprises tailored to match the priorities of international donors. An official in the Afghanistan Investment Support Agency commented, "Our government doesn't know what a market economy is. It says slogans, but it does nothing practical. It has no strategy and no industrial policy. It doesn't have professional and technical people...insecurity is caused by the government and the Taliban. They are the same. They act illegally. This creates a distance between the people and the government."

***International actors distort the business environment.*** Afghanistan is "donor drunk," with easy money engendering dependence and rent-seeking.<sup>12</sup> In Kabul, locals game the system – for instance, by

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AFGHAN MINING EXECUTIVE

fabricating a nonprofit organization to obtain free laptop computers or refusing to take literacy classes without receiving a salary. Enterprising Afghans rapidly adapt to the perceived priorities of international funders. An education program manager explained that Afghans were willing to pay to learn English and IT skills, but never for agriculture-related training or basic accounting skills. The reason is straight-forward: Western-friendly skills can land a job at the U.N. or with an international donor paying 2,500 dollars per month, versus 200 dollars per month for an entry-level professional job at an Afghan firm. Even established multinational companies routinely lose top talent to better-paying non-governmental organizations (NGOs) or international contractors. Frequently, international plans backfire in their second-order economic effects and create further distortions: In Kabul, real-estate prices rival those in Manhattan, while inflated labor wages undercut donor hopes that Afghans might compete with Bangladesh or Pakistan in large-scale production of exports.<sup>13</sup> Rent-seekers flourish in the security, construction and transportation sectors employed by the international community. Short time horizons create a breed of cagey middlemen who specialize in manipulating both Westerners and Afghans to maximize opportunistic profits. Rapid shifts in priorities leave projects orphaned. Unclear American policy pronouncements exacerbate uncertainty. Multiple Afghan business people told us they are waiting to assess the implications of the July 2011 deadline to begin withdrawing U.S. troops before deciding on further investment.

## The Way Ahead: Empowering Afghan Entrepreneurship and Firms

Afghanistan's private sector holds unrealized potential. Neglect, misguided policies and a general lack of accountability, coordination and follow-through perpetuate this situation. It is time for a new approach that empowers Afghan entrepreneurs and firms. International actors should put Afghans in the lead wherever possible and enable, not distort, the business environment. A comprehensive new strategy should include several critical elements.

***Infuse private sector talent to support the growth of Afghan businesses.*** Little business expertise resides within the U.S. military, diplomatic corps and development agencies. While General David Petraeus, Ambassador Karl Eikenberry and Ambassador Richard Holbrooke coordinate military and political efforts, no visible senior U.S. representative is tasked with promoting economic growth. The Department of Defense (DOD) Task Force for Business and Stability Operations is a step forward, but insufficient. Military officers controlling large sums of grant money generally do not have access to business advice or an economic awareness of second-order effects. Moreover, development experts are not enough – as one Afghan raisin producer explained, having two agronomist advisers does not translate into a purchase agreement to export raisins to Russia. Business expertise is needed across many provinces to enable the formation and expansion of the many small enterprises that can be the engine of economic growth.

The United States should appoint a senior official, preferably with private sector experience, and that person should be given operational control of the disparate American stakeholders in this field. Additionally, Afghanistan needs to attract and leverage private sector talent, filling domestic gaps with expertise from the Afghan diaspora and foreign business professionals who wish to lend their assistance. New methods may be necessary to avoid the crippling

bureaucracy that impedes many development projects, which feature large security footprints, tight restrictions on freedom of movement, little incentive for ground-level performance and onerous short-term paperwork burdens. One possible model is the military's transition team concept, whereby personnel could be embedded in Afghan businesses and mentor indigenous talent.

## ***Support Afghan enterprises with a better regulatory and operating environment, public-private partnerships and linkages to multinational firms.***

The Afghan government, with international support, should aim to create a pro-business environment that provides incentives, protections and access to domestic and foreign markets for Afghan industries. Poor infrastructure, corruption, foreign dumping and inability to access markets, insurance and financing all hamper Afghan firms' ability to gain a foothold domestically and compete internationally. An Afghan official working for a USAID implementing partner commented, "It is impossible for Afghans to establish businesses. There are no protections for industrialists. There are no incentives except for importer tycoons who run our economy."

In spite of these challenges, Zarang Motorcycles, the Afghan beverage industry (see box, page 7) and other success stories demonstrate the promise of Afghan enterprises. Beyond the obvious areas of agriculture and mining, other sectors with high growth potential and lower barriers to entry, such as light manufacturing and services, should be priorities.<sup>14</sup> The Afghan government and international community can facilitate the formation and expansion of enterprises in these sectors through a variety of measures: increasing public-private cooperation; incentivizing multinational companies to partner with Afghan firms while mitigating risk; increasing domestic production and reducing import tariffs on raw materials; improving industrial infrastructure, principally power supply and road networks; fostering trade linkages between

## Afghanistan's Beverage Industry

Several water and soda manufacturers exist throughout Afghanistan, enabled partially by an unusual degree of support from the Afghan government and international forces. In 2004, Afghan trader Habib Gulzar invested 25 million dollars in a Coca-Cola bottling plant, while another Afghan group simultaneously started Cristal Mineral Water. The manufacturers struggled to be profitable until two key developments emerged: The Afghan government raised the import duty on outside beverages

from 2.5 percent to 20 percent and ISAF mandated international forces to procure bottled water and soda locally. While these changes enabled Gulzar and Cristal to expand their operations, several other producers also found success catering to the average Afghan outside of Kabul. In Herat, the company SuperCola produces bottles and juice packs, employs approximately 1,000 people and launched a new soda can line in fall 2010. In Kandahar, the Etehad Beverage Company continues to

turn an operating profit, dominating the local market after an initial 5 million dollar outlay to build and develop their factory. According to one senior Afghan businessman, as of 2010 only 5 percent of Afghan beverages were imported, down from 100 percent in 2003. An Afghan beverage company CEO saw further opportunities, noting: "I have to get my bottle caps from Turkey, the pre-form plastic from Pakistan, the label and the shrink wrap from Dubai ... they all could be made here instead."

different regions of Afghanistan, the economies of which are often oriented more toward neighboring countries than neighboring provinces; encouraging the international community to procure locally whenever possible; negotiating bilateral and regional trade agreements that curtail dumping and increase access to markets in the Persian Gulf, India and the West; and increasing transparency and reducing corruption in the government's relationship with the private sector.<sup>15</sup>

***Empower Afghans by increasing access to capital and business advisory services.*** Entrepreneurs need institutions that provide access to capital in shared equity and structured lending forms, with an embedded advisory business development component. The solution to Afghanistan's systematic capital problems is not as simple as expanding credit in the so-called "missing middle" of enterprises that fall between microfinance and large-scale infrastructure lending. Mustafa Kazem, who runs the 55 million dollars Afghan Growth Fund that invests in Afghan businesses, explained that a large number of applications

he receives are poor business models or ill-designed schemes seeking to benefit from oversupply of funds available through the donors. Even those applicants with reasonable plans are often unable to articulate simple financial matters on paper. When creditors do make loans, they can have little trust in collateral – most land is not legally registered – and find themselves unable to repossess property through the corrupt Afghan judiciary. Additionally, Muslim beliefs make many businesses, particularly outside of Kabul, averse to interest-bearing loans.

A more effective model would rely on bidirectional growth funds with an expectation for return, rather than using primarily unidirectional "charity" initiatives. Financing relationships would be long-term and continuing, with incentives for a sustained commitment from both lenders and loan recipients. Afghans could compete for loans in a clear and transparent fashion, but the investing institutions must also be proactive about identifying promising sectors and individuals. The most crucial element for success is finding the right entrepreneurs to support.



*Change development incentives to ensure implementation and reward long-term results.* The current system of international development incentives is perverse, rewarding contract implementers for short-term gains and glossy reports instead of sustainable outcomes and projects seen through to completion.<sup>16</sup> Evaluation is based on money spent – “burn rates” – and vague social metrics; trade fairs and conferences take the place of actual business deal flow all too often.<sup>17</sup> Attempts to increase international procurement from local Afghan firms are undercut by international firms with cost-plus contracts that provide no incentive to purchase in Kabul instead of Dubai. The logistics chain primarily values short-term responsiveness, and security rules often deny Afghans access to tenders from the international community.<sup>18</sup> The current system should be streamlined and improved, removing detrimental layers of subcontractors. While large numbers of consultants, development officials and NGOs write white papers, there are very few who work at the ground level in roles accountable for seeing practical projects to completion. Navy Lieutenant Tim Graczewski, the senior military economic advisor for Regional Command South during summer 2010, told stories of going into the field to brief economic growth plans: “It was as if Microsoft had 1,000 people doing corporate strategy, but only two software engineers actually making a product.”

*Make clear long-term commitments.* The international community should pair its short-term approach to stabilization with a long-term commitment to Afghanistan’s future in order to reduce harmful uncertainty in the business environment. A Western development official commented, “The main obstacle is time...We’re in a big hurry. We have aggressive goals for nation-building and are trying to implement a counterinsurgency strategy faster. But this process won’t happen in a hurry.” In interviews with Afghan businesses and foreign

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investors, the question of what would happen in July 2011 and beyond loomed large. Based on our interviews, businesses are less concerned with troop levels and aid dollars and more concerned with whether the international posture is predictable beyond the next six months. Commitments may be modest and nuanced to reflect regional realities, but they must be clear. Such statements of commitment should send a powerful message that allows businesses to plan for the long term, discourages rent-seeking and opportunistic behavior, and allays Afghan fears of abandonment. Corresponding trust-building actions will also be necessary. For example, donors can undertake public-private infrastructure projects in the more stable areas or provide future purchase guarantees to create predictable revenue for Afghan businesses. Once given a minimally certain framework, Afghan entrepreneurs will find a way.

## Conclusion

Based on our field research, we conclude that robust private sector development is possible and vital to Afghanistan’s future, but that the international community must be thoughtful about how it attempts to enable progress. War should not be an excuse to resurrect flawed concepts, such as that centrally planned growth is necessary due to a chaotic environment or that, with enough money, donors can simply create a developed economy for locals to enjoy. A vibrant private sector must be built from the ground up, with each business adapting to unique circumstances in an environment where government



provides a basic level of security, removes as much unpredictability as possible, and creates a regulatory framework for success.

Private sector development is not a quick or easy solution to Afghanistan's ills. Moreover, it requires a fundamental shift: Afghan entrepreneurs must be empowered to be the key drivers. Outsiders must accept an enabling role while remaining aware of their potential to create harmful distortions. Importantly, this effort requires smarter policy and the right people, not necessarily more money. With targeted help, Afghanistan can see real and sustainable growth in the next decade and beyond.

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## ENDNOTES

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2. Organization for Economic Development and Cooperation, "Official Development Assistance Recipients by Country," Web database.
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6. Carl Schramm, "Expeditionary Economics: Spurring Growth after Conflicts and Disasters," *Foreign Affairs* (May/June 2010).
7. Nathaniel C. Fick and Clare Lockhart, "The Economic Imperative: Stabilizing Afghanistan Through Economic Growth," Center for a New American Security; Anne Habiby and Deirdre Coyle Jr., "The High-Intensity Entrepreneur," *Harvard Business Review* (September 2010).
8. Our research was informed by On the Frontier Group, Afghanistan Research Evaluation Unit and Altai Consulting's excellent field studies on constraints and opportunities in business sectors such as carpets, marble, raisins, media, construction, microfinance, etc.
9. Author observations; Center for International Private Enterprise's (CIPE) survey of 738 Afghan businesses in May 2010 found that 48 percent had been formed in last five years, and 76 percent of all businesses expected net profits to grow in the next six months. Note: Roshan is officially known as Telecom Development Company Afghanistan Ltd.
10. The top three constraints to business in the CIPE survey were: insecurity, corruption and lack of electricity. In the World Bank's "Afghanistan Investment Climate in 2008" enterprise survey of 1066 firms, the top six constraints to business were: policy enforcement; electricity; crime, theft, and disorder; corruption; access to land; and access to finance.

11. To provide just two examples, both government and business interview subjects separately described how a large portion of the lucrative Host Nation Trucking contract was directed to the defense minister's son and how a sudden change in import regulations had benefited a cabinet official's brother who already had his supplies inside the country.

12. "Donor drunk" is the phrasing of a senior Afghan government official. According to the Afghanistan Ministry of Finance's "Donor Financial Review" published in November 2009, international donors had disbursed 35 billion dollars in development assistance from 2002 to 2009. As of September 2010, the United States alone has cumulatively allocated 56 billion dollars for relief and reconstruction. Special inspector general for Afghanistan, "Quarterly Report to Congress" (30 October 2010).

13. Author observations, monthly rent for a four-bedroom home could be more than \$10,000; James Melik, "Property Market in Kabul Bucks Trend," BBC World Service (23 November 2009). Interviews with prominent Afghan businessmen Jahid Mohseni and Tamim Samee described inflated wages for semi-skilled labor (compared to Pakistan) beginning as early as 2002. Ironically, the disparity in wages has made Afghanistan an export market for Pakistani labor.

14. Dowdy and Erdmann: "Non-tradable industries in these sectors (trade, retail, construction, transportation, etc.) typically account for half of GDP and approximately two-thirds of employment growth in developing economies."

15. Thoughts on improving investment into Afghanistan in order to create jobs were informed by Robert Mosbacher's paper, "A New Strategy to Leverage International Development," Global Economy and Development: Working Paper 41, Brookings Institute (May 2010). The idea of regional trade linkages was first voiced by Dowdy and Erdmann; see also a report from William Byrd of the World Bank: "Afghanistan Needs Pro-Private-Sector Growth" (8 June 2005).

16. The perceived need to maximize short-term performance over long-term sustainability was described during in-country interviews with both United States Agency for International Development officials and contract implementers. See also: Ben Arnoldy, "How USAID loses hearts and minds," *Christian Science Monitor* (28 July 2010). John Dowdy and Andrew Erdmann, "Private-Sector Development in Afghanistan, The Doubly Missing Middle."

17. The senior U.S. development official went further to explain that "each layer of a traditional development project has no incentives to acknowledge or learn from failure – the focus is on keeping the money flowing."

18. Peace Dividend Trust (<http://www.peacedividendtrust.org/>) is devoted to bridging the gap between international buyers and Afghan suppliers, with some successes. The recent launch of the Afghanfirst.org and Afghanbids.com websites is also an attempt to improve Afghan access to bid information.

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**Photo Credit**  
Merchants Haji Taj Muhammad, and Muhammad Hassoin show their wares, during the first East Region Economic Growth and Investment Promotion Conference, at Nangarhar governor's palace, in Jalalabad, Afghanistan, March 2010.

(STAFF SGT. GARY A. WITTE/U.S. Army)