

## Commercial Law Needs Assessment

*Survey commissioned by the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH*



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# Executive Summary

This survey was commissioned by GIZ – Rule of Law in the provinces of Balkh, Badakhshan, Kunduz, and Takhar. It is based on the assumption that Afghan businesses’ lack of legal knowledge and access to legal advice frustrates economic growth in the region and that improved access would bring increased certainty to the marketplace, decrease business risk, and stimulate more informed business decision-making and domestic investment in the North. It was therefore important to achieve a basic understanding of: 1) the actual socio-economic profiles of Afghan medium businesses in Northern Afghanistan; 2) their current needs for legal advice.

**Definition of “Medium Businesses”** – This survey aims to target in priority medium-sized private businesses: all the private companies with more than 5 employees were in the scope of the research, as they are more likely to request legal assistance than micro- or small- family owned commercial entities. This assumption was based on preliminary discussions with the GIZ staff, with ACCI and AISA counterparts, as well as focus groups with businessmen from Kabul and Mazar-e-Sharif.

**Gender** – Out of 621 respondents, only 2% were female interviewees (10 individuals). Most of them run carpet weaving and tailoring activities, beauty parlours, and health clinic; moreover, 6 of them work in Balkh, which may validate the assumption that Balkh is a more dynamic and modern city. Last, and based on the statement of the interviewees, only 3% of the surveyed companies reported having women among their owners – Balkh (Mazar-e-Sharif) having a relatively lower gender imbalance (7%).

**Education** – When asked about their highest completed level of education, more than three-fourths (77%) of the respondents declared that they had been to school while 19% of business owners are illiterate – which of course tends to impede upon their capacity to deal with administrative issues and get information on legal matters. Moreover, 15% of the respondents said that they had a university degree (to be compared with 5% only for Badakhshan, Balkh, and Kunduz households).

**Actual Skills** – More surprisingly, only 1% of respondents reported having attended vocational or technical schools. In this regard, there are almost no vocational or technical schools in the four-targeted provinces, despite the sharp increase of private training institutes and international VET (GIZ, Mercy Corps, AKF, etc.). Finally, medium business owners or managers often have very general and basic skills and acquired most of their business related skills through on-the-job experience.

**Ownership and Legal Structure** – Asked how they had acquired their company, 80% of business owners indicated that they had created their company using their own money; symmetrically, a large majority (74%) of business owners declared the legal status of their company being one of “sole proprietorship”. It confirms that most medium business owners are individual entrepreneurs, who generally create their companies themselves or, to a much lesser extent, inherit the company from their family. When disaggregated, these data show that there is no significant differences between activities: construction companies, retail shops, real estate agencies and even local NGOs often have similar profiles.

**Employees** – A breakdown of the surveyed companies by numbers of employees in the four provinces shows that a large majority (55%) has between 5 to 9 employees. It highlights the fact that the category of medium-businesses is mostly composed of small economic structures, with basic pyramidal hierarchies and no HR, finance, or legal departments. When we consider the gender breakdown, an average 14% of full-time employees were said to be female employees; Balkh tends to differ from other provinces with a significantly higher rate (20% when the other three provinces have only 12% of female employees). When asked to explain how they hired their employees, most employers said that they used informal networks (employees’ friends, employees’ relatives, and bazaar for almost three-fourth of the respondents).

**Employment Dynamics** – If we now consider the employment dynamics of the surveyed companies, it is interesting to note that among the 591 companies that were created prior to 2010, the employment increase rates are quite impressive when comparing the number of full-time employees at the start of the company and at present: from +279% in Kunduz, to +141% in Badakhshan. Most companies have started with 2 to 5 employees and have managed to develop their business, capital, and number of employees in a relatively positive business climate.

**Company Income** – The average monthly income was AFA 229,500 (equivalent to US\$ 4,990); however, most medium company income levels are way below this line and the median income is closer to AFA 50,000 (or US\$ 1,090). Medium size businesses are not a homogenous economic category and a breakdown by income highlights the fact that they are composed of a large basis of low-revenue companies (47% below AFA 50,000 per month), by contrast with the 10% of companies that earn more than AFA 500,000 of monthly income.

**Business Climate** – Overall, 49% of the 542 respondents who accepted to give some information on the company income said that it had increased compared to the previous year. There is, however, a clear gap between low-income (less than 50,000 AFA per month) and high-income companies (more than 50,000 AFA per month), as only 45% of the former declared that their income had increased compared with a year before, when 52% of the latter said that it had increased. Last, the level of confidence that medium business owners and managers show for the local business climate is more than encouraging, as 54% of them consider that they will increase their income next year.

**Company Expenses** – Similarly, employers were asked to estimate their cost structure: salaries are the main budget item (33%), followed by rental costs (20%), food (18%), and transportation (13%). Electricity and heating expenses (7%) are of course extremely volatile throughout the year and we can only provide a specific snapshot that does not reflect the average day and was probably underestimated by the interviewees as most companies use city power.

**Registering** – On average, 93% of the surveyed companies are officially registered (mostly with the local Department of Finance or the municipality). In practice, it does not mean that local medium companies: 1) are actually registered, or that they 2) understand the actual significance and potential benefits of registration. Registration procedures tend to be a formality with no technical or legal frame, allow governmental (municipal) actors to get their commission at the same time.

**ACCI** – The Afghan Chamber of Commerce and Industry (ACCI) is an independent organisation that is serving the advocacy and business facilitation needs of private sector; however, there seems to be a significant gap between the institutional image and the actual mission of the organisation. The four surveyed ACCI provincial offices are still hindered by a clear capacity deficit: a poorly educated staff, a sclerotic bureaucracy, absenteeism, the absence of dedicated buildings, and a general inability to fulfil basic business services are some of the complaints that have fuelled these perceptions.

**AISA** – If AISA benefits from an excellent reputation among the international community, its status is still unclear for most local companies, which barely perceive the benefits they can get from an official registration. Medium-sized companies are only likely to get registered with AISA when they work in areas (urban centres of Mazar-e-Sharif and Kunduz) and sectors (construction), which allow them to have access to important contracts with larger companies, governmental agencies or international organisations. Otherwise, they barely know the AISA (25% answered positively, when asked whether they knew the agency) and they almost never perceive the benefit they can get from the registration.

**Attitude towards laws and regulations** – To better evaluate the attitude of medium-business owners towards labour laws, respondents were asked to give their opinion about the existing regulations that define the employer/employee relationships. A large majority (87%) said that they considered that labour laws and regulations were important for both employers and employees. Most respondents (58%) also considered that labour laws and regulations could avoid employers' abuses, which suggests that business owners and managers have a good understanding of the objective necessity of the law.



**Importing** – Afghan medium-size businesses mostly operate at a local and domestic level: only 10% said that they imported some of their products. The countries of origin of the imported products are Pakistan (73% of the mid-size companies that import goods), Iran, (31%), China (23%), Turkey (14%), and India (11%). Last, 97% of the respondents answered that trade laws were both necessary and useful to their business: even if they often consider that commercial rules are not fair, company owners keep thinking that laws and regulations are absolutely necessary to the development of the social and economic of the environment they live in.

**Exporting** – Only a few companies have access to foreign markets (12 of the 619 respondents) with only 3 economic sectors export some of their production: mining, carpets, and dry fruits. The main export countries are Pakistan (10/12), Iran (6/12), and Tajikistan (4/12); China and Turkmenistan (2/12), UAE, and Europe (1/12) were also mentioned more punctually. It is a major concern that only a handful of companies have access to international market opportunities. In this regard, when asked whether they knew institutions for export promotion – like EPAA, FACT, Women’s Federation, ANSA, etc. – none of the respondents answered positively.

**Tax System** – There seems to be a general understanding and acknowledgement of the necessity of paying taxes: which sheds light on the increasing contradiction between an acceptance of the tax system and the shared perception that governmental representatives or semi-official authorities are increasingly corrupt in most Northern provinces. By contrast, such a negative perception of governmental officials does not seem to be fuelled by *actual* corrupt or unethical behaviours: when asked if their company had been inspected by tax officials over the last fiscal year, more than 70% answered positively (from 62% in Balkh to 81% in Badakhshan), but, out of them, only 8% said that a gift or informal payment had been requested during the procedure.

**Corruption** – Following the same logic, respondents were asked whether they considered that the tax system was fair or unfair: it is interesting to note that a large majority (62%) said that the tax system was unfair. Most of the people we interviewed do not share the same understanding of the notions of “tax system” and “corruption”. For most respondents, “paying taxes” does not necessarily mean that they deal with the legal and formal tax procedures; in most cases, it only means that they generally agree to pay to have a stamped document that allows them to develop their business activities. In this regard, “corruption” is seen as almost non-existent (3% on average and 1% in Badakhshan, which is one of the most corrupt provinces in Afghanistan) even if they almost always have to pay unofficial fees to middlemen or bribes to governmental officials to get their commercial authorizations sorted out.

**Obstacles to Business** – Lack of accessible *land* (68% of the respondents identified it as a “moderate”, “major” or “very severe” obstacle) and reliable *electricity* (63% of the respondents) are the major obstacles to the development of companies’ business. Land is of course a key issue, for both companies and individuals, as many business areas are already overcrowded in the direct neighbourhood or suburbs of provincial urban centres. If *security* is not considered as an obstacle by a majority of respondents (50%), there is a relatively high proportion of companies (20%), which consider it as a “very severe” obstacle – mostly companies relying on road transportation for their supply. Access to credit was rated as a minor obstacle (83% of the respondents said that it was only a minor obstacle or not an obstacle at all), which confirms the assumption that finding money to set up a business is not a major issue (through relatives, community, *hawalas* or banks). However, in many financial institutions, interest rates take into account the important risk premium associated with the local market (15-20% on a one-year loan).

**The Status of the Reform and its Practical Implementation** – The process for reforming Afghanistan commercial laws was initiated by the Afghan government – namely the Ministry of Commerce and Industry – in 2002. Considering the current status of most of the new commercial laws, it seems clear that the parliamentary step is crucial. Some laws published in 2007 are still in the limbo and are unlikely to be enacted on the short-run. It does not mean that these laws are not used as legal

references but, in theory, their application can be overruled, as they have not been confirmed by the Parliament. More practically, there are strong doubts about the actual implementation of the reformed legal frame – especially at the provincial level.

**The Formal Sector** – The formal commercial law sector in Afghanistan remains unable to reach most rural or remote districts and functioning poorly in areas where it is present. Political and/or religious patronage, endemic corruption, lack of skills, lack of Infrastructure, lack of coordinated efforts between formal and informal institutions, and gender Imbalance are among the obstacles that undermine the development of a fair and efficient judiciary system in the four-targeted provinces.

**The Informal Sector** – The “informal justice sector” (councils or “*shuras*”) mix rule-based as well as pragmatic approaches to a wide range of legal arrangements resolve the vast majority of legal disputes (from inheritance claims to commercial cases or contract matters). Traditional justice mechanisms clearly represent an effective opportunity for increasing access to justice, as they generally involve community elders, religious leaders, and other respected individuals whom parties trust. However, there are several risks or weaknesses that often hamper the functioning of *shuras* and *jirgas*: political dependency, lack of homogeneity, lack of case records, as well as predatory arborescence.

**The Hoqooq** – Many international organisations have thought about relying on the *Hoqooq* (“Rights”) Department of the Ministry of Justice to improve the rule of law (especially at provincial level). Based on the 40 interviews we had with *Hoqooqs*, it is not realistic, as several structural obstacles still undermine the functional capacity of this institution: absence of executive power, lack of skills, nepotism, a poor image among the population, and a questionable sustainability (when the international funds run dry). As such, there is clearly no evidence that the *Hoqooq* can actually be a reliable and sustainable solution for solving commercial disputes and improving the overall judicial frame in Afghanistan.

**Perception of Commercial Laws and Regulations** – Most medium-sized business owners know about the key laws and regulations that constitute the commercial law framework: for instance, 98% said they had heard about the labour law and regulations, 88% about the law on private investment, 86% about the company registration law. Of course, the fact that such a significant majority of interviewees answered positively does not necessarily mean that they have a clear understanding of the *content* of the commercial laws: in Faizabad, Balkh and Kunduz, none of the participants was able to provide us with any specific content detail. But focus group participants and survey respondents unanimously insisted on the significant role played by the commercial laws and only an insignificant proportion of respondents considered that commercial laws and regulations are useless (less than 2% for commercial laws that regulate local exchanges, and only 3% for international trade laws).

**Perception of Legal Assistance** – Legal counselling does not benefit from a good image among company owners, as there was a relatively poor performance feedback from other business owners who had requested the support of legal experts. Less than 2% of the interviewed company representatives actually requested the services of legal experts in the four-targeted provinces. This negative perception of legal assistance was finally confirmed when respondents were asked if the assistance of a legal expert could be of any help to their company in the future: on average, only 4% (27 out of 621) of them answered positively (with no significant difference between the surveyed provinces or districts). Such a strong prejudice against legal advisors or assistance in all the surveyed provinces and districts (rural or urban) may explain why so many legal assistance initiatives have been unsuccessful in the past few years.

**Taking the economic context into account** – International organisations working on humanitarian or development initiatives in Afghanistan have generally sought to strengthen a necessary collaboration with local governmental authorities, which is of course a requirement to promote a sustainable political, social, and economic development in the country. However, international organisations

should take the worsening socio-economic context into consideration when they design their strategies. The announced and progressive withdrawal of international aid to Afghanistan will immediately impact the solvency of the state (with a projected financing gap of 25% of GDP by 2021/22) and hamper the MoF capacity to pay civil servants. In these regards, it is important that the GIZ-RoL program does not focus exclusively on one aspect of the judicial landscape and ties its strategy into both formal and informal, as well as public and private sectors to define its strategy.

**Strengthening the Capacity of the ACCI** – Despite its structural and material issues, ACCI should play a leading role in the GIZ-RoL strategy. ACCI is an official governmental agency that *also* depends on independent businessmen. Logics of private and self-interests would make ACCI the better place to promote the commercial law in Badakhshan, Balkh, Kunduz, and Takhar provinces. However, given ACCI's lacks of capacity, the GIZ-RoL should work almost from scratch to create and strengthen the capacity of the ACCI, by capitalizing on the positive experience conducted with AISA to build on AISA's structural efficiency and ACCI's historical authority among Afghan companies: pilot test initiatives, training workshops, equipment supply, advocacy with public and private actors, and legal clinics embedded in local ACCIs. On the long run, the success or failure of legal clinics will mostly depend on private business owners' trust: if they prize the services of the organisation, they will take its ownership and make it sustainable.

**Promoting an advocacy strategy to create a network of formal *and* informal key players** – More frequent interactions could create mutual understanding and trust between formal and informal judicial sectors. The GIZ-RoL could take the indirect lead on it, through the ACCIs, by setting neutral settings between state officials and *shura* or *jirga* leaders. Symmetrically, university, BAR associations (AIBA), private lawyers, private education institutes, and paralegals should also be targeted, as they are more likely to strengthen a resilient and sustainable legal network. A public commercial law awareness program for medium and small businesses, to inform local company owners about their legal rights and responsibilities, could be launched to progressively change the perception of commercial law assistance. Last, the GIZ-RoL could benefit from other legal assistance programs (USIP, NRC's ICLA) to deepen its understanding of community-based solutions, land issues, and dynamics of the formal and informal judiciaries.

**The main conclusion of this study is to prioritize sustainability over short-term objectives: building the capacity of public institutions (DoJ and MoC) is of course a necessary objective, but when the international funds run dry, only a multi-lateral strategy emerging from the private economic sector as well as formal and informal actors, is likely to succeed.**

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## Acronyms

ACCI - Afghan Chamber of Commerce and Industry  
AIBA – Afghan Independent Bar Association  
AISA - Afghan Investment Support Agency  
AKF - Aga Khan Foundation  
AKDN - Aga Khan Development Network  
ANDS - Afghan National Development Strategy  
ANSA - Afghanistan National Standards Authority  
APTTA - Afghanistan Pakistan Transit Trade Agreement  
AREU - Afghanistan Research and Evaluation Unit  
ASMED - Afghanistan Small and Medium-Sized Enterprise Development  
CIM - Centrum für internationale Migration und Entwicklung.  
CSO - Central Statistics Office  
CSOs - Civil Society Organisations  
DED - Deutscher Entwicklungsdienst  
DoJ - Department of Justice (provincial level)  
EC - European Community  
EPAA - Export Promotion Agency of Afghanistan  
FACT - Federation of Afghanistan Craftsmen and Traders  
GIZ - Deutsche Gesellschaft für Internationale Zusammenarbeit  
HH - Household  
ICLA - Information Counselling and Legal Assistance  
IDP - Internally Displaced Person  
INGO - International Non-Governmental Organisation  
IOM - International Organisation for Migration  
ISIC - International Standard of Industrial Classification  
MEW - Ministry of Energy and Water of the Islamic Republic of Afghanistan  
MoA - Ministry of Agriculture  
MoE - Ministry of Education  
MoEc - Ministry of Economy  
MoF - Ministry of Finance  
MoJ - Ministry of Justice  
MoLSAMD - Ministry of Labour, Social Affairs, Martyrs and Disabled  
MoWA - Ministry of Women Affairs  
NAWI - Sustainable Economic Development Programme  
NGO - Non-Governmental Organisation  
NRC - Norwegian Refugee Council  
NRVA - National Risk and Vulnerability Assessment  
NSP - National Solidarity Programme  
RoL - Rule of Law  
SME(s) - Small and Medium Enterprise(s)  
UNDP - United Nations Development Programme  
UNHCR - United Nations High Commissioner for Refugees  
USAID - United States Agency for International Development  
USIP - United States Institute for Peace  
WB - World Bank  
WFP - World Food Programme

# 1. Introduction

*“To live outside the law, you must be honest”.*

Robert Allen Zimmerman

## 1.1. Background

The Afghan Government’s ANDS strategy identified the private sector as the “engine of growth” for the future of Afghanistan and set a goal for itself “to create the conditions in which a dynamic and competitive private sector can flourish, contributing to economic growth, employment creation and poverty reduction.”<sup>1</sup> By formalizing the economy, ensuring that businesses are in compliance with legal requirements, and creating methods of legal enforcement that are available to all, Afghanistan can reduce the risk of doing business and thereby increase the levels of private investment in the country. A formalized economy also creates conditions that “promote exports, ensure the safety of goods in the domestic market, and ensure adequate levels of competition necessary for the equitable operation of the marketplace”<sup>2</sup>.

However, despite the large amounts of international support that has been disbursed to date and pledged for the future to develop and promote the private sector in Afghanistan<sup>3</sup>, remarkably little attention has been paid to strengthening the legal framework within which Afghan businesses operate. Over the last ten years, international organisations have worked in close collaboration with the government of Afghanistan to develop a transitional commercial reform project, covering specific areas of the commercial law – including foreign investment, arbitration and contracts, labour and employment, as well as environmental management. However, most commercial laws introduced in recent years, such as the Corporations and Limited Liability Companies Law, Partnerships Law, Business Arbitration and Mediation Laws, etc. have yet to be complemented with regulations instructing government entities on how to implement them.

In practice, the formal legal framework for commercial entities is therefore incomplete as well as unknown and unacknowledged by businesses. With little or no access to legal information or qualified legal advice, Afghan companies conduct business in a legal void and base their business decisions on a mixture of common sense and common practice, which not only creates great uncertainty but also strongly impedes any further development of their activities.

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<sup>1</sup> Islamic Republic of Afghanistan, “Afghanistan National Development Strategy - An Interim Strategy for Security, Governance, Economic Growth & Poverty Reduction,” Volume 1, p. 155,

<sup>2</sup> Arsala, Hedayat Amin. 2007. Afghanistan’s Economy – The Government’s Plan: Building a New Afghanistan.

<sup>3</sup> According to a 2009 Ministry of Finance report, international donors have pledged up to \$327.8 million to be invested in private sector development and trade initiatives between 2009 – 2013. Islamic Republic of Afghanistan Ministry of Finance, *Donor Financial Review*, Report 1388, November 2009, p. 43.

In order to promote a more trustworthy legal framework GIZ Rule of Law project proposes to train and support the placement of commercial lawyers in GIZ-assisted business support entities, such as the ACCI or business development centres, throughout northern Afghanistan. These lawyers would provide GIZ stakeholders as well as GIZ projects themselves with commercial law advice and other legal services, work to build demand for business law services within the private sector, and foster the emergence of a community of business law professionals in the region.

## 1.2. Objective and Definitions

**Objective of the survey** – The Project’s rationale is based on the assumption that Afghan businesses’ lack of legal knowledge and access to legal advice frustrates economic growth in the region and that improved access would bring increased certainty to the marketplace, decrease business risk, and stimulate more informed business decision-making and domestic investment in the North. It is therefore important to achieve a basic understanding of the need of Afghan businesses in Northern Afghanistan for legal advice and assistance with business planning, decision-making, and risk mitigation strategies.

**What “Medium Businesses” are and are not** – Considering the specificities of the Afghan economic market, this survey aims to target in priority medium-sized private<sup>4</sup> businesses and excludes two types of companies: 1) small-sized businesses, as most of them are family-owned shops that are not likely to get registered and interested in legal advice; 2) larger national companies (like Alokozay Safi Airways, or Azizi Bank), as they all have well-structured finance and legal departments. However, the definition of what is meant by “medium business” in the Afghan context still needs to be clarified as it strongly differs from one country to another: for example, the traditional definition of SME (Small and Medium Enterprise) in Germany has a limit of 255 employees, while, in the United States, small business refers to companies with fewer than 100 employees medium-sized business to those with fewer than 500 employees. The European Union, however, has started to standardize the concept and its current definition categorizes companies with fewer than 10 employees as "micro", those with fewer than 50 employees as "small", and those with fewer than 250 as "medium"<sup>5</sup>. By contrast, it is obviously irrelevant to duplicate western definitions in the Afghan socio-economic context; as such, the review team considered that all the private companies with more than 5 employees were in the scope of the research. This assumption was based on preliminary discussions with the GIZ staff, with ACCI and AISA counterparts, as well as focus groups with businessmen from Kabul and Mazar-e-Sharif.

**What Commercial Law and Lawyers are and are not** – This needs assessment interprets the concepts of “law” and “commercial law” very broadly. The formal governmental legal framework is the most dilapidated and lowest functioning of several rule-based systems that Afghan businesses must operate within. Beyond the formal, government-prescribed law, Afghan businesses must also fashion their business practices around norms governed by customary expectations derived from culture and religion as well as general business norms that are common in the Afghan context, and those that are specific and unique to particular economic and commercial sectors. As such, a

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<sup>4</sup> As they represent a key social, political, and economic player, we also surveyed 4 Afghan NGOs to offer a better picture of the socio-economic landscape in the targeted provinces. However, it should be noted that most local NGOs did not accept to answer our questions (4 out of 17, whereas most private companies easily accepted our request: 617 out 820).

<sup>5</sup> See European Commission (2003-05-06). "Recommendation 2003/361/EC: SME Definition". Retrieved 2009-04-05.

“lawyer” must therefore also be understood just as broadly as a subject expert in rule-based systems who ideally would be able to provide advice and counselling to businesses regarding concerns arising from their having to navigate any or all of these formal and informal rule-systems.

*Picture 2: Electronics Store in Mazar-e-Sharif*



## 1.3. Research Tools & Fieldwork

### 1.3.1. Fieldwork Location

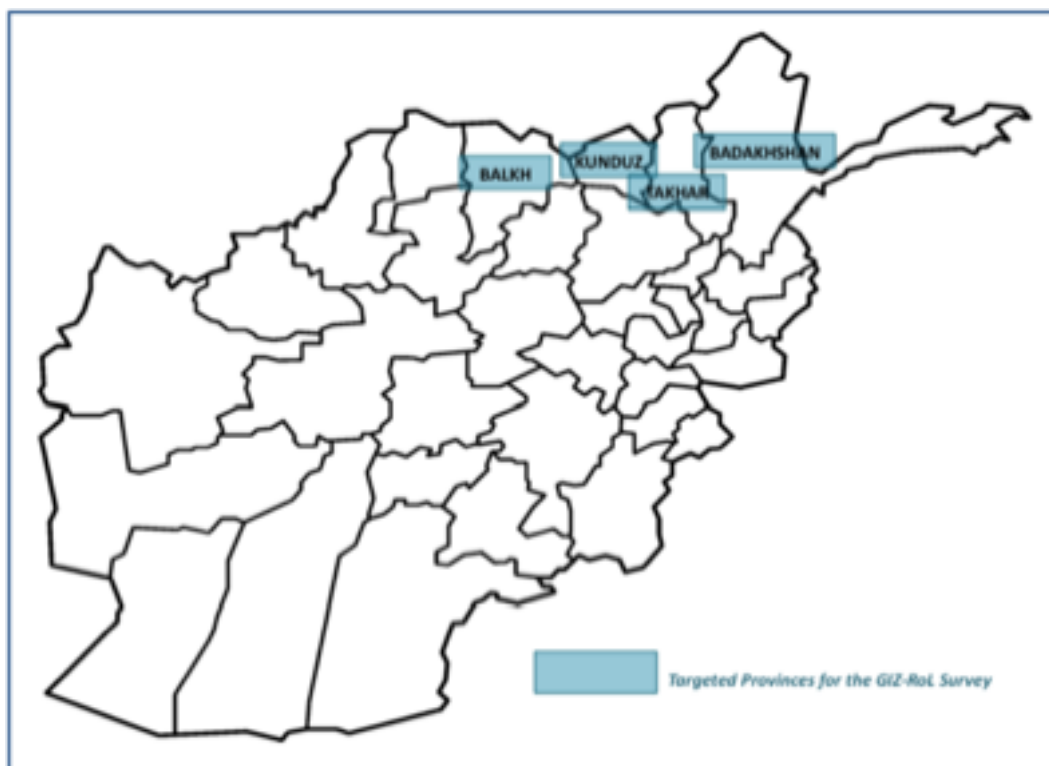
Based on initial discussions with the GIZ Rule of Law project, 4 provinces were selected for the review, providing a geographic spread in the North and North-Eastern regions of the country. As illustrated in the map below, the 4 provinces are Balkh, Kunduz, Takhar, and Badakhshan. In each province, 2 to 4 districts were selected to allow for a greater representativeness of the sample. These areas include:

- **“Central”** districts, where the administrative and economic provincial capital is located;
- **“Peripheral”** districts, immediately surrounding the central district and provincial capital;
- **“Remote”** districts, separated from “central districts” by at least one administrative district.

The fieldwork was divided in 2 phases during the month of March and April 2011 with the following breakdown:

- **March 4<sup>th</sup> to 28<sup>th</sup>**: Quantitative Fieldwork in Balkh, Kunduz, Takhar, and Badakhshan;
- **April 6<sup>th</sup> to April 22<sup>nd</sup>**: Additional Focus Groups in Balkh, Kunduz, and Badakhshan (based on the key findings of the first phase).

*Chart 2: Map of Surveyed Provinces*





### 1.3.2. Survey Team

All provinces were visited and evaluated directly by all project staff, international and national alike, who ensured a successful data collection process. As agreed in the original proposal, a team of international and national consultants (team leaders and interviewers) led qualitative and quantitative interviews in all 4 provinces to meet the following target number of interviews and focus group discussions.

The research team consisted of 2 international consultants, 2 national consultants from Kabul, and 16 interviewers, selected on the basis of their thorough experience leading surveys and their detailed knowledge of the local area. To better fine-tune the research tools, one researcher from the *Massachusetts Institute of Technology* (MIT) reviewed the questionnaires and guidelines and helped the review team refine the analytical frame of the report.

During the fieldwork phase, the responsibilities were divided as such:

- 2 national consultants each led one team of 8 interviewers – 10 men and 6 women – in the 4 targeted provinces;
- All interviewers led on average 4 quantitative interviews per day of fieldwork;
- 1 international and the 2 national consultants ensured the monitoring and supervision of the fieldwork;
- Both the international and national consultants carried out qualitative interviews (case studies and key informant interviews) in all the targeted socio-economic communities and organisations.

### 1.3.3. Quantitative Assessment

**Sampling Size** – The review team interviewed a total of 621 company representatives in all the four-targeted areas. With such samples, we will be able: 1) to provide representative data of the existing network of local medium businesses; 2) to tailor our recommendations to the specific socio-economic profile of each municipality; 3) to draw comparisons and do benchmarks between the six municipalities.

**Sampling Methodology** – In order to include a representative sample of the various socio-professional and economic profiles of respondents, the sampling methodology followed a cluster-then-random approach (multi-stage sampling) and was structured as follows:

- In the urban core, 10 clusters or Primary Sampling Units (PSUs) were selected at random, based on the World bank/NRVA PSU stratification;
- A quota of interviews was allocated to each selected area (10 per each PSU) to reduce, as much as possible, the effect of homogeneity or bias in sampling.

The number of companies interviewed in each PSU was theoretically the same throughout the sampling methodology in the four main municipalities (Mazar-e-Sharif, Kunduz, Taloqan, and Badakhshan). However, as it was sometimes impossible to find medium-sized businesses in the selected PSUs, the final number of interviews significantly differed among the targeted provinces, districts, and sampling units. As shown in the table below, for instance, the review team could not find companies with more than 4 employees in Sholgara (Balkh province), Bangi or Farkhar (Takhar province); correlatively, it was much more difficult to find companies with more than 4 employees in Mazar-e-Sharif than in Taloqan (Takhar province, where field interviewers have spent more time but

finally interviewed less respondents than in any other province). Overall, 86% of the interviews took place in urban districts (cities of Faizabad, Mazar-e-Sharif, Kunduz, and Taloqan) and only 3% in remote districts, which clearly highlights the lack of structured economic network and business organisations in secondary and remote districts.

*Table 3: Sampling per Targeted Province and Districts*

PROVINCES	DISTRICT PROFILES			TOTAL
	URBAN	PERI-URBAN	REMOTE	
Badakhshan	Faizabad	Baharak	Jurm	<b>173 (28%)</b>
	<b>138</b>	<b>27</b>	<b>8</b>	
Balkh	Mazar-e-Sharif	Balkh	Sholgara	<b>167 (27%)</b>
	<b>149</b>	<b>18</b>	<b>0</b>	
Kunduz	Kunduz	Khanabad	Imam Saheb	<b>180 (29%)</b>
	<b>146</b>	<b>23</b>	<b>11</b>	
Takhar	Taloqan	Bangi	Farkhar	<b>101 (16%)</b>
	<b>101</b>	<b>0</b>	<b>0</b>	
<b>TOTAL</b>	<b>534 (86%)</b>	<b>68 (11%)</b>	<b>19 (3%)</b>	<b>621</b>

**Pilot test** – A series of two pilot tests was conducted (in Dari) in Kabul, including both quantitative and qualitative questionnaires and interview guidelines. As survey standards require, the results of the pilot tests were used to refine the research tools and produce final questionnaires. Both female and male interviewers were utilized to ensure participation of women-led groups and female community members.

**Quality Control** – After completion of the quantitative fieldwork, an independent M&E team monitored 20% of the questionnaires (phone interviews). The same team will also monitored 20% of the questionnaires (after the data entry phase) to check that the questionnaires were correctly entered.

#### 1.3.4. Qualitative Assessment

**Key Informant Interviews** – Aside from the initial meetings and in-depth interviews conducted with GIZ staff, international consultants led other key informant interviews with key stakeholders in each province. These Key Informant Interviews (KII) aimed at gathering additional qualitative data on the locations surveyed, as well as collecting socio-economic information on local labour market and business climate. The KII process was designed to allow the team to meet with a range of stakeholders relevant to the topic of the assignment – starting with the GIZ staff (RoL, NAWI, DETA) to other partners and stakeholders: Department of Justice (DoJ), Afghanistan Investment Support Agency (AISA), Afghanistan Chamber of Commerce and Industry (ACCI), Federation of Afghanistan Craftsmen and Traders (FACT), as well as local and international key players – like Aga Khan Foundation (AKDN-AKF), Afghanistan Small and Medium-Sized Enterprise Development (USAID-ASMED), Norwegian Refugee Council (NRC), among others. These interviews were led using a semi-open questionnaire and will last about 1 hour each.

**Case studies** – In each location, 2 case studies were led for a total of 8 case studies overall. These case studies were selected from both male (7) and female (1) group participants, and based on their socio-professional representativeness. The questionnaire followed a guideline of open-ended questions structured around the same themes as the quantitative questionnaire. However, it also

integrated viewpoints from other members of their immediate environment. This approach was used to provide a level of qualitative description to complement the data collected through the large-scale quantitative survey on one end, and the information obtained through focus groups or the key informant interviews on the other. These case studies lasted on average 2 hours.

**Limitations & Constraints** – The main constraint for our survey team was to locate companies fitting our criteria (more than 4 employees) out of the main urban centres (and especially in peri-urban and remote districts, as it was agreed with the GTZ staff that the review team would survey different district profiles).

In addition, in the provinces of Kunduz and Takhar, the review team’s district selection had to be reviewed to take into account security and logistical considerations. In Kunduz province, for instance, the trip to Imam Saheb (Northern border) was finally cancelled due to recurrent gunfights in the central districts of the province. As a result, the 11 respondents from Imam Saheb were interviewed over the phone, which is not fully satisfactory and of course introduces an inevitable bias in the selection of respondents for the survey.

Moreover, in the Afghan context, there is often a strong acquiescence bias, as most respondents tend to provide interviewers with the “right answer”. This point is of course crucial as: 1) culturally, Afghan people – and especially the poor – are reluctant to directly criticize the support provided by governmental and international organisations, even if they are not fully satisfied with it; 2) politically, sensitive subjects (like corruption, taxes, and governmental services) cannot be understood with basic survey questions and methodologies (unilateral questions). Our mix of both quantitative and qualitative approaches precisely aimed to mitigate this double risk.

By contrast, another phenomenon has been observed (especially in Northern provinces), which led us to consider some of the answers and figures given by the interviewees with a pinch a salt. “Survey fatigue” is now a common factor that has been taken into account when doing some fieldwork research in the Afghan context. When asked, at the end of each interview, whether they considered that both the opinions and figures given by the interviewee were truthful and reliable, our team of field interviewers acknowledged a relatively significant doubt (see table 4 below: only 0.3% of “non truthful interviews” and 1.9% of “unreliable numbers”, but 4.7% of “somewhat truthful” opinions). We of course had to take this bias into account in both the data cleaning and analysis phases<sup>6</sup>.

*Table 4: Robustness Tests*

<b>Robustness Test (perception survey for interviewers only)</b>		
<i>The responses to the questions regarding opinions and perceptions were:</i>		
Truthful	590	95.0%
Somewhat truthful	29	4.7%
Not truthful	2	0.3%
<i>The responses to the questions regarding figures (productivity and employment numbers) were:</i>		
Estimated computed with some precision	609	98.1%
Arbitrary and unreliable numbers	12	1.9%

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<sup>6</sup> Basically, we excluded outliers (the 2% of extreme values) and did not take into account “not truthful” and “arbitrary” answers.

## 1.4. Structure of the Report

This report is divided into five chapters. The introduction provides background and contextual information, as well as the methodological approach that was used to gather qualitative information and quantitative data. The second chapter draws a picture of the socio-economic profile of the surveyed companies and businesses. This profiling follows four steps: a demographic, social and economic profile, with a specific analysis of ownership and legal structures, HR and recruitment channels, as well as company income and expenses. The third chapter then provides a detailed overview of companies' attitudes towards commercial laws and regulations, by following the different steps of a company life (from the registration process to payment of taxes). Based on this assessment, the fourth section tries not only to determine whether the formal and informal judicial mechanisms can provide adequate answers to companies' legal problems, but also to gauge companies' perception of those answers. The last chapter provides practical recommendations for the GIZ-RoL staff to improve its legal assistance to medium-sized companies in Badakhshan, Balkh, Kunduz, and Takhar.

*Picture 3: Carpentry in Kunduz province (Khanabad)*



## 2. Surveyed Companies' Socio-Economic Profile

To better identify the actual needs of the targeted subcategory of commercial entities (“medium businesses”, see “1.2. Objective and Definitions”), this chapter will shed light on the major social and economic characteristics of the 621 surveyed companies. In the four-targeted provinces, medium-sized private company owners and managers offer a wide range of socio-economic profiles. However, some dominant features may be highlighted: a strong gender imbalance (2% of female business owners and 14% of female employees), a relatively high educational level (80% of literate respondents) and technical skills acquired on-the-job. The segment of medium-sized businesses is generally composed of small economic structures, with basic pyramidal hierarchies and no HR, finance, or legal departments. By contrast, the employment trends are extremely positive with a significant upward trend over the years, in all the surveyed provinces and cities. Finally, a breakdown by income highlights the fact that medium-sized companies are composed of a large basis of low-revenue companies – with almost 50% below US\$ 1,000 per month.

### 2.1. Respondent Profiles

**Age** – The average age of the 621 respondents was 34.1, which does not provide significant information, unless it is compared with other data. As such, to get a more accurate picture of the actual age structure of the targeted business owners and directors, we focused on a particular province (Badakhshan) to draw specific comparisons with two types of existing data: 1) a “Labour Market Survey” of Faizabad, Jurm, and Baharak (March 2010)<sup>7</sup>; 2) the most recent CSO data for settled urban population<sup>8</sup>.

As shown in the table and chart below, which only take into account 16 to 70 year old people, the three age structures have common trends with a very young demographic basis. However, there are also more specific characteristics that belong to medium-business owners and managers, as shown in table 5:

- The bracket of 16 and 30 year old people tends to be quite high for Faizabad employers and employees (61.8%) as well as settled urban population (50.4%), whereas it “only” comprises 43.2% of the interviewed medium business owners and managers;
- Symmetrically, if 27.8% and 28.2% of (respectively) the Faizabad workforce and the settled urban population are between 31 and 45 years, our survey showed that 45.5% of the medium business owners and managers were comprised in the same bracket.

In these regards, it is worth noting that if most medium-businesses are owned and managed by relatively young people, this population is often more experienced than the average workforce or urban population: *“I now have my own construction company and I am proud of it. But it took me a lot of time before I could reach my goal and it will take even more time before I can rest! I started as a clerk in a small local NGO and I learnt additional skills, especially in accounting, procurement, and budgeting. After 5 years in that NGO, I created my company with my brother. It was in 2009 and we now have 8 full-time employees and a lot of part-time workers” (Aminullah, 36, Owner of a Construction Company, Kunduz).*

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<sup>7</sup> “Labour Market Survey – Faizabad and its surroundings” (“Samuel Hall Consulting” for AKDN-UCA), March 2010. During the course of this survey, 322 employers (106) and employees (216) were interviewed.

<sup>8</sup> Afghanistan Statistical Yearbook 2009-2010, Central Statistical Office (CSO), “Settled Urban Population by Age Group”.



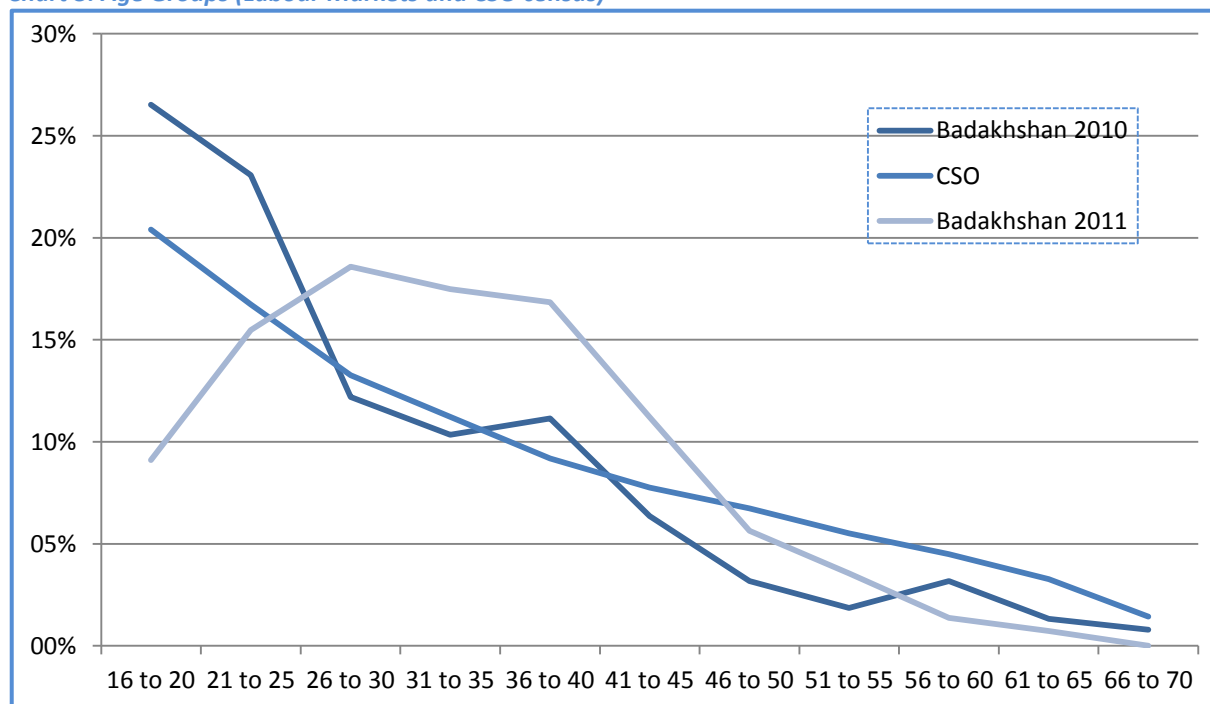
**Table 5: Age Groups (labour markets and CSO census)**

<b>Age Groups</b>	<b>Medium Businesses (GIZ-Badakhshan 2011)</b>	<b>Employers and Employees (AKDN-Badakhshan 2010)</b>	<b>Urban Population (CSO 2010)</b>
16 to 20	9,1%	26,5%	20,4%
21 to 25	15,5%	23,1%	16,7%
26 to 30	18,6%	12,2%	13,3%
31 to 35	17,5%	10,3%	11,2%
36 to 40	16,8%	11,1%	9,2%
41 to 45	11,2%	6,4%	7,8%
46 to 50	5,6%	3,2%	6,7%
51 to 55	3,6%	1,9%	5,5%
56 to 60	1,4%	3,2%	4,5%
61 to 65	0,7%	1,3%	3,3%
66 to 70	0,0%	0,8%	1,4%
<b>Mean</b>	33.2	29.4	No Data
<b>Median</b>	30	25	No Data
<b>Respondents</b>	167	322	No Data

\* Source: Afghanistan Statistical Yearbook 2009-2010, Central Statistical Office (CSO), "Settled Urban Population by Age Group" and Faizabad Labour Market Survey ("Samuel Hall" for AKDN, 2010)

The chart below confirms the fact that the age dispersion of the majority of medium-business owners and managers ranges between 25 and 40, which is quite indicative of what a representative of the ACCI in Faizabad called a "new category of experienced and skilled local entrepreneurs". More generally and if we consider the four targeted provinces, we can apply the same reasoning, as the average age of the interviewed business owners and managers was 33.6 years.

**Chart 3: Age Groups (Labour Markets and CSO census)**



**Function** – As defined in the objectives of this survey, the interview teams prioritized directors and managers, to get accurate information on the economic activity of the company as well as its relations with formal and informal institutions. As such, we considered that it was probably more adequate to get the direct perception and feedback of the top management. The table below shows that, on average, the research team interviewed more than four-fifth of the directors (82.1%) and owners (83.9%). The significant difference between Balkh (76.6%) and Badakhshan (85.5%) may be explained by the relatively higher complexity of Mazar-e-Sharif’s companies’ structure and environment (multiple shareholders, multiple relevant markets, etc.) – which was clearly confirmed in the different focus groups that were conducted with business owners: *“From my point of view, Mazar and Faizabad have nothing in common, when it comes to business. Mazar is almost a small hub in Central Asia, with a real economic potential and different markets. Faizabad is still isolated with no real internal demand and a weak business sector. It clearly explains the differences between the different business and entrepreneur profiles you have in these two cities”* (Senior Management, Economic Development, AKFED-AKDN).

*Table 6: Status and Function of the respondents (breakdown per province)*

Provinces	What is your function in the company?		Are you the owner of the company?		Number of Respondents
	Director	Manager	Owner	No	
Badakhshan	85.5%	14.5%	86.7%	13.3%	173
Balkh	76.6%	23.4%	79.0%	21.0%	167
Kunduz	83.9%	16.1%	85.6%	14.4%	180
Takhar	82.2%	17.8%	84.2%	15.8%	101
<b>TOTAL</b>	<b>82.1%</b>	<b>17.9%</b>	<b>83.9%</b>	<b>16.1%</b>	<b>621</b>

**Gender** – As shown in the table below, out of 621 respondents, only 1.6% were female interviewees (10 individuals). Most of them run carpet weaving and tailoring activities (6, including 4 directors and owners), beauty parlours (3, including 3 directors and owners), and health clinic (1 manager); moreover, 6 of them work in Balkh, which may also validate the assumption that Balkh is a more dynamic and modern city.

If we draw another comparison with recent labour market data applying similar methodologies, this information is – paradoxically – confirmed by 2010 data: there were 20.2% of female interviewees (without any gender quota) among the employees and employers of the “Faizabad Labour Market”<sup>9</sup>, with 15.1 % of female employers (21 out of 106); but only two of these female employers were running medium-sized businesses (with more than 5 employees), which tends to validate the very low percentage of female medium-business managers and owners that was found in Badakhshan (1.7% only, 3 out of 173 interviewees).

More anecdotally and surprisingly, out of the 14 beauty parlours that were surveyed, only 3 were run by women: *“Of course, beauty parlors are for women. But it’s better to let men run them as it gives a better and more professional image to the business. In Takhar, even women are happier when they see that the beauty institute is owned by a man”* (Mariam, Beauty Parlor employee, Takhar). Such a basic explanation might not be fully convincing but it shows that there is clearly a question of social acceptability that lies behind this dramatic gender underrepresentation at the upper managerial level.

<sup>9</sup> “Labour Market Survey – Faizabad and its surroundings” (“Samuel Hall Consulting” for AKDN-UCA), March 2010. During the course of this survey, 322 employers (106) and employees (216) were interviewed.

*Table 7: Gender of the respondents (breakdown per province)*

<b>What is the Gender of the Respondents?</b>			
<i>Provinces</i>	<i>Male</i>	<i>Female</i>	<i>Total</i>
Badakhshan	98.3%	1.7%	173
Balkh	96.4%	3.6%	167
Kunduz	99.4%	0.6%	180
Takhar	100.0%	0.0%	101
<b>TOTAL</b>	<b>98.4%</b>	<b>1.6%</b>	<b>621</b>

To corroborate these first figures, respondents were asked whether there were any female(s) among the owners of the firm. Once again, and based on the statement of the interviewees, only 2.7% of the surveyed companies reported having some women among their owners – Balkh (Mazar-e-Sharif) having a relatively lower gender imbalance (6.6%).

*Table 8: Function of the respondents (breakdown per province)*

<b>Amongst the owners of the firm, are there any females?</b>			
<i>Provinces</i>	<i>Yes</i>	<i>No</i>	<i>Respondents</i>
Badakhshan	2.3%	97.7%	173
Balkh	6.6%	93.4%	167
Kunduz	0.6%	99.4%	180
Takhar	1.0%	99.0%	101
<b>TOTAL</b>	<b>2.7%</b>	<b>97.3%</b>	<b>621</b>

**Education** – Table 9 below maps the existing disparity when discussing the average educational and literacy levels among the different provinces: when asked about their highest completed level of education, less than one-fourth (23.0%) of the respondents declared that they had not been to school with 18.5% declaring they were illiterate. If we take into consideration comparable and updated literacy rates in three of the targeted provinces (with the exception of Takhar)<sup>10</sup>, we can assume that business owners and managers display a level of literacy rate beyond that of most households (45.3% said that they had not attended school with 40.9% declaring they were illiterate). However, the significant percentage of illiterate respondents (18.5%) often impedes upon their capacity to deal with administrative issues and get accurate information on legal matters, “which fuels corruption and bribery, as “[businessmen] often use paralegal intermediaries, who take advantage of their ignorance of both the administration and the commercial law to make money” (ACCI Director, Mazar-e-Sharif).

Following the same logic, it is interesting to note that 14.5% of the respondents said that they had completed a university degree (to be compared with 5.1% only for Badakhshan, Balkh, and Kunduz households), which confirms that private business owners and managers are a more educated segment of the urban population, even if university degrees are not professional *per se* as: 1) the level of Afghan universities is still relatively poor and most departments rely on outdated manuals and pedagogic techniques; 2) the overall approach is overly theoretical and it is often difficult for University students to bridge the gap between the campus and the market place: “I graduated from Kabul University in economics but the courses and subjects were not in line with the real life anymore. We had manuals from 1960 sometimes. I decided to get additional courses in a private institute and I finally got a BBA from a famous training centre in Kabul, Kardan. But when I

<sup>10</sup> Badakhshan, Balkh, and Kunduz. See the “Review of WFP Food-for-Training Component” (“Samuel Hall Consulting” for WFP), December 2010. During the field work phase, 1217 different households were interviewed to provide WFP with an impact evaluation of its FFT component.

*moved to Mazar and started my own company, I realized that all the things I had learnt were inadequate for the local market!” (Mahboob, Owners of two companies in IT and construction, Mazar-e-Sharif).*

Finally, if medium business owners or managers tend to have a higher level of education than the average population, they often have very general and basic skills and acquired most of their business related skills through on-the-job experience (financial, legal, or administrative knowledge).

*Table 9: Education level of the respondents (breakdown per province)*

<b>What is the highest level of education you have completed?</b>								
<i>Provinces</i>	<i>Illiterate (no schooling)</i>	<i>Literate (no schooling)</i>	<i>Primary school</i>	<i>Secondary school</i>	<i>High school</i>	<i>Vocational Technical school</i>	<i>University</i>	<i>Total</i>
Badakhshan	21.4%	3.5%	9.8%	13.3%	37.6%	0.0%	14.5%	100%
Balkh	12.6%	4.2%	10.8%	13.8%	40.7%	1.2%	16.8%	100%
Kunduz	20.6%	3.9%	11.7%	11.7%	38.9%	2.8%	10.6%	100%
Takhar	19.8%	7.9%	8.9%	15.8%	29.7%	0.0%	17.8%	100%
<b>TOTAL</b>	<b>18.5%</b>	<b>4.5%</b>	<b>10.5%</b>	<b>13.4%</b>	<b>37.5%</b>	<b>1.1%</b>	<b>14.5%</b>	<b>100%</b>

More surprisingly, the percentage of respondents who reported having attended vocational or technical schools is really low (1.1%). In this regard, direct field observations confirmed that there are almost no vocational or technical schools in the four-targeted provinces, despite the recent and sharp increase of private training institutes. In other words, if it is now relatively easy to find accounting or English courses in Mazar-e-Sharif, Taloqan, Faizabad or Kunduz, it is still almost impossible to acquire vocational or technical skills through a professional and recognized institute. The few exceptions seem to focus on basic technical skills, like DED’s training centre in Faizabad, which teaches mechanics to young trainees (see picture below).

*Picture 4: DED Vocational Training Centre (Faizabad)*



Such an obvious gap may have to do with the specific industrial activity of these four provinces: as there is still no major production or transformation industry for the moment, the need for technical skills is limited to a basic set of learn-by-doing activities, like fixing machines (photocopiers, refrigerators, electrical fittings, cars, TV, etc.) or recycling objects (aluminium, steal, copper, but also plastic) rather than designing or producing new industrial components or items. This business characteristic is confirmed by the list of ISIC activities that were surveyed during the fieldwork; there are barely two or three medium businesses (out of 621) that belong to production or transformation industries and would require advanced technical skills.

## 2.2. Company Profiles

The table below describes the different companies that were surveyed (according to the “cluster then random” sampling methodology described in paragraph 1.3.3.). It was often difficult – if not impossible (in most peri-urban and remote places) – to find companies matching the definition and criteria of “medium businesses”, as only a few local businesses employ more than 5 people.

ISIC Code	Badakh.	Balkh	Kunduz	Takhar	Total	%
<b>A. AGRICULTURE, LIVESTOCK, FORESTRY</b>	<b>13</b>	<b>17</b>	<b>16</b>	<b>5</b>	<b>51</b>	<b>8.2%</b>
• <i>Agrticulture (Medium and Large Size)</i>	9	12	11	4	36	5.8%
• <i>Bee Farm</i>	1	1	0	0	2	0.3%
• <i>Livestock</i>	3	4	5	1	13	2.1%
<b>B. MINING AND QUARRYING</b>	<b>3</b>	<b>7</b>	<b>1</b>	<b>3</b>	<b>14</b>	<b>2.3%</b>
<b>C. MANUFACTURE</b>	<b>78</b>	<b>61</b>	<b>67</b>	<b>35</b>	<b>241</b>	<b>38.8%</b>
• <i>Bakery</i>	4	1	1	2	8	1.3%
• <i>Butcher</i>	6	2	4	4	16	2.6%
• <i>Carpentry</i>	12	10	11	6	39	6.3%
• <i>Carpet Weaving</i>	4	9	4	3	20	3.2%
• <i>Car Repair</i>	11	6	12	5	34	5.5%
• <i>Construction Manufacturing Company</i>	3	3	2	0	8	1.3%
• <i>Dried Fruit</i>	3	1	4	1	9	1.4%
• <i>Electric Components (Repair)</i>	5	2	5	0	12	1.9%
• <i>Furniture</i>	0	1	0	2	3	0.5%
• <i>Sewing, Embroidery</i>	6	7	5	3	21	3.4%
• <i>Tailoring</i>	10	9	8	4	31	5.0%
• <i>Welding</i>	14	10	11	5	40	6.4%
<b>D. ELECTRICITY, GAS, STEAM</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>1</b>	<b>0.2%</b>
<b>F. CONSTRUCTION</b>	<b>7</b>	<b>5</b>	<b>5</b>	<b>7</b>	<b>24</b>	<b>3.9%</b>
<b>G. WHOLESALE AND RETAIL TRADE</b>	<b>17</b>	<b>22</b>	<b>28</b>	<b>10</b>	<b>77</b>	<b>12.4%</b>
• <i>Car Sale</i>	0	6	6	3	15	2.4%
• <i>Electric Components (Sale)</i>	4	2	6	1	13	2.1%
• <i>Grocery Stores</i>	13	14	16	6	49	7.9%
<b>H. TRANSPORTATION AND STORAGE</b>	<b>1</b>	<b>4</b>	<b>6</b>	<b>2</b>	<b>13</b>	<b>2.1%</b>
<b>I. ACCOMMODATION AND RESTAURANT</b>	<b>7</b>	<b>9</b>	<b>10</b>	<b>7</b>	<b>33</b>	<b>5.3%</b>
<b>J. COMMUNICATION</b>	<b>12</b>	<b>14</b>	<b>12</b>	<b>12</b>	<b>50</b>	<b>8.1%</b>
• <i>Computer/IT</i>	3	5	4	8	20	3.2%
• <i>Stationery</i>	1	3	0	0	4	0.6%
• <i>Telecommunications (phones)</i>	8	6	8	4	26	4.2%
<b>K. FINANCIAL SERVICES</b>	<b>4</b>	<b>1</b>	<b>1</b>	<b>0</b>	<b>6</b>	<b>1.0%</b>
<b>L. REAL ESTATE</b>	<b>3</b>	<b>6</b>	<b>8</b>	<b>4</b>	<b>21</b>	<b>3.4%</b>
<b>M. PROFESSIONAL SERVICES</b>	<b>3</b>	<b>3</b>	<b>4</b>	<b>2</b>	<b>12</b>	<b>1.9%</b>
• <i>Business and Consulting Services</i>	0	1	0	0	1	0.2%
• <i>Legal and Accounting Activities</i>	3	2	4	2	11	1.8%
<b>N. SUPPORT ACTIVITIES</b>	<b>5</b>	<b>2</b>	<b>5</b>	<b>3</b>	<b>15</b>	<b>2.4%</b>
• <i>Travel (people)</i>	5	2	5	3	15	2.4%
<b>P. EDUCATION (TRAINING CENTRES)</b>	<b>3</b>	<b>6</b>	<b>8</b>	<b>4</b>	<b>21</b>	<b>3.4%</b>
<b>Q. HEALTH AND SOCIAL WORK</b>	<b>7</b>	<b>9</b>	<b>4</b>	<b>4</b>	<b>24</b>	<b>3.9%</b>
<b>R. ARTS AND RECREATION</b>	<b>4</b>	<b>6</b>	<b>4</b>	<b>0</b>	<b>14</b>	<b>2.3%</b>
• <i>Beauty Parlours</i>	4	6	4	0	14	2.3%
<b>U. NGOs (Local)</b>	<b>0</b>	<b>1</b>	<b>1</b>	<b>2</b>	<b>4</b>	<b>0.6%</b>
<b>TOTAL</b>	<b>167</b>	<b>173</b>	<b>180</b>	<b>101</b>	<b>621</b>	<b>100%</b>

The International Standard of Industrial Classification of All Economic Activities (ISIC) code was developed by the UN as a standard way of classifying economic activities. The ISIC system is now used widely by governments and international bodies as a way of classifying data according to economic activity, which helps standardize data collection and promote international comparability.



## 2.2.1. Ownership and Legal Structure

Asked how they had acquired their company, 80.3% of owners indicated that they had created their company using their own money (Table 11); symmetrically, table 12 shows that a large majority (74.2%) of business owners declared the legal status of their company being one of “sole proprietorship”. It confirms that most medium business owners are individual entrepreneurs, who generally create their companies themselves or, to a much lesser extent, inherit the company from their family. From this point of view, it’s worth noting that there is almost no significant difference between small (less than 6 employees) and medium businesses (more than 5 employees) when it comes to ownership and legal structure, as both have similar characteristics (basic unipersonal structures run by the founder and owner). Lastly, when disaggregated, these data show that there is no significant differences between activities: construction companies, retail shops, real estate agencies and even local NGOs often have similar profiles. As heard in a large majority of the focus groups that were conducted with business owners, “Local company proprietorship and legal structures are very simple in [Kunduz], because [businessmen] mostly focus on short-term benefits: [they] don’t want to invest money in complex structures, with multiple people, for several years. We don’t have enough business skills for it and it would be too risky in such a versatile environment” (Ehsanullah, Construction company, Kunduz).

*Table 11 and 12: Status of the company (breakdown per province)*

How did you (or the owner) acquire this company?					
Provinces	He/I inherited it	He/I bought it to someone else	He/I created it with his/my own money	Other	Respondents
Badakhshan	11.6%	0.0%	87.9%	0.6%	173
Balkh	24.0%	4.2%	71.3%	0.6%	167
Kunduz	23.6%	1.1%	74.7%	0.6%	180
Takhar	6.9%	1.0%	92.1%	0.0%	101
<b>TOTAL</b>	<b>17.6%</b>	<b>1.6%</b>	<b>80.3%</b>	<b>0.5%</b>	<b>619</b>
What is the legal status of this company?					
Provinces	Sole proprietorship	Partnership	Limited Liability Enterprise		Respondents
Badakhshan	69.4%	19.1%	11.6%		173
Balkh	73.7%	15.0%	11.4%		167
Kunduz	79.4%	16.1%	4.4%		180
Takhar	74.3%	11.9%	13.9%		101
<b>TOTAL</b>	<b>74.2%</b>	<b>15.9%</b>	<b>9.8%</b>		<b>621</b>

## 2.2.2. Employees

A breakdown of the surveyed companies by numbers of employees in the four provinces shows that a large majority (54.6%) has between 5 to 9 employees. It highlights the fact that the category of medium-businesses is mostly composed of small economic structures, with basic pyramidal hierarchies and no HR, finance, or legal departments. Not surprisingly, Balkh offers a very specific profile with a relatively reduced proportion of 5-to-9 employee companies and a larger segment of 10-to-19 employee companies (49.1%), which confirms the preeminent economic status of Mazar-e-Sharif in the North of Afghanistan; correlatively, companies with more than 20 employees account for 9.0% of the provincial total in Balkh, when their proportion is only 5.9%, on average for the 3 other provinces).

*Table 13: Full-time employees (breakdown per province)*

How many full-time employees work in your company today?					
Provinces	Between 5 and 9	Between 10 and 19	Between 20 and 99	More than 99	Respondents
Badakhshan	61.8%	34.1%	3.5%	0.6%	173
Balkh	41.9%	49.1%	7.8%	1.2%	167
Kunduz	60.0%	32.8%	4.4%	2.8%	180
Takhar	53.5%	38.6%	7.9%	0.0%	101
<b>TOTAL</b>	<b>54.6%</b>	<b>38.5%</b>	<b>5.6%</b>	<b>1.0%</b>	<b>621</b>

If we now consider the employment dynamics of the surveyed companies, it is interesting to note that among the 591 companies that were created prior to 2010, almost of them declared having hired additional employees: *“five years ago, we started with a very small structure of 2 employees and, progressively, we hired new people with different sets of technical skills, which allowed us to provide new services and develop our business”* (Mostafa, Dry fruit company, Kunduz). As shown in table 14 below, the employment increase rates are quite impressive when comparing the number of full-time employees at the start of the company and at present: +279% in Kunduz, +200% in Balkh, +186% in Takhar, and “only” +141% in Badakhshan (on average). Such impressive increase rates tend to indicate that companies have progressively increased their activity: most of them have started with 2 to 5 employees and have managed to develop their business, capital, and number of employees in a relatively positive and dynamic business climate – highly favourable to entrepreneurship and flexible business structures.

Correlatively, when respondents were asked to indicate the number of the owner’s relatives (family only) directly working as full-time employees of the company, on average, one-third of the full-time employees are owner’s relatives, as shown in table 14 below. Many different reasons can explain this nepotism: 1) as diplomas have no practical value on the labour market, most employers tend to favour interpersonal network as a professional guarantee; 2) as labour regulations are almost non-existent (in practice) for small and medium enterprises, it becomes a way to hire people at a lower cost and keep the money in the family circle.

Lastly, when we consider the gender breakdown, an average 14.3% of full-time employees were said to be female employees; once again, Balkh tends to differ from other provinces with a significantly higher rate (19.6% when the other three provinces have only 12.2% of female employees): *“It is easier for us to work in Mazar than in Balkh or Sholgara, because Mazar is the centre of the province and people are less traditionalist and more open minded (...). It’s the same with other provinces: you cannot go freely in the streets of Kunduz or Takhar if you are a woman, but you can walk in many streets of the centre of Mazar”* (Mehwish, NGO Field Officer, Mazar-e-Sharif and Kunduz).

*Table 14: Information on the employees of the company (breakdown per province)*

<b>Information on the employees of the company</b>				
<i>Provinces</i>	<i>Number of Full-Time Employees when the Business started</i>	<i>Number of Full-Time Employees Today</i>	<i>Percentage of Relatives among Full-Time Employees</i>	<i>Percentage of Female Full-Time Employees</i>
Badakhshan	2.9	7.0 (+141%)	27.6%	13.8%
Balkh	3.6	10.8 (+200%)	35.9%	19.6%
Kunduz	3.3	12.5 (+279%)	34.1%	11.8%
Takhar	2.9	7.3 (+186%)	31.1%	10.0%
<b>TOTAL</b>	<b>3.2</b>	<b>9.7 (+203%)</b>	<b>33.0%</b>	<b>14.3%</b>

### 2.2.3. Company Income

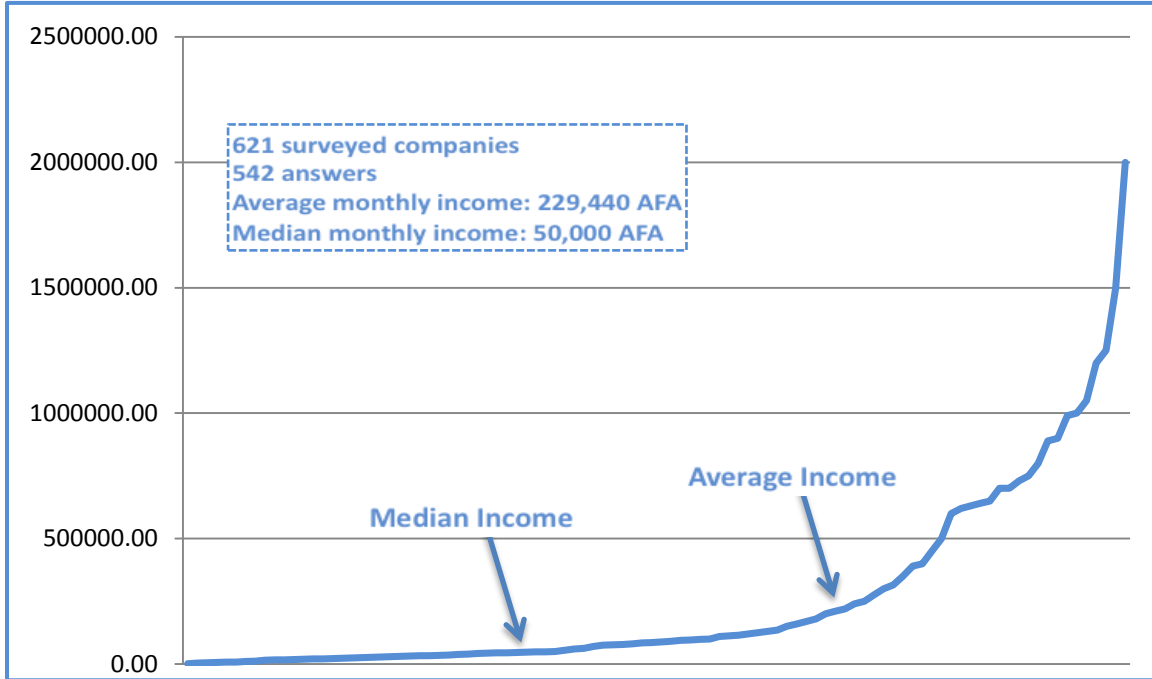
To better grasp the economic reality of the targeted markets, business owners were asked to provide their average monthly income. All the data provided below should be taken with a grain of salt, as: 1) the information source is only declarative (and thus based on a subjective and individual assessment); 2) many local businessmen do not consider “monthly income” as a relevant baseline and do not use it as a budgetary milestone; 3) some respondents do not understand clearly the difference between key concepts like “income”, “benefits”, “cost”, etc, which may also undermine the accuracy of our data<sup>11</sup>. However, considering the high answer rate on such a sensitive issue, our data does provide representative and reliable business indicators: out of 621 companies, 542 accepted to answer, which is more (87.3%) than the usual rate (between 70% and 75% based on 4 comparable business or market surveys).

As shown in chart 4 below, the average monthly income was AFA 229,440 (equivalent to US\$ 4,987); however, most medium company income levels are way below this line and the median income is closer to AFA 50,000 (or US\$ 1,090). We can infer from such a strong difference between average and median monthly incomes that medium size businesses are not a homogenous economic category and offer a wide range of socio-economic profiles – from the small stationery shop that employs 5 full-time unskilled workers to the large construction company directly works with local PRTs, has its own finance department, and employs 10 full-time semi-skilled people and 50 to 100 temporary workers.

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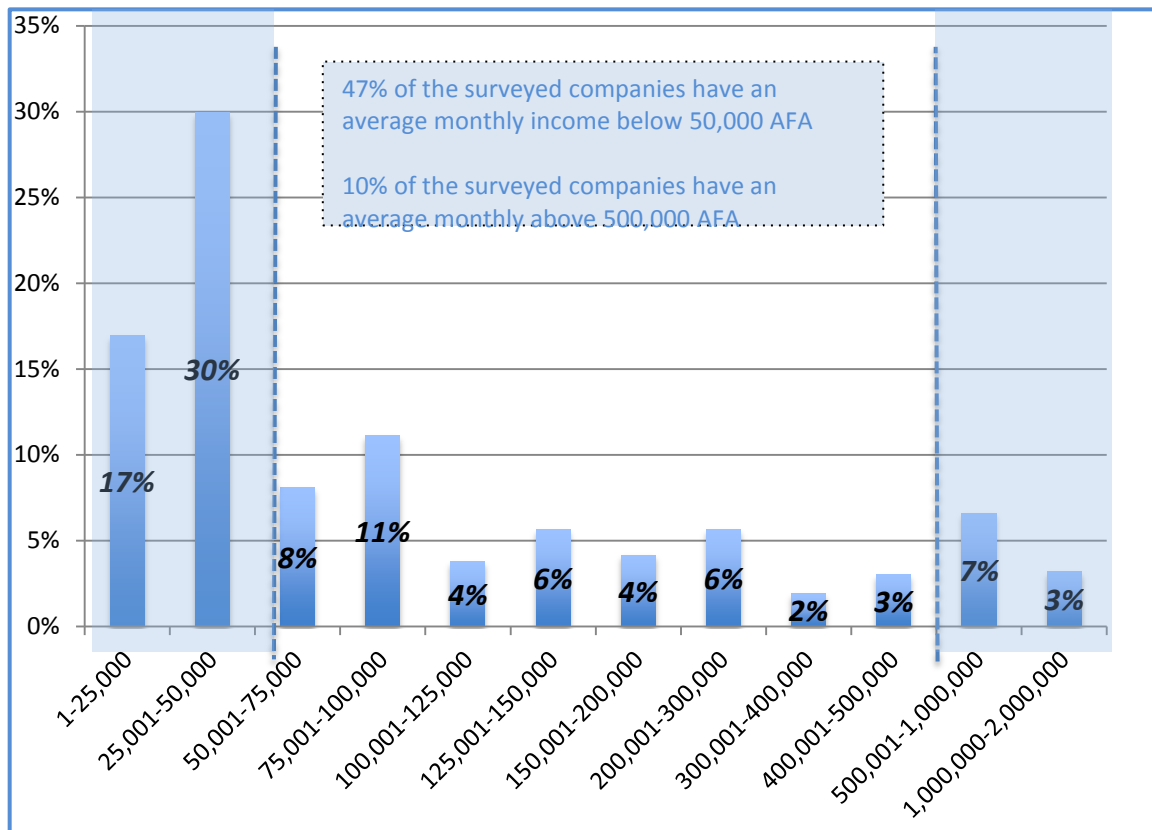
<sup>11</sup> It should be noted, however, that we specifically monitored and double-checked the 10% of extreme answers (30 companies with the lowest income and 30 with the highest income).

Chart 4: Companies' Income (1/2)



From the same perspective, a breakdown by income highlights the fact that medium-sized businesses are composed of a large basis of low-revenue companies (47% below 50,000 AFA per month), by contrast with the 10% of companies that earn more than 500,000 AFA of monthly income, as shown in the graph below.

Chart 5: Companies' Income (2/2)



Finally, respondents were asked to indicate whether the income of their company: 1) had increased or decreased compared with the previous year, and; 2) would increase next year compared with this year. These questions do not only provide interesting economic and business indicators, they also reflect the perception of the business community towards the local environment. In these regards, it is worth noting that:

- 1) Overall, 48.5% of the 542 respondents said that the income of their company had increased compared to the previous year. There are, however, significant differences among the surveyed provinces (41.1% only in Balkh, but 52.9% in Badakhshan and 60.4% in Takhar) which might be explained by the dynamism of Takhar and Badakhshan in comparison with previous years: *“It is now easier to have access to Faizabad by road from Taloqan or Mazar thanks to all the international investments in road construction. As a consequence, the local business market, especially in Badakhshan, and to a lesser extent in Takhar, is getting bigger everyday, with more opportunities, more offer and more demand”* (CSO Data Analyst, Kabul);
- 2) There is a clear gap between low-income (less than 50,000 AFA per month) and high-income companies (more than 50,000 AFA per month), as only 45.0% of the former declared that their income had increased compared with a year before, when 51.6% of the latter said that it had increased, which may be explained by the fact that *“most bigger local companies have now understood that they needed to develop sound management and cost-effectiveness techniques to mitigate the impact of bad business years and keep making profit regardless of the context”* (Project Manager, ASMED, Mazar-e-Sharif);
- 3) The level of confidence that medium business owners and managers show for the local business climate is more than encouraging, as 54.3% of them consider that they will increase their income next year. Once again, low-income companies tend to be relatively more pessimistic (51.8% only); by contrast, Balkh respondents, who had reported a moderate increase in their income for this year (compared with other provinces), showed a great optimism for next year, with 64.0% of them considering that their income of their company would increase (to be compared with 50.8% for the other three provinces).

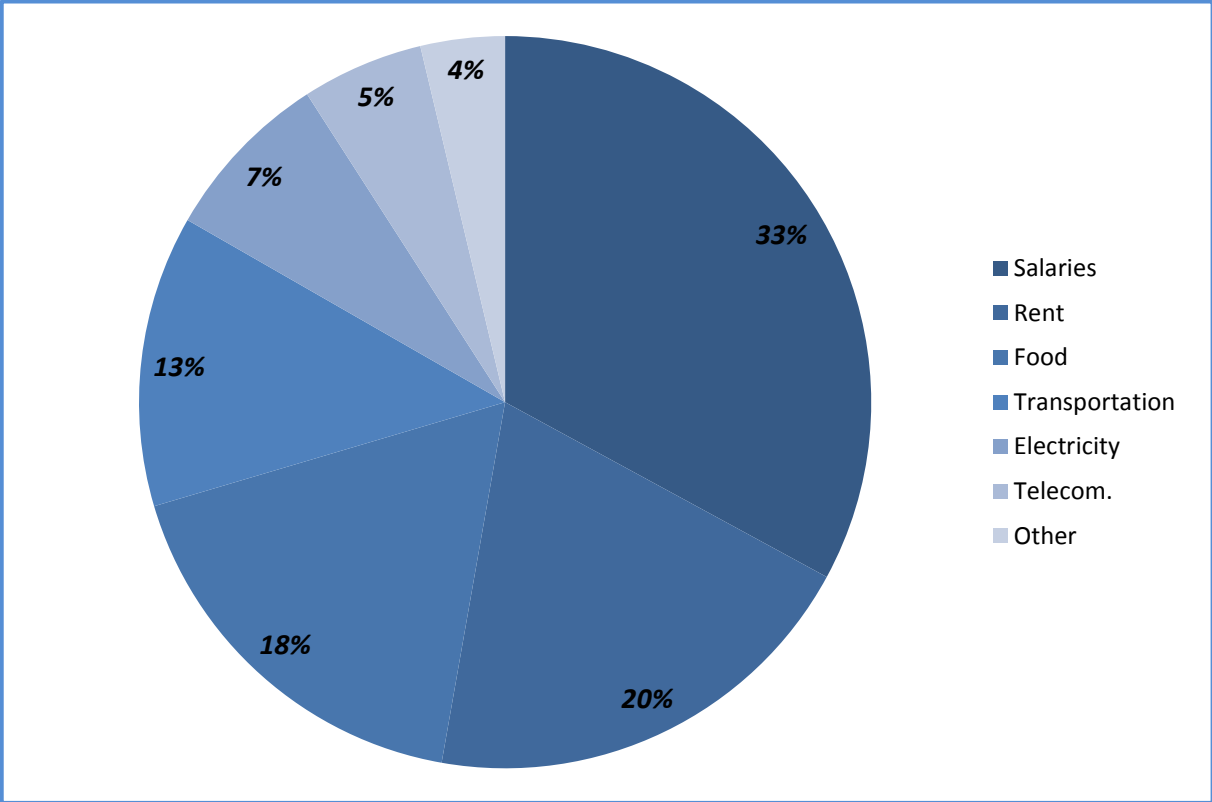
*Table 15 and 16: Income and business trends (breakdown per province)*

<b>Has the income of the company increased or decreased compared with last year?</b>						
<i>Provinces</i>	<i>Increased</i>	<i>Decreased</i>	<i>Stayed the Same</i>	<i>No Income (New Company)</i>	<i>No Answer</i>	<i>Respondents</i>
Badakhshan	52.9%	31.8%	12.9%	0.6%	1.8%	170
Balkh	41.1%	31.9%	23.9%	3.1%	0.0%	163
Kunduz	44.4%	42.2%	12.8%	0.6%	0.0%	180
Takhar	60.4%	30.7%	5.9%	2.0%	1.0%	101
Lowest Incomes	45.0%	36.0%	16.3%	2.2%	0.5%	255
Highest Incomes	51.6%	33.5%	13.3%	0.9%	0.9%	287
<b>TOTAL</b>	<b>48.5%</b>	<b>34.7%</b>	<b>14.7%</b>	<b>1.5%</b>	<b>0.7%</b>	<b>542</b>
<b>According to you, will the income of the company increase or decrease compared with this year?</b>						
<i>Provinces</i>	<i>Increase</i>	<i>Decrease</i>	<i>Stay the Same</i>	<i>No Answer</i>	<i>Respondents</i>	
Badakhshan	52.9%	12.9%	20.0%	14.1%	151	
Balkh	64.0%	11.0%	16.5%	8.5%	148	
Kunduz	45.0%	18.3%	23.3%	13.3%	154	
Takhar	57.4%	10.9%	22.8%	8.9%	89	
Lowest Incomes	51.8%	14.2%	18.1%	15.9%	255	
Highest Incomes	57.0%	13.3%	22.6%	7.6%	287	
<b>TOTAL</b>	<b>54.3%</b>	<b>13.7%</b>	<b>20.5%</b>	<b>11.5%</b>	<b>542</b>	

**2.2.4. Company Expenses**

Similarly, employers were asked to estimate their cost structure. The answers that were gathered provide a good picture of the relative cost structure of the surveyed companies (see table 17 below): salaries are the main budget item (33%), followed by rental costs (20%), food (18%), and transportation (13%). Electricity and heating expenses (7%) are of course extremely volatile throughout the year and we can only provide a specific snapshot that does not reflect the average day and was probably under-estimated by the interviewees as most companies use city power.

*Chart 6 and Table 17: Company expenses (breakdown per province)*



What are the main budget items of this company?								
Provinces	Salaries	Rent	Food	Transportation	Electricity	Telecom.	Other	TOTAL
Badakhshan	31.0%	14.5%	17.6%	19.5%	10.5%	5.8%	1.1%	37,109
Balkh	35.5%	19.4%	14.8%	9.2%	8.3%	4.4%	8.3%	36,344
Kunduz	32.7%	18.9%	19.3%	12.4%	5.3%	5.6%	5.7%	34,964
Takhar	32.9%	21.6%	19.7%	10.6%	6.4%	5.9%	2.9%	42,326
Total	32.9%	19.9%	17.6%	12.9%	7.6%	5.4%	3.7%	37,342

If we narrow down the analysis to the provincial level, the relative weight of salaries is systematically confirmed and tends to be the major budget item (from 31.0% in Badakhshan to 35.5% in Balkh). By contrast, there are significant differences for other budget items: for instance, transportation and electricity account for a higher budget proportion in Badakhshan where “road accessibility and access to city power are still the most important problems” (Assadullah, Mechanics, Faizabad).



## 2.2.5. Auditing and Certification

Last, to draw a more accurate image of the surveyed medium-size businesses in the four-targeted provinces, respondents were asked if the financial statements of their companies were checked by external auditors (at least once a year). The figures below clearly show that auditing and certification have still not become part of everyday business life: only 3.7% reported having their financial statements regularly checked by external auditors.

**Table 18: External auditors (breakdown per province)**

Does this company have its financial statement checked by an EXTERNAL auditor?				
Provinces	Yes	No	I do not know	Total
Badakhshan	4.0%	94.8%	1.2%	173
Balkh	5.5%	92.1%	2.4%	165
Kunduz	1.1%	98.9%	0.0%	179
Takhar	5.0%	95.0%	0.0%	100
<b>TOTAL</b>	<b>3.7%</b>	<b>95.3%</b>	<b>1.0%</b>	<b>617</b>

A specific focus group on accounting and auditing practices tends to confirm that medium-size companies do not understand the reason why they should check their accounts regularly:

- *“It is often impossible or very expensive to find people to check your account. Takhar is not Kabul and we do not have this kind of people here” (Esmatullah, IT Company, Taloqan).*
- *“Even if our accounts were checked and double-checked, it would not be useful for the department of finance because most of the employees of the DoF do not have a clue of what an account is” (Ibrahim, Stationary, Taloqan).*
- *“There are no reason why we should pay additional money for something that nobody uses here. If employees of the DoF come to visit you and have a look at your financial statements, you can always fix the right price with them. It’s all about negotiation and not about regulations”. (Ehsan, Construction Company, Taloqan).*

Correlatively, less than one-fourth of the surveyed companies (22.7%) reported having a specific bank account for their company. For once, Badakhshan is clearly one step ahead: 28.9% of the surveyed mid-size companies have their own bank account, which can be explained by the relatively high number of banks (Azizi, Maiwand, Kabul Bank, etc.) and micro-finance institutions (BRAC, FMFB) in Faizabad.

**Table 19: Bank and saving account (breakdown per province)**

Does this company have a bank/saving account?				
Provinces	Yes	No	I do not know	Total
Badakhshan	28.9%	71.1%	0.0%	173
Balkh	24.0%	73.7%	2.4%	167
Kunduz	15.0%	84.4%	0.6%	180
Takhar	23.8%	76.2%	0.0%	101
<b>TOTAL</b>	<b>22.7%</b>	<b>76.5%</b>	<b>0.8%</b>	<b>621</b>

*Findings extracted from the Faizabad Labour Market Assessment (for AKDN-UCA, 2010)*

Despite a relatively flaccid local economic activity, Faizabad companies now seem to understand the potential benefits they can get from credits and loans in a province where traditional abusive loans (with prohibitive interest rates that led many farmers into debt traps) are progressively replaced by micro-finance for both personal and professional investments. Micro finance institutions (namely BRAC and FMFB) have introduced products such as loans for traders, re-conversion loans, which are high but non-abusive (with interest rates of, respectively, 1.50% and 1.25% a month) and stimulate entrepreneurship not only in Faizabad but also in the most important Badakhshani cities (Kishm, Baharak, Jurm, Yumgan, Ishkashem, Shighnan, Darwaz, and Zebak).

*Pictures XXX and XXX: FMFB agency and Microcredit loan beneficiary in Faizabad*



Other interesting initiatives, conducted by NGOs, tend to develop a new culture in the province, like the Self Help Groups (SHGs) formed in Baharak, Jurm or Ishkashim by AKF or Mission East. They have revealed an authentic potential to mobilize resources through savings by providing affordable credit to SMEs (mostly agricultural companies or cooperatives).

### 3. Companies' Attitudes towards Laws and Regulations

To understand the nature of the relationship between medium-sized companies and the commercial law framework, the following section sheds the light on the different aspects of the business life, by focusing not only on technical aspects but also on legal ones: Do companies respect the law? And how do they perceive laws and regulations? The attitude of medium-sized business representatives towards laws and regulations is quite ambiguous: on the one hand they tend to respect the local *practices* with regards to the commercial laws and regulations; on the other, they do not necessarily understand the actual significance and potential benefits of registration, labour laws, trade laws, tax systems, etc. In these regards, both ACCI and AISA, which could play a key advocacy role, still suffer from either structural efficiency deficits or a lack of recognition. This absence of institutional support may also explain why Afghan medium-size businesses mostly operate at a local and domestic level – with only a handful of the surveyed companies that have access to foreign markets (for importing or exporting goods).

#### 3.1. Registering

To better grasp the awareness and effectiveness of the registration process among the four provinces and the 621 companies, respondents were asked to answer questions about both the status of the company with regards to the registration *and* to their understanding and acceptance of the process itself. Table 20 below shows that a large and homogenous majority of the respondents knew that a private company or organisation has to be officially registered to operate: from 90.3% in Balkh to 95.0% in Takhar.

Table 20: Registration Awareness (breakdown per province)

Do you know that a company has to be officially registered to operate?		
Provinces	Yes, I know	Respondents
Badakhshan	92.9%	172
Balkh	90.3%	167
Kunduz	93.9%	180
Takhar	95.0%	101
<b>TOTAL</b>	<b>92.9%</b>	<b>620</b>

Correlatively, on average and as shown in table 21 below, 93.1% (578) of the 620 surveyed owners and managers reported being officially registered<sup>12</sup>. During the interview, respondents were systematically asked to show the interviewer a copy of their license, so that interviewers can make sure that: 1) companies were actually registered; 2) both parties shared the same understanding of registration requirements. Thanks to this empirical double-check, we found out that: 78.6% of the surveyed companies were registered with the local Department of Finance (DoF) and 77.0% with the municipality. In practice, it means that most companies reported paying taxes to the DoF and being identified by the Municipality; however, it does not mean that local medium companies: 1) are actually registered, 2) do understand the actual significance and potential benefits of registration.

Moreover, most companies are not registered with their line Ministry, despite all the official explanations we got from different governmental counterparts, stating that “a private company has

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<sup>12</sup> Among the non-registered companies, when asked to give the reason(s) why they were not registered, 55% said that they did not know it was necessary, 51% that they did not have enough information, and 33% that they did not have enough money; by contrast, only 16% said that the process was not fair and transparent enough and only 19% said it was a waste of time.

to be registered with the Ministry of Commerce or the AISA, and with his line Ministry: Ministry of Tourism for travel agencies, Ministry of Public Work for construction companies, Ministry of Education for private training and education centres” (Senior Officer, Ministry of Commerce, Kabul). Overall, only 7.5% of the surveyed companies reported being registered with their line Ministry (see table below: Departments of Education, Transportation, Public Health, Agriculture and Irrigation, Justice, Communication, Tourism, or Rural Rehabilitation and Development).

Lastly, the review team also noticed, through direct qualitative observations and focus group discussions with local businessmen, that:

- In spite of the official and legal stamp provided by the line Department or the Department of Commerce (if any) or by the Municipality itself, registration procedures seems unlikely to ensure that registered companies actually meet the basic administrative, financial, and qualitative requirements that one could expect from medium-sized private companies;
- The official representatives in charge of the registration process have no practical expertise of their respective sector: “These civil servants are supposed to decide whether I can teach or not, but they would be unable to pass our entrance exam” (Aziz, Teacher, Learning Centre, Faizabad).

In short, registration procedures tend to be a formality with an overly flexible technical and regulatory frame, which allows governmental departments or local Municipalities to get their commission at the same time.

**Table 21: Registration status (breakdown per province and organisations)**

Are you registered with one of the following organisations?						
	Badakh.	Balkh	Kunduz	Takhar	Respond.	Percentage
DoF	82.1%	70.1%	82.1%	81.2%	488	78.6%
Municipality	83.2%	63.5%	81.0%	82.2%	478	77.0%
DoE	5.2%	15.0%	14.5%	6.9%	67	10.8%
AISA	8.8%	13.0%	11.7%	6.9%	65	10.5%
ACCI	6.4%	12.0%	11.2%	4.0%	55	8.9%
DoEd	0.6%	2.4%	3.9%	2.0%	14	2.3%
DoTransportation	0.6%	0.6%	2.2%	5.0%	11	1.8%
DoPH	0.6%	3.6%	0.0%	3.0%	10	1.6%
AIBA	0.0%	0.6%	2.2%	0.0%	5	0.8%
DAIL	0.0%	0.6%	1.7%	0.0%	4	0.6%
Craftsman Union	1.2%	0.0%	1.1%	0.0%	4	0.6%
DoJ	1.2%	0.0%	0.6%	0.0%	3	0.5%
DoCommunication	0.6%	0.6%	0.0%	0.0%	2	0.3%
DoTourism	0.0%	0.6%	0.0%	0.0%	1	0.2%
DoRRD	0.6%	0.0%	0.0%	0.0%	1	0.2%
<b>Not Registered</b>	<b>4.6%</b>	<b>14.4%</b>	<b>3.4%</b>	<b>5.0%</b>	<b>43</b>	<b>6.9%</b>

Lagging behind Departments of Finance, Municipalities, and Departments of Economy, two organisations seem more promising and professional: the *Afghan Chambers of Commerce and Industry* (ACCI) and the *Afghan Investment Support Agency* (AISA, “the one-stop shop for investors”).

**ACCI** – The Afghan Chamber of Commerce and Industry (ACCI) is headquartered in Kabul and operates in 21 provinces (including Balkh, Kunduz, Takhar, and Badakhshan). Created in 1931, the ACCI benefits from both a strong establishment throughout the country and a relatively good international image. ACCI is an independent organisation that is serving the advocacy and business facilitation needs of the private sector; it claims that its current membership exceeds 37,000 private

sector organisations. However, there seems to be a significant gap between the institutional image and the actual mission of the organisation: *“the organisational capacity of ACCI headquarter in Kabul is strong with visionary leadership and a capable secretariat; but the situation is less encouraging in ACCI provincial branches”* (AKF Programme Manager, Economic Development, Kabul Office). At national and international levels, it seems that the mission of the ACCI is twofold:

- 1) Being a commercial showcase of the country, with many partnerships – for instance, with the Dutch Employer’s Cooperation Programme (DECP), the USAID’s Trade and Accession Facilitation for Afghanistan (TAFa) project, the Czech Chamber of Commerce, the German Federal Ministry for Economic Cooperation and Development, the German Trade and Investment Agency, and of course GIZ;
- 2) Passing on political messages to Afghan traders and voicing governmental propaganda, in a context of increasing tension between Pakistan and Afghanistan: *“Our role is also strategic as we have to make sure that not only our members but also the government and international organisations understand the duplicity of the Pakistan side, as shown in the scandalous non-implementation of the APTTA (Afghanistan Pakistan Transit Trade Agreement)”* (Director of ACCI, Kabul).

Notwithstanding the key advocacy role, the ACCI still suffers from a strong imbalance between Kabul and the provinces. The provincial branches are semi-autonomous entities, with all the policy related issues directed by the Kabul-based headquarters. The provincial board is locally elected but the staff members are selected and paid for by the ACCI from Kabul. The locally elected provincial board ensures governance at the local level, but having centrally appointed and salaried staff does not create a sense of urgency to make the provincial chamber a sustainable one.

The four surveyed ACCI provincial offices are still hindered by a clear capacity deficit: a poorly educated staff, a sclerotic bureaucracy, absenteeism, the absence of dedicated buildings, and a general inability to fulfil basic business services are some of the complaints that have fuelled these perceptions: *“In Mazar, the ACCI takes advantage of its position, between the Departments of Justice and Commerce. When you have a commercial dispute, for instance, they provide illiterate businessmen with contacts within the DoJ or DoC. They tell them to pay middlemen and get money themselves for their advice. To make it short, they are not business facilitators, they only want to have their share of the corruption pie”* (Esmatullah, Director, Electronics, Mazar-e-Sharif).

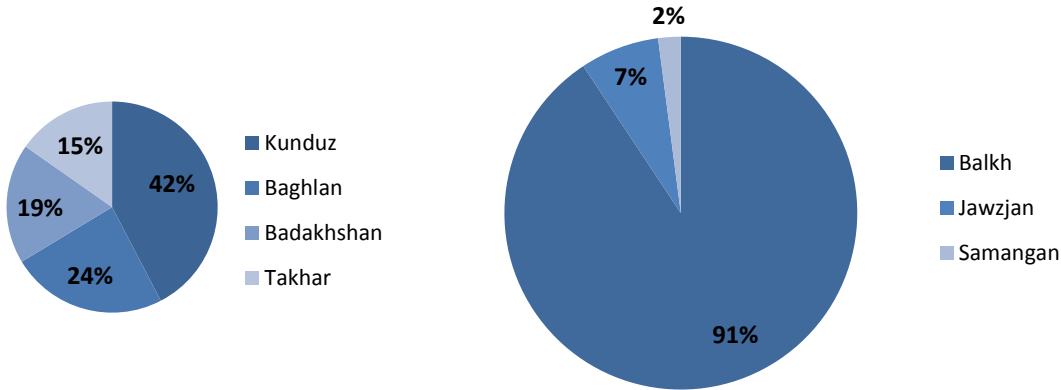
To corroborate these recurrent field observations, the review team also noticed that the “Legal Services and Arbitration Department” (which is supposed to provide ACCI members with advice on the legal framework pertaining to business laws and regulations) has no existence but in the status of the organisation. This unit was actually established to be a mediation body aligned on international arbitration standards (jurisprudence, dispute settlement, property rights, etc.); however, none of the four surveyed offices in Mazar-e-Sharif, Kunduz, Taloqan or Faizabad, had heard about it, which tends to confirm the significant gap between the ACCI Kabul and the provincial offices: the former has a political agenda (governmental messages and strategic international partnerships), while the latter are for the moment unable to provide even basic business or information services to their members.

Another striking feature of local chambers of commerce is the total absence of interaction between ACCI and AISA (see below) in the two cities where the AISA has offices (Mazar-e-Sharif and Kunduz). This absence of communication between the two agencies may take root in: 1) their distinct historical background, as AISA is often perceived as a recent foreign institution while ACCI is considered as a traditional and well-accepted institution; 2) their frequent overlaps (registration, investment promotion, investors’ support, industrial park development, etc.). As such, there is clearly an opportunity to build on AISA’s structural efficiency and ACCI’s historical authority among Afghan companies.

**AISA** – If we take the World Bank *Doing Business 2011* for Afghanistan as a common reference, it seems that the country scores low on most “doing-business” indicators and ranks 167 globally. However, business registration is an area where Afghanistan is close to international best practices. The creation of the Afghanistan Investment Support Agency registration process – which is theoretically the official registration agency with the Ministry and Departments of Commerce – puts Afghanistan in 25<sup>th</sup> place worldwide on the ease of starting a business in 2011 (and 17<sup>th</sup> in 2007)<sup>13</sup>. Unfortunately, the following section shows that most medium-sized companies still do not benefit from the recognised quality of the services provided by the AISA at both national and regional levels.

As the AISA kindly accepted to send us the full lists of AISA registered companies (as of March 2011) for both Mazar-e-Sharif (1213 companies in Balkh, Jawzjan, and Samangan provinces) and Kunduz (518 companies in Kunduz, Baghlan, Badakhshan, Takhar provinces) offices, it was striking to notice that most registered companies are located in the provinces where AISA offices operate: respectively, 91% and 42% of AISA registered companies in Balkh and Kunduz are also located in Balkh and Kunduz, which validates the idea that “AISA regional offices, despite all the benefits that they can bring to local businesses, are often too far from secondary provinces and either people don’t know what we do and what they can get from us, or they don’t want to pay additional costs, like travel and registration fees, for an agency that is not close to their province” (Senior Management, AISA, Mazar-e-Sharif Office).

**Charts 7 and 8: Companies registered with AISA (518 in Kunduz and 1213 in Balkh)**



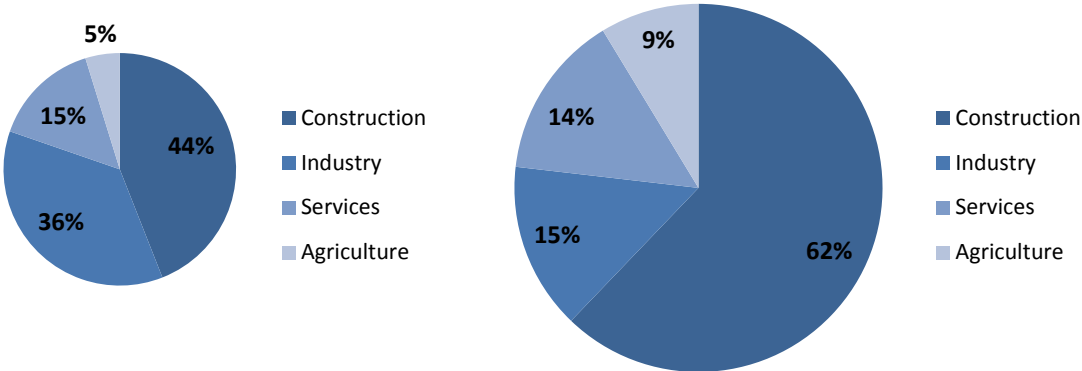
If we now focus on the sector of the registered companies, the relative weight of construction companies among the officially AISA registered entities is quite significant: as shown in the two charts below, and based on AISA’s own activity categorization, 39% for the Kunduz office and 62% for the Balkh office. The main reason seems to be the need for most construction companies to be registered with both AISA and Department of Finance to get bigger contracts: “If you want to bid on big construction contracts with governmental organisations or international agencies, you need to be registered and the administrative has to be transparent from the first day. Otherwise, they choose other competitors, whatever the quality and skills of the company” (Besmullah, Construction Company, Mazar-e-Sharif). Therefore, there is strong evidence that only a small fraction of non-construction companies are officially registered with AISA, and once again “[they] register to be in the position to win contracts with NGOs and international organisations. The first time I sent a proposal to a European NGO for pipes, they told me that I needed to get registered first. I did not get the

<sup>13</sup> See <http://www.doingbusiness.org/data/exploreconomies/afghanistan>



contract but I finally got registered with AISA and now I have worked several times with the Aga Khan [Foundation] and GIZ over the last three years” (Mohammad, Plastic Industry, Badakhshan).

Charts 9 and 10: Companies registered with AISA (breakdown by economic activity)



When turning to the findings of our survey, only on-fourth of the 621 respondents (24.8%) answered positively when asked whether they knew the AISA. Behind this relative lack of recognition of AISA from most local companies, there are a few key elements to take into account:

- 1) If AISA benefits from an excellent image and reputation among the international community, its status is still unclear for most local companies, as the difference with other agencies (and especially the MoC and local municipalities) is not always acknowledged and as they barely perceive the benefits they can get from an official registration: *“I wish the company were registered with AISA, but honestly, I still don’t know why I should be registered with them – or any other agency! What would I pay 5,000 AFA every year if I don’t get anything from this investment and if I don’t need it? With 5,000 AFA, there are a lot of things I can do for this shop”* (Esmatullah, Computer and IT Solutions, Mazar-e-Sharif).
  
- 2) AISA’s offices in the four targeted areas are located in Mazar-e-Sharif and Kunduz only, which often prevents companies from other provinces (Takhar and Badakhshan) or remote districts from registering their entity. The table below highlights this point, as Balkh and Kunduz are the provinces with the highest percentages of companies that both know and are registered with AISA. In this regard, 28.2% of the respondents surveyed in Balkh knew of AISA and 13.0% of the companies located in Balkh were registered with AISA; following the same logic, 26.0% of Kunduz interviewees knew of AISA and 11.7% of the companies located in the Kunduz province were registered with AISA. By contrast, the lower registration rates in Badakhshan (8.8%) and Takhar (6.9%) correspond to lower awareness rates (respectively 21.4% and 21.2%). At a provincial level, the same reasoning applies, as none of the 68 companies located in periurban areas and none of the 19 companies located in remote districts knew of AISA (or were registered with the agency).

Table 22: AISA awareness (breakdown per province)

Do you know the Afghanistan Investment Support Agency?			
Provinces	I know the AISA	I am registered with AISA	Respondents
Badakhshan	21.4%	8.8%	167
Balkh	28.2%	13.0%	173
Kunduz	26.0%	11.7%	180
Takhar	21.2%	6.9%	101
<b>TOTAL</b>	<b>24.8%</b>	<b>10.5%</b>	<b>621</b>

- 3) There seems to be an old (but decreasing) prejudice against the agency itself (often perceived as a bureaucratic tool of centralization from Kabul and the international community), despite its high professionalism and the quality of its services: *“AISA was known as a foreign entity and most Afghan businessmen were initially reluctant to deal with them. However, after a few years, people understood that it was in their interest to deal with AISA, as it’s a transparent, efficient, and trustable agency”* (Shekib Construction Company, , Mazar-e-Sharif).
- 4) In line with the data provided by the Mazar-e-Sharif and Kunduz AISA regional offices, there is clear evidence that construction companies have better awareness and registration rates than other business sectors: 83% (19 out of 23) of the surveyed construction companies knew of (and were registered with) AISA when only 7.7% (46 out of the remaining 598) surveyed companies were actually registered with the agency! Carpet weaving (10 out of 20 companies knowing AISA and 5 being registered), transportation (respectively 6 out of 8 and 5 out of 8), and the health sector (14 out of 24 but only 2 registered companies out of 24) also present relatively high awareness and registration rates – for very similar reasons: *“Here in Kunduz, we have a very famous tradition of carpet weaving. However, we cannot make money on the local market because people prefer cheaper carpets from Pakistan and are not ready to pay more money for good-quality handmade carpets. So, we need to export our carpets to other places, with the support of international organisations and by showing our productions in Dubai or Tachkent. The first step for this is the registration process: through AISA, we can have a legal stamp that says that we are a serious company and we can also have access to foreign markets and carpet fairs”* (Ibrahim, Carpet Seller, Kunduz).

To summarize the key findings of our survey, it is finally worth noting that medium-sized companies are only likely to get registered with AISA when they work in areas (urban centres, especially Mazar-e-Sharif and Kunduz) and sectors (construction) which allow them to have access to important contracts with larger companies, governmental agencies or international organisations. Otherwise, they barely know the agency and they almost never perceive the benefit they can get from the registration process.

To fine-tune these first elements of analysis, respondents were asked to answer a set of questions regarding formal and informal businesses:

- When asked if they considered the registration of their business as a necessary or useless step, 97.7% of the interviewees said that it was necessary (from 93.4% in Balkh to 100% in Kunduz and Takhar);
- When asked if they thought that their company was competing against unregistered or informal companies, 72.9% said it was probably the case (from 69.8% in Badakhshan to 78.2% in Takhar).

These data show that most medium-sized companies have a clear understanding of the reality of the competition in their sector and that they almost unanimously understand – at least theoretically – the necessity of the registration process. However, focus group discussions also showed that most businessmen are barely able to identify the potential benefits they can get from a registration with AISA or with any other formal registration institution.

*Field visit to the New Mazar-e-Sharif Industrial Park (Guremar Park, April 2011)*

Hajji Hassan’s nut processing facility is located in the Mazar-e Sharif New Industrial Park (Guremar Park), around 10km to the east of the city. The park is divided between AISA and the Chamber of Commerce management, and AISA’s half of the park is clearly better developed than ACCI’s half, where Hajji Hassan’s facility is located. The only other major operator in this part of the park is a large salt factory that has invested \$4 million processing equipment, which suggests that other industrialists have confidence in the long-term future of the park. However, there is much to be done to improve the services and conditions of the park: there is still no city power (power would have to be purchased from the salt factory, which has paid for a private line from the Afghanistan grid), no roads, no water, and no site security. The lack of coordination and interactions between ACCI and AISA is clearly an obstacle to the development of the park, as both agencies tend to duplicate services rather than rationalizing them: *“They both have money from the same international donors, they both have the same objectives, but they have no common agenda – which strongly undermine their credibility and efficiency” (ASMED representative)*. To corroborate these first observations, the manager of a salt factory adjacent to the nut processing facility was also briefly interviewed. Overall, he was satisfied with the level of support from ACCI, and after six months of operating had no complaints about the location. There was no problem hiring staff at the industrial park as the owners had hired a car to shuttle professional staff from the city each day, and the workers lived on site in the week. However, the factory has clearly had to invest heavily outside of any AISA/ACCI investments, as demonstrated by the investment made in a 200-meter well, the electricity line and the access road.

*Pictures XXX and XXX: Mazar-e-Sharif Guremar industrial park (April 2011)*



## 3.2. Recruiting

When asked to explain how they hired their employees, most employers said that they used the most traditional Afghan network system: friends (72.7%) or relatives (69.1%): *“If I want to find the right man for the right position, I cannot trust diplomas or rely on a single interview. So it is wiser to trust my close friends who know the type of person I want to hire, his qualities, skills, and limitations”* (Mostafa, Employer, Carpentry, Baharak). Following the same approach, informal networks (employees’ friends, employees’ relatives, and bazaar) are also key resources for local employers, which confirms the key role played by the direct and indirect family network when it comes to finding jobs: *“I hired my son because it is the best way to make sure that he is well-trained to do what he will have to do in the future”* (Humayoun, Learning Centre, Faizabad). More significantly, for retailers, manufacturers, or livestock owners (traditional or unskilled activities), it is a way to decrease salary costs by keeping the money in the immediate family circle: *“I could not pay an additional salary. My company is too small for it. By hiring my son, I can keep his salary within the household to help feed his brothers and sisters”* (Esmatullah, Welding shop, Jurm).

**Table 23: Recruitment channels**

Which channels or networks do you use to recruit new employees?		
	Respondents	Percentage
Friends	449	72.7%
Relatives	427	69.1%
Friend of employees working in the company	223	36.1%
Through the bazaar	181	29.3%
Relatives of employees working in the company	173	28.0%
Job advertisement in a local radio/TV	20	3.2%
Through the mosque	12	1.9%
Job advertisement in a local newspaper	11	1.8%

When asked whether the number of their employees would fluctuate (increase, decrease) or stay the same, it is worth noting that most managers and business owners were quite optimistic, with an average of 62.8% expressing their thought that the workforce of their company would increase in the future. The higher percentage observed in Badakhshan (71.7%) may be explained by the current dynamism of its labour market (thanks to a – still fragile – economic development mostly driven by new roads and international investments). Such a unanimous optimism confirms local businessmen’s confidence in their respective markets, as seen in 2.2.3 (where 54.3% of the respondents answered that the income of their company would probably increase in the future): *“There is a true culture of small entrepreneurship in Afghanistan. Paradoxically, however, most people do not seek to increase the size and income of their business: once they are established and socially identified as company owners or businessmen, they will try to make short-term profits and benefit from their social image, without necessarily investing in the development and sustainability of their company”* (AKF, Programme Manager, Economic Development).

**Table 24: Employment trends (breakdown per province)**

Do you think that the number of your employees will increase, stay the same or decrease?					
	Increase	Stay the same	Decrease	I don’t know	Total
Badakhshan	71.7%	22.0%	2.3%	4.0%	173
Balkh	59.6%	32.5%	6.0%	1.8%	166
Kunduz	55.1%	33.7%	3.9%	7.3%	178
Takhar	66.3%	29.7%	1.0%	3.0%	101
<b>TOTAL</b>	<b>62.8%</b>	<b>29.4%</b>	<b>3.6%</b>	<b>4.2%</b>	<b>618</b>

To better evaluate the attitude of medium-business owners towards labour laws, respondents were asked to give their opinion about the existing regulations that define the employer/employee relationships. Answers were prompted and multiple-choice was possible. Out of 617 respondents, a large majority (87.0%) said that they considered that labour laws and regulations were important for both employers and employees, as they were a way “for everybody to understand his role and responsibilities in the work environment” (Mahboob, IT company, Mazar-e-Sharif). Following this logic, most respondents (58.2%) considered that labour laws and regulations could avoid employers’ abuses, which suggests that business owners and managers have a good understanding of the objective necessity of the law – aside from the potential subjective interest they may find in bypassing it; symmetrically, 47.2% of the respondents, said that labour laws and regulations were also a way to avoid employees’ abuses, even if “employers often take advantage of their position to fire employees, decrease their salaries, and ask them to work too much, whereas employees do not really have the opportunity to disagree as most of them are happy to have a job and know that they can be replaced easily” (Wadood, Furniture company, Taloqan).

There seems to be, however, a significant difference between Balkh (and specifically Mazar-e-Sharif) and the other surveyed provinces: if 86.7% of the Balkh interviewees said that labour laws were important for both employers and employees, only a minority agreed to consider that they could play a role in avoiding abuses (44.6% for employers’ abuses and 38.0% for employees’ abuses, when respectively 63.2% and 50.6% of the respondents from the other three provinces answered positively to the same questions); likewise, if only 2.7%, on average, of the respondents in Badakhshan, Kunduz and Takhar said that they did not understand the necessity of labour laws – even if they had to take them into account – the percentage in Balkh province is significantly higher (10.8%), as more business owners there are inclined to consider regulations (and labour regulations especially) as “a repressive obstacle that prevent them from developing their activity as they want” (Commercial Lawyer, Mazar-e-Sharif).

**Table 25: Perception of Labour Laws (breakdown per province)**

<b>In your activity, do you think that labour laws are necessary or optional?</b>					
<b>Provinces</b>	<b>Badakhshan</b>	<b>Balkh</b>	<b>Kunduz</b>	<b>Takhar</b>	<b>TOTAL</b>
Yes, they are important for both employers and employees	77.9%	86.7%	93.3%	92.0%	87.0%
Yes, they are important to avoid employers’ abuses	68.0%	44.6%	57.0%	66.0%	58.2%
Yes, they are important to avoid employees’ abuses	53.5%	38.0%	45.8%	54.0%	47.2%
Yes, because it is the law	46.5%	38.6%	45.3%	45.0%	43.8%
No, but it is the law	2.3%	10.8%	3.4%	2.0%	4.9%
No, because they are an obstacle to the development of business	0.0%	1.2%	0.6%	0.0%	0.5%
No, because employees use them unfairly	0.0%	0.0%	0.6%	0.0%	0.2%
Respondents	172	166	179	100	617



### 3.3. Importing and Exporting

#### 3.3.1. Importing

The data collected on import figures tends to confirm that Afghan medium-size businesses mostly operate at a local and domestic level: only 10.3% of the 619 companies that were surveyed in the four targeted provinces said that they imported some of their products. If Badakhshani companies are clearly lagging behind – mostly because of the structurally reduced economic activity of Faizabad – only 12.7% of Mazar-e-Sharif mid-size businesses reported importing some of their products to sell them on the local market. When asked to mention the country of origin of the imported products, respondents who answered positively mentioned Pakistan (73.4% of the mid-size companies that import goods), Iran, (31.3%), China (23.4%), Turkey (14.1%), and India (10.9%). Only 3 companies (4.7%) reported importing products from the neighboring Tajikistan and Uzbekistan.

*Table 26: Import (breakdown per province)*

<b>Does your company DIRECTLY import some of the products you sale?</b>			
<i>Provinces</i>	<i>Yes</i>	<i>No</i>	<i>Respondents</i>
Badakhshan	12 (6.9%)	161 (93.1%)	173
Balkh	21 (12.7%)	145 (87.3%)	166
Kunduz	17 (9.4%)	163 (90.6%)	180
Takhar	14 (14.0%)	86 (86.0%)	100
<b>TOTAL</b>	<b>64 (10.3%)</b>	<b>552 (89.7%)</b>	<b>619</b>

Following this logic, respondents were asked whether they had submitted an application for an import license. As only 9.5% of them answered positively, we asked to the interviewees who answered negatively why they had not submitted a formal application to import foreign goods: one-fourth of the respondents said that the license was too expensive; less than one-fifth said that getting a license would have taken too much of their time; and only 5% said that an informal gift or bribe had been requested during the licensing process.

*Picture 5: Carpet Seller in Kunduz (Imports from Iran and Pakistan)*





As such, it seems that the licensing process *per se* is not considered as a serious obstacle but focus groups have shown that most medium-size-business owners are reluctant to *directly* import goods from other countries: most of them do not have the critical size to do so and they rather rely on bigger local companies or wholesalers. It confirms the empirical observations that one can easily make in any Afghan shop and the results of our survey, as there are mainly imported products in Afghan shops and companies: *“There is almost no production industry in [Afghanistan] and there is barely a transformation industry. Services and international organisations keep the economic activity artificially alive but all the basic goods are imported from Pakistan and China”* (World Bank, Technical Expert).

Last, it is worth noting that respondents almost unanimously consider that trade and customs laws are necessary to the development of the local economic and business environment: 96.6% answered that trade laws were both necessary and useful to their business (93.3% in Balkh and 98.8% in Badakhshan). Once again, the quantitative survey corroborates the in-depth individual interviews we had with local traders and business owners: even if they often disagree with governmental authorities, even if they consider that commercial rules are not fair, they keep thinking that laws and regulations are, *per se*, absolutely necessary to the development of the social and economic of the environment they live in.

**3.3.2. Exporting**

According to our survey, only a few companies have access to foreign markets. And if 12 of the 619 respondents answered positively (less than 2%, see the table below), only 3 economic sectors export some of their production: mining, carpets, and dry fruits. If we consider the four surveyed provinces, there is no provincial exception to the rule that says that *“Afghan companies do not export their products”* (ACCI, Mazar-e-Sharif).

Due to their geographic isolation, Badakhshani companies seem even less inclined to export their products. Qualitative interviews with local entrepreneurs and businessmen have led the review team to think that there is still no real economic market in Faizabad (and Badakhshan): the lack of adequate road access (for the moment), the lack of a reliable and affordable electricity system (in spite of many hydro-power projects) are major constraints that prevent local companies to develop long-term strategies. Of course, international organisations have sought to develop income generating activities and small entrepreneurship in almost all the districts of the province; however, it seems that these succesful initiatives have not brought about real economic changes in the province, as most companies still rely on traditional technological, marketing, and business approaches. The bottomline is that out of 173 middle-size companies, none of them seem to export its products to the neighboring countries (Tajikistan and, to a lesser extent, Pakistan and China).

*Table 27: Exports (breakdown per province)*

Does your company DIRECTLY export some of the products it sells?				
Provinces	Yes	No	I don't know	Respondents
Badakhshan	0	173	0	173
Balkh	5	158	3	166
Kunduz	3	177	0	180
Takhar	4	95	1	100
<b>TOTAL</b>	<b>12</b>	<b>603</b>	<b>4</b>	<b>619</b>
<b>TOTAL (%)</b>	<b>1.9%</b>	<b>97.4%</b>	<b>0.7%</b>	<b>619</b>

If we now pay attention to the few companies that do export some of their products, it is interesting to see that mining, carpets, and fruits are among the three main export products of the country:

- **Mining (marble)** – Out of 14 mining and quarrying companies, 2 reported exporting a significant amount of their marble (more than 25%) to Pakistan, Iran, and even China. However, according to more in-depth interviews with the two directors of these companies, they clearly complained about the technical limitations that hinder the development of their activity: *“We cannot seriously compete with other international companies. Our extraction skills are still very traditional, we have high transportation costs, we pay a lot of bakshish to reach the border and the security is getting worse every day. So, even if the Afghan marble is good, we don’t have the capacity to supply international markets with our products”* (Freidoon, Marble company, Mazar-e-Sharif).
- **Dry fruits** – According to a feasibility study of the MoRRD (*“Operationalizing processing plant in Mazar”*), 80% of Afghan produced almonds are exported. However, it seems that dry fruit export roads almost systematically use Kabul as a trading hub to Pakistan and India: even traders from Mazar channel their almonds through Kabul (80%) and only 20% of them send their productions to Pakistan or India directly. The data collected during the interviews with 20 dry fruit companies tend to confirm this information, as 3 of them said that they exported some of their nuts to Pakistan; however none of the dry apricot producers we interviewed said that they were exporting some of their products. Once again, the Afghan potential for export seems huge but it is still undermined by many technical and logistical factors: *“The international reputation of Afghan soft-shell almonds, natural and tasty, is a strong asset and there is a continuous demand from regional markets (particularly in countries like India, where Afghan dried fruit and nuts have a good reputation). However, Afghan almonds also suffer from their inconsistent quality, poor packaging, uneven processing, and lack of certification (especially regarding their certification as aflatoxin-free)”* (Almond Technical Expert, Roots of Peace).
- **Carpets** – One-fourth of the 20 producers reported exporting carpets directly to neighboring countries. If Kunduz and Mazar carpets have an excellent reputation on the international market, they still suffer from competition with Pakistani lower-quality carpets. Focus groups with carpet producers and sellers indicate that the main challenges affecting the export potential of the carpet industry are: 1) the atomization of the production and the lack of organized producer associations; 2) the lack of subsidies to carpet weavers, who cannot compete with imported carpets from Pakistan anymore; 3) the transportation cost increase as well as the worrying development of illegal taxes and bribes on the major export roads; 4) and the lack of working capital, which prevents a lot of small producers from getting bigger international contracts.

For the 12 respondents of these three sectors, the main export countries are Pakistan (10/12), Iran (6/12), and Tajikistan (4/12); China and Turkmenistan (2/12), UAE, and Europe (1/12) were also mentioned more punctually. These data are of course not representative of the provincial export dynamics; however, they tend to confirm the information we got from the MoCI regarding the destination countries of 2010 national exports. As shown in the table below, the two main bordering countries (namely, Pakistan and Iran) are systematically in the top-3 export destinations (by land) for the key exported goods (fresh and dry fruits, medical herbs, carpets<sup>14</sup>).

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<sup>14</sup> It should be noted that the MoCI does not have any estimate for marble exports (which is also one of the main national exports).

*Table 28: Projection for the main export goods in 1390 (march 2011 to march 2012) – source: MoCI/EPAA*

Product	By Air	By Land	Total
Fresh Fruits	19,190 tons to India 50 tons to Saudi Arabia 600 tons to other countries	44,730 tons to Pakistan 90 tons to Iran 630 tons to other countries	65,290 tons
Fresh Vegetables	2,000 tons to UAE, Germany, Austria, England	16,700 tons to Pakistan 16,300 tons to Turkmenistan 960 tons to Uzbekistan 700 tons to Iran 500 tons to Tajikistan 240 tons to Kazakhstan 180 tons to Russia 130 tons to Kirgizstan	37,710 tons
Dried Fruits	520 tons to Saudi Arabia 130 tons to Germany 7,750 tons to America 9,020 to other countries	43,590 tons to Pakistan 42,430 tons to India 18,800 tons to Common Wealth countries 1,520 tons to Iran 30 tons to China	123,790 tons
Medical Herbs	9,870 tons to India 400 tons to Saudi Arabia 90 tons to Germany 9,220 tons to other countries	11,440 tons to Iran 5,190 tons to Pakistan 800 tons to America	37,010 tons
Carpets		444,900 sqm to Pakistan 8,800 sqm to India 4,500 sqm to China 3,530 sqm to Common Wealth countries 2,500 sqm to Germany 2,200 sqm to Saudi Arabia 800 sqm to Iran 18,300 sqm to other countries	485,530 square meters

If the ongoing extensions of the Mazar and Faizabad airports may contribute to the development of local exports, it is therefore a major concern that only a handful of companies have access to international market opportunities. In this regard, when asked whether they knew institutions for export promotion – like EPAA<sup>15</sup>, FACT<sup>16</sup>, Women’s Federation, ANSA<sup>17</sup>, etc. – none of the 621 respondents answered positively.

Among the abovementioned entities, one of the most promising is probably the EPAA, despite its obvious capacity limitations. EPAA is an agency of the Ministry of Commerce and Industries that was established in September 2006 with the financial and technical support of both GIZ and CIM (*Centrum für internationale Migration und Entwicklung*). EPAA's Export Step-by-Step Strategy is supposed to “turn SMEs which are eager to export into internationally successful operators [by] (...) identifying new international opportunities, markets and partner”. In practice, however, there seems to be a clear gap between EPAA’s mission statement and its actual achievements: “We do our best but it is true that only a few companies know our services and almost exclusively in Kabul. Our problem is twofold: we are a relatively new agency and we are supposed to change traditional

<sup>15</sup> Export Promotion Agency of Afghanistan

<sup>16</sup> Federation of Afghanistan Craftsmen\Traders: created in 1987, FACT is present in 14 provinces and often works hand in hand with local ACCIs.

<sup>17</sup> Afghanistan National Standards Authority (ANSA)

*business mentalities – which is extremely difficult in this country. As such, a long-term advocacy strategy may be the only way to convince talented middle-businessmen that they should try to export their products” (EPAA Officer, Kabul).*

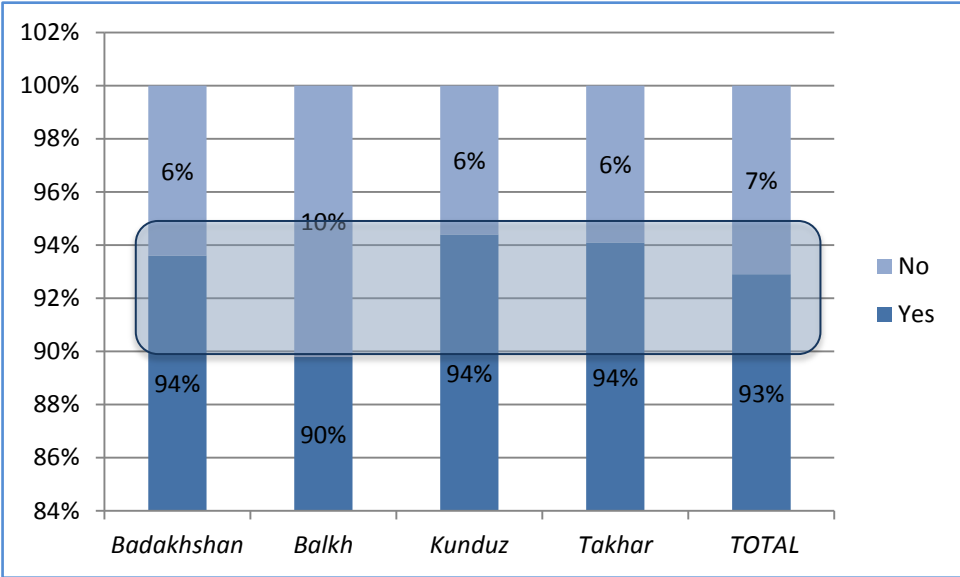
By contrast, it is encouraging to note that most national institutions for export promotion (EPAA, FACT, ACCI, Women’s federation, or ANSA) are partly financed – to a level of at least 40% by their own funds through membership fees or associated business services. In a political context where the future of civil servant salaries and public administration budgets are uncertain, it is of course a very positive sign as it may contribute to these organisation’s self-sufficiency; in the meantime, and as stated earlier, only a few large companies benefit from the services of these agencies and their image and credibility still suffer from this anonymity.

### 3.4. Paying Taxes

The 619 surveyed companies almost unanimously (92.9%) reported paying official taxes, with no significant between the four targeted provinces (89.8% for Balkh and 94.4% for Kunduz). The only relative exception is the city Mazar-e-Sharif (urban centre), where 17 of the 131 medium-size businesses (13%) said that they did not pay taxes; on the opposite, only 4 of the 87 companies (4.6%) surveyed in peri-urban or remote districts (cities of Baharak, Jurm, Balkh, Sholgara, Khanabad, Imam Saheb, Bangi, Farkhar) admitted to not paying any taxes. In these regards it seems more difficult to hide a business activity from governmental representatives in secondary urban centres where people tend to know each other and where medium- and large-size businesses are almost non-existent.

Of course, answers may be biased, as respondents are often reluctant to acknowledge that they do not follow tend to find the “right” answer on such a sensitive topic; however, there seems to be a general understanding and acknowledgement of the necessity of paying taxes: *“I know that the money we pay to the government is not always well used but there is no other choice. [...] A large part of the money goes to corrupted civil servants and we cannot accept it; but on the other hand, the money we pay can help build roads, schools, and power plants. [...] So we need to pay and ask for more transparency”* (Focus Group participants, Taloqan).

Chart 11: Paying taxes, a four-point bracket



Such statements were quite common during our qualitative field assessment and they also shed light on the increasing contradiction between an acceptance of the tax system and the shared perception that governmental representatives or semi-official authorities are increasingly corrupt in most Northern provinces: *“In the North, the opportunistic or predatory behaviour of government officials and local elites is credited with widely held negative perceptions of government, essentially creating a disconnect between local communities and formal governance”* (Field Officer, The Liaison Office, TLO, Kabul).

By contrast, such a negative perception of governmental officials does not seem to be fuelled by actual corrupt or unethical behaviours: when asked if their company had been inspected by tax officials over the last fiscal year, more than 70% answered positively (from 62.3% in Balkh to 80.9% in Badakhshan), but, out of them, only 7.7% said that a gift or informal payment had been requested during the procedure (from 3% in Badakhshan to 11% in Kunduz). The picture is in fact extremely contrasted and the situation in Imam Saheb (27.3%), Mazar-e-Sharif (9.9%) or Kunduz (9.4%) cannot

be compared with the one in all the other surveyed cities. Imam Saheb, in particular, not only suffers from rising levels of insecurity around the city, but also from its geographical location near the Tajik border, which tends to have a negative impact on local corruption practices<sup>18</sup>.

*Table 29: Tax Laws (breakdown per province)*

Provinces	Necessary	Clear	Corrupted	Unfair	Respondents
Badakhshan	99.4%	92.5%	0.6%	71.1%	173
Balkh	93.4%	75.4%	4.2%	68.9%	167
Kunduz	96.1%	84.4%	2.8%	58.3%	180
Takhar	96.0%	85.1%	3.0%	43.6%	101
<b>TOTAL</b>	96.1%	84.4%	2.6%	62.3%	621

To better gauge medium-size-business owners’ attitude towards the tax system, respondents were asked to elaborate on the first question “Is the tax system necessary?” and indicate whether they considered that the local company and commercial tax system was: 1) clear; 2) corrupted; and 3) unfair. Based on the additional focus group discussions we had with local entrepreneurs and business owners from the four provinces, it is worth noting that:

1. If most respondents (84.4%) acknowledged that the local commercial tax system was *clear* (from 75.4% in Balkh to 92.5% in Badakhshan), such positive results should be considered with caution, as almost one-fifth of the interviewees are illiterate (see 2.1.1. Socio-Demographic Data: Age, Function, Gender, and Education). In practice, respondents seem to have a clear understanding of the concept of tax even if most of them do not necessarily pay taxes to the same institutions (Department of Finance, Municipality, Ministry of Commerce, etc.) and do not have a clear understanding of who their official interlocutor should be. So, in this context, when it comes to the commercial tax system, what does “clear” mean? The question was asked to two groups of businessmen from Kunduz (focus group with modern service suppliers, like IT, computers, telecommunications, etc.) and Badakhshan (focus group with more traditional traders from the bazaar), and the answers were almost always identical: *“If you don’t pay taxes, people know it and talk. Everybody has to pay taxes to the community. However, it does not have to be official or legal. [...] Of course, it is better if you pay to the Ministry of Commerce and the Ministry of Finance; but it is often too complicated and you need to pay additional fees to corrupted middlemen to facilitate the process. In this case, it is better to pay money to local officials or to the municipality. At least, we know them and they can help us if we have a problem with the government”* (Nazer, IT Company, Kunduz and Emal, Jeweler, Baharak).
2. This first point is interesting from a cultural and cognitive standpoint as it shows that most of the people we interviewed do not share the same understanding of the notions of “tax system” and “corruption”. For most respondents, “paying taxes” does not necessarily mean that they deal with the legal and formal tax procedures; in most cases, it only means that they generally agree to pay to have a stamped document that allows them to develop their business activities. In this regard, “corruption” is seen as almost non-existent (2.6% on average and 0.6% in Badakhshan, which is one of the most corrupt provinces in

<sup>18</sup> There are only a dozen of official border-crossings to Tajikistan along the 1,206 km border, but there are hundreds of illegal and unofficial crossings – increasing significantly in winter when the Amu Daria River narrows and in some areas partially freezes.



Afghanistan<sup>19</sup>) even if they almost always have to pay unofficial fees to middlemen or bribes to governmental officials to get their commercial authorizations sorted out. In this context, there is often a cultural misunderstanding about the different meanings of the notion of “corruption” in the Afghan context: *“Corruption does not mean that you have to pay bakshish. Corruption is when the bakshish you pay to get a stamped document or an official authorization is significantly higher than what it should be. In other words, there is an acceptable corruption, which is not considered as corruption”* (Technical Advisor, Ministry of Commerce and Industry). All the discussions we had with traders and community leaders in the four-surveyed provinces tend to validate this assumption.

3. Following the same logic, respondents were asked whether they considered that the tax system was fair or unfair: it is interesting to note that a large majority (62.3%) said that the tax system was unfair. Based on our qualitative assessment, however, the striking contradiction between the low percentage of respondents (2.6%) who said that the tax system was “corrupted” and the high percentage of the same respondents who considered that the same system was “unfair”, found an explanation in the in-depth individual interviews and focus groups: most respondents thought that the social position of the taxpayer had an influence on the amount of taxes he has to pay. As such, on the one hand, interviewees consider that the tax system is necessary and *relatively* not corrupted, but, on the other, they complain about its unfairness, as *“the richer you are, the less you pay”* (Ahmed, Craftsman, Baharak).

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<sup>19</sup> “Badakhshan provincial profile”, The Liaison Office (TLO), February 2011.

### 3.5. Growing

To gauge employers' perceptions of their own business activity, survey respondents were asked to quantify the main obstacles to the future development of their business activity. Answers were prompted and interviewees were asked to rank them on a five-point scale (from "1 = no obstacle" to "5 = very severe obstacle").

*Table 30: Obstacles to business development*

ALL PROVINCES	No obstacle	Minor obstacle	Moderate Obstacle	Major obstacle	Very severe obstacle
Access to credit	72.5%	10.3%	10.1%	5.2%	1.9%
Access to Communications	70.4%	16.6%	5.8%	1.8%	5.5%
Access to Water	63.8%	7.9%	5.6%	9.8%	12.9%
Labour Regulations	60.1%	24.0%	9.5%	5.8%	0.6%
Skills of the employees	54.8%	23.2%	12.7%	5.0%	4.3%
Competition in your sector	53.6%	20.0%	17.0%	8.2%	1.1%
Lack of Security (Crime, Theft, etc.)	50.3%	16.9%	8.1%	4.5%	20.2%
Taxes	49.1%	9.0%	9.7%	12.9%	19.3%
Corruption	42.6%	16.1%	16.6%	11.8%	12.9%
Administration and Bureaucracy	36.4%	14.5%	24.6%	15.3%	9.2%
Access to Electricity	26.9%	9.8%	10.3%	13.8%	39.1%
Access to Land	20.9%	10.8%	19.3%	15.8%	33.2%

As shown in the above table, the two most frequent answers are the lack of accessible *land* (68.3% of the respondents identified it as a "moderate", "major" or "very severe" obstacle) and reliable and affordable *electricity* (63.2% of the respondents). City power is less expensive than generators but, of course, less reliable and most industries and manufactures cannot take the risk of a blackout in the middle of their activity: *"I work in chemical products. My generator is a real financial burden. It costs too much but, on the other hand, I have to pay for it because it is reliable. If there is a shortage or a blackout of more than 5 minutes, all my products can be destroyed"* (Hamid, Chemicals, Faizabad). Land is of course a key issue, for both companies and individuals, as many business areas are already overcrowded in the direct neighbourhood or suburbs of provincial urban centres: *"The lack of land is by far the first issue companies have to deal with today. It is extremely expensive to get a land and you can never be sure of the deeds, as there is always someone to say that the land was his before you buy it or rent it. In our department, 70% of civil or commercial cases are land issues. The rest are labelled as "family cases" but even in "family cases", you have a majority of land-related cases"* (Hoqooq, Department of Justice, Kunduz).

If security is not considered as an obstacle by a majority of respondents (50.3% of the 621 interviewees), the relatively high proportion of companies (20.2%), which considers it as a "very severe" obstacle corroborates the findings of the qualitative interviews we had, as security issues highly depend on two factors:

- The geographic area (see the breakdown by province in annex 1: it is a "very severe obstacle" for 13.2% of the Balkh respondents, 19.0% in Kunduz, 22.0% in Badakhshan, and 30.7% in Takhar);

- The business sector, as many companies highly depend on external suppliers, and thus on transportation by road: *“When the situation gets worse around Kunduz, it is too risky for my business as convoys can be attacked and goods stolen by local bandits. It happened twice already and I lost a lot of money” (Assad, Mechanics, Kunduz).*

Moreover, it is interesting to see that **access to credit** was rated as a minor obstacle (82.8% of the respondents said that it was only a minor obstacle or not an obstacle at all), which confirmed the assumption that finding money to set up a business is not a major issue and the entrepreneurs we interviewed confirmed that it was relatively easy to get a loan from their family, community (*mantaqa*), *hawalas* or banks. It is for instance possible for private companies to borrow money through micro-credit institutions (FMFB, BRAC, etc.), even if interest rates take into account the important risk premium associated with the local market (15-20% on a one-year loan). However, it is often more difficult to find money to further develop a medium-sized business: *“There is clearly a problem of credit and skills. If you want to reach a certain critical size, you need accounting, managerial, and technical skills that are not mandatory in more modest companies” (Project Manager, ASMED, Mazar-e-Sharif).*

Institutional burdens (**taxes, corruption, administration and bureaucracy**) are consistently ranked among the secondary obstacles that *“slow down our business activity but don’t put it at risk” (Ibrahim, IT Company, Mazar-e-Sharif):* respectively, 41.9% (taxes), 41.3% (corruption), and 49.1% (administration and bureaucracy) of the respondents identified those topics as “moderate” to “very severe obstacles”.

Last but not least, **labour regulations** are not seen as a serious obstacle by the interviewed company representatives, who view them as a minor (60.1%) or inexistent (24.0%) obstacle, as: 1) the existing labour regulations are quite flexible; 2) most companies do not even know them; 3) the local DoLSAs (Department of Labour and Social Affairs) barely play their watchdog role with medium-sized companies.

## 4. Commercial Law in Theory and Practice

This section will focus on the formal and informal justice systems to better appreciate the respective roles they play in the judiciary system. In theory, commercial cases can either be solved through the formal judiciary (courts) or the informal system (community councils). The actual divide between formal and informal justice in Afghanistan, however, is rarely defined, and cases often pass back and forth between the district governor, local courts, other government offices, and local elders. Other bodies (ACCI, *Hoqooqs*) can also play a mediation role to reduce both parties' expenses and come to an acceptable agreement. In practice, there are strong doubts about the actual implementation of the reformed legal frame – especially at the provincial level: the formal commercial law sector in Afghanistan remains unable to reach most rural or remote districts and functions poorly in areas where it is present. Political and/or religious patronage, endemic corruption, lack of skills, lack of Infrastructure, lack of coordinated efforts between formal and informal institutions, as well as gender imbalance, are among the obstacles that undermine the development of a fair and efficient judiciary system in the four targeted provinces. Similarly, the functioning of the “informal justice sector”, while representing a real opportunity for solving legal disputes and raising awareness about commercial law, is still unevenly hampered by political dependency, lack of homogeneity, lack of case records, as well as predatory arborescence. Finally, if focus group participants and survey respondents unanimously insisted on the significant role played by commercial laws, legal counselling does not benefit from a positive image among company owners, with a strong prejudice against legal advisors or assistance in all the surveyed provinces and districts (rural or urban).

### 4.1. Formal and Informal Justice(s)

#### 4.1.1. The Status of the Reform and its Practical Implementation

The process for reforming Afghanistan commercial laws was initiated by the Afghan government – namely the Ministry of Commerce and Industry – in 2002. Between 2002 and 2009, the government of Afghanistan and international institutions (Adam Smith-ASI, USAID-EGGI, USAID-TAFA, GIZ-NAWI, The World Bank, etc.) have worked with American, European, and Egyptian lawyers to review and readjust the Afghan commercial law framework. As the drafting phase is generally over, the table below provides an update on the current status of the newly drafted laws by the MoCI.

- Considering the current status of most of the new commercial laws, it seems clear that the parliamentary step is crucial. Some laws published in 2007 are still in the limbo and are unlikely to be enacted on the short-run. It does not mean that these laws are not used as legal references but, in theory, their application can be overruled as they have not been confirmed by the Parliament.
- More practically, there are strong doubts about the actual implementation of the reformed legal frame – especially at the provincial level. None of the key informants we interviewed in the four provinces knew about the reform: *“A lot of reforms have been done since 2001. But in the real life, we don't care. Companies have to deal with real issues and we generally use common sense with them, rather than international changing models”* (Clerk at the Commercial Court, Mazar-e-Sharif).

*Table 31: Current status of the commercial law reform*

<b>LAWS</b>	<b>CURRENT STATUS</b>
<i>Corporation and limited liability companies</i>	Adopted by presidential decree. Published in the official gazette 2007-01-03. Awaiting parliamentary confirmation.
<i>Partnership law</i>	Adopted by presidential decree. Published in the official gazette 2007-01-03. Awaiting parliamentary confirmation.
<i>Arbitration law</i>	Adopted by presidential decree. Published in the official gazette 2007-01-03. Awaiting parliamentary confirmation.
<i>Commercial mediation law</i>	Adopted by presidential decree. Published in the official gazette 2007-01-03. Awaiting parliamentary confirmation.
<i>Contract law</i>	Awaiting confirmation by the parliament, sent on 04-08-2010
<i>Agency Law</i>	Awaiting confirmation by the parliament, sent on 04-08-2010
<i>Trademark law</i>	Enacted by the parliament. Published in the official gazette on 09-01-2009
<i>Copy right law</i>	No information available.
<i>Registration of foreign patent law</i>	No information available.
<i>Private investment law</i>	Adopted by presidential decree. Published in the official gazette 2005-12-21. Awaiting parliamentary confirmation.
<i>Bankruptcy law</i>	Drafting under progress
<i>Regulation for corporations and limited liability companies</i>	Drafting under progress

Source: GIZ-NAWI (MoCI)

The next three sections will deal with the usual means used by companies to solve commercial disputes. In practice, both formal and informal mechanisms are commonly used.

#### 4.1.2. The Formal Sector

The major organs of the formal sector include the Supreme Court, High (Appeal) Courts, and Primary Courts (located in cities, municipalities, districts or even village clusters). Moreover, the Ministry of Justice (MoJ) contains a law department (the *Hoqooq*, which conducts preliminary investigation and informal mediations before a case is sent to court) and a legal drafting department (the *Taqnin*). In theory, and according to the 2004 Constitution, the courts are required to apply constitutional law first, then statutory law, and finally customary law, which is an expression of local history, politics, and identity, with a strong emphasis on compromise and restorative justice; in the meantime, Shari'a Law, which is not textually mentioned, is a cross-cutting system of legal principles, as no law may contradict the provisions of Islam.<sup>20</sup>

Focusing more specifically on the commercial law sector, the table below summarizes the different levels of executive, legislative, and judiciary sectors with regards to the commercial law.

<sup>20</sup> 2004 Constitution, Article 130.

*Table 32: Organisation of the formal sector*

<p><b>1. The National Assembly and the Presidential Decrees</b></p> <p>The Constitution permits two ways for new legislation to be brought into force as binding law. The primary way is through ratification by the National Assembly and endorsement by the President (Art. 94). However, the majority of the newer commercial laws were pushed through by Presidential decree, either during the period prior to the election of the first National Assembly in 2005. Several laws that were prepared prior to this but which were not passed by decree are still awaiting parliamentary review and ratification five years later.</p>
<p><b>2. Taqin</b></p> <p>The <i>Taqin</i> is the branch of the Ministry of Justice that is mandated with: 1) reviewing all proposed laws for compliance prior to their submission to the National Assembly for ratification; 2) with drafting body within the Ministry of Justice. The <i>Taqin</i> has separate departments and areas of legal specialization: Labour and Economic Laws, Civil and Commercial Laws, Penal and Administrative Laws, International Laws, Private Sector Laws, Research and Legal Leadership.</p>
<p><b>3. Ministry of Commerce and Industries</b></p> <p>The Ministry of Commerce and Industries is the primary body in Afghanistan that is charged with establishing and implementing a national private sector development policy. A key aspect of its work is to <i>“establish a legal and regulatory framework necessary for the functioning of an efficient free market economy, and to have in place a modern system of commercial legislation.”</i> As such, it provides input on all legislative matters that are related to Afghanistan’s business environment.</p>
<p><b>4. Ministry of Finance</b></p> <p>The Ministry of Finance is responsible for the management and execution of budget, collection of taxes, organisation and control of public expenditures and payments to the government. It provides input on all legislative matters that are related to Afghanistan’s financial, tax and customs environment. The Afghanistan Customs Department (ACD) is a department within the Ministry that is responsible for enforcing the 2005 Customs Law and collecting customs revenues.</p>
<p><b>5. Commercial Courts</b></p> <p>Theoretically, control over the commercial courts is exclusively the domain of the Supreme Court, which is constitutionally empowered to regulate the entirety of the judiciary (Art. 95 of the 2004 Constitution). Currently, the number of staffed and functioning commercial courts around the country are limited to Afghanistan’s major cities. In the absence of any functioning specialized commercial court in a given region, a local civil chamber has alternate jurisdiction to hear commercial disputes. Procedure in the Commercial Courts is established in the 1963 Commercial Court Procedure Law. This law sets a limited structure of pleadings allowing parties to submit and revise their claims and defences, after which the judge is supposed to hold a hearing and set a date for trial. With only one set of procedures and requirements, all claims, regardless of their scale, are subject to the same court fees, which are exclusively levied against the losing party as a percentage of the award (Arts. 286-290).</p>
<p><b>From Michael Leach’s <i>Afghanistan’s Commercial Law Sector (Draft) September 2010</i></b></p>

In practice, however, the formal commercial law sector in Afghanistan remains unable to reach most rural or remote districts and functioning poorly in areas where it is present. Among the obstacles that undermine the development of a fair and efficient judiciary system in the four-targeted provinces, the key informants we interviewed mentioned the following points:



- **Political patronage:** Appointment of judges links closely not to their legal expertise, but rather to the patronage relationship built within the system, as well as their personal, tribal, ethnic, or political affiliations with the district or provincial leadership: *“Judicial leaders and staff in the provinces always have affiliations with political factions and local commanders” (USIP, Legal Expert, Kabul).*
- **Religious Patronage:** Graduates from the *Sharia* School currently form a majority in the judicial leadership with clear ties to conservative political parties; they of course do their best to appoint as many of their political loyalists as possible to positions in the judiciary and court system. *“The influence of these lawyers from Sharia Schools on the courts seriously undermines the autonomy of the judicial system, even if they are often more rigorous and skilled than University students” (NRC, Legal Expert, Kabul).*
- **Lack of Skills:** Many judges and legal professionals are still illiterate and lack the basic skills to understand or apply the laws of the country. Moreover, many judges do not have access to official legal texts and are thus unaware of recent changes to the commercial law framework.
- **Lack of Infrastructure:** In all the surveyed provinces, our focus groups and key interviews showed that the commercial law system (and more generally the judiciary) suffers from a severe lack of organisational structure as well as material resources: *“Newly built courts and other justice-sector buildings are not being used for their intended purposes. Formal courts, including family courts, are either non-existent or barely functional in most rural areas. Moreover, competition for resources breeds mistrust among the different state institutions and hampers the functioning of the state justice sector” (USIP, Legal Expert, Kabul).*

*“District officials are viewed as working for their own self interests with the provision of justice severely undermined and considered to favor the influential, with communities tending to view the courts as a last resort.”*

(The Liaison Office)  
TLO Researcher, Badakhshan
- **Endemic Corruption:** Based on the focus groups we had with business owners, private lawyers, as well as community leaders, it seems that one reason for the strong mistrust with regards to the formal judiciary is the widespread level of corruption within its administration. Most plaintiffs who attempt to bring commercial cases through formal channels often face the request for money or compensation for performing official functions.
- **Gender Imbalance:** A rapid assessment of the four target provinces showed that there were no women lawyers or judges in both urban and rural areas: *“Rural women have great difficulty accessing the formal court system. Families are not supportive. Bringing a case that involves women in a local court or community council would create some troubles in the village” (Mahboob, Elder, Baharak).*
- **Lack of coordinated efforts:** Reform efforts, initiated by the central government and the international community, have produced minimal improvements on the field (at both provincial and district levels). It is mostly due to a poor coordination among both Afghan justice institutions and their international partners, and a clear absence of decentralized information and capacity: *“Quite surprisingly, the rule of law was almost ranked last in the agenda of international priorities. The reasons are unclear but the topic is of course extremely sensitive: too religious, too political, etc.” (EU, Legal Advisor, Kabul).*

### 4.1.3. The Informal Sector

The “informal justice sector” or “customary law sector” covers orally transmitted customary rules and regulations, often based on a local understanding of Islamic legal traditions. In the four target-provinces, community councils or “shuras” generally include these informal justice mechanisms, which mix rule-based as well as pragmatic approaches to a wide range of legal arrangements (i.e. commercial contracts, land titles, resolving disputes, developing social relations). Decisions are often consensual and obtained through arbitration, negotiation, and mediation processes; they are mostly based upon restorative justice to better preserve the communal harmony through *islahi* (reconciliation) rather than on legal aspects. *“The only thing these methods have in common is that they reflect a level of fairness and justice broadly accepted by the majority of the population and they are all outside the scope of the formal state justice system”*<sup>21</sup>. The traditional forums of the informal justice sector resolve the vast majority of legal disputes (from inheritance claims to commercial cases or contract matters) and are particularly active in rural areas. It is estimated that around four-fifth of all legal disputes are dealt with through *Jirgas/Shuras*<sup>22</sup>.

As such, traditional justice mechanisms clearly represent an effective opportunity for increasing access to justice, as they generally involve community elders, religious leaders, and other respected individuals whom parties trust<sup>23</sup>; however, the key informants we interviewed highlighted several risks or weaknesses that often hamper the functioning of *shuras* and *jirgas*:

- **Political dependency:** In the province of Balkh, where the review team has spent more time investigating the traditional mechanisms solving commercial cases (in the districts of Balkh and Sholgara), informal courts and councils clearly lack from an effective political independence: *“In most cases, these informal bodies [called shuras or jirgas] are influenced by commanders or governors either indirectly – when the local political leader sets the legal tone and “guidelines” those councils should adopt to favour his relatives, friends, or personal objectives – or directly – when they appoint their partisans to positions within local shuras.”* (USIP, Legal Expert, Kabul).
- **Lack of homogeneity:** By definition, the political and legal roles played by informal justice mechanisms can hardly be synthesized, as they do not constitute a homogenous justice system. As such, gauging informal justice systems always requires a nuanced understanding of local power dynamics and dispute resolution systems: *“There are many different and complex organisational realities that lie behind the word shura. And you have to tailor your approach and strategy to each of them if you want to actually promote justice”* (AREU, National Researcher, Mazar-e-Shura).
- **Lack of case records:** Most decisions taken within the informal judicial system aim to reach

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<sup>21</sup> Sheila Reid and Conor Foley, “Land and Property: Challenges and Opportunities for Returnees and Internally Displaced People in Afghanistan” (NRC, 2009).

<sup>22</sup> “Institutionalization of the Justice System”, Sudhindra Sharma and Pawan Kumar Sen, in Asia Foundation “State Building, Security and Social Change in Afghanistan – Reflections on a Survey of the Afghan People, 2008”, page 49.

<sup>23</sup> See “Afghanistan’s political and constitutional development”, Chris Johnson, William Maley, Alexander Thier and Ali Wardak) (Overseas Development Institute, 2003): *“People often prefer jirga/shura to formal justice institutions because they are conducted by respected elders with established social status and a reputation for piety and fairness. In many cases, disputants personally know and trust local elders. In addition, elders reach decisions in accordance with accepted local traditions and values that are deeply present in the collective conscience of the village or tribe. Also unlike state courts, jirga/shura settle disputes without long delays and without financial costs. Illiteracy also discourages people from using courts - the overwhelming majority of Afghans are unable to make applications, read or understand the laws or do the paperwork. Furthermore, while the state justice system criminalises and excludes offenders, the traditional system largely aims at the reconciliation of disputants and the reintegration of offenders into the village or tribe”*.

an agreement that preserves the harmony of the community. As such, there is no real reason to keep track of the cases and we could not find any commercial case record in all the community councils we visited. This absence of archive is of course detrimental and contributes to the mistrust of many company owners: “A few years ago, the elders said that I was right and that the other company had to pay mine. Last year, the other company tried to steal my land again and I then asked the shura to give their opinion on the case. I thought they would say the same thing, but there is no archive and I could not defend my case properly. Now, I have to accept their judgment because it is better for the community, even if it is not fair for my company!” (Najeeb, Construction Company, Imam Saib).

- **Predatory arborescence:** The international community’s increased focus on “traditional institutions” (like *shuras*) as a means for delivering services and stabilizing unsafe areas has led to a significant growth of informal bodies labelled as “*shuras*”. However: 1) as shown by Johnson and Leslie<sup>24</sup>, those allegedly ‘representative’ and ‘traditional’ bodies often manipulate international organisations to benefit from their financial support; 2) the institutional duplication and a systematic financial incentivisation policy have had the counterproductive effects to undermine the authority of local *shuras* and to fuel the corruption among their members.

#### 4.1.4. The *Hoqooq*, Formal and Informal Judiciary

Although not a member of the judiciary, the *Hoqooq* (“Rights”) Department of the Ministry of Justice is rooted in the Regulation Governing the Operations and Activities of the Ministry of Justice, which obliges the Ministry of Justice to “defend the right of ownership, labour rights, family rights, and other rights of citizens based on their complaints,” and “enforce judgments issued by courts on civil rights disputes” (Article 7). The *Hoqooq* often plays the role of mediator by setting up the conditions of an informal discussion to encourage both sides of a dispute to settle their cases, and getting a commission on the estimated value of the case<sup>25</sup>. If disputants agree on a settlement with the mediation of the department it is up to them to register the result to a relevant government office. If the case is not settled, the department will send the case to a primary court. Many organisations (USAID, WB, GIZ) have thought about relying on this formal/informal body to improve the rule of law (especially at provincial level). Based on the 40 interviews we had with *Hoqooqs* – as well as the quantitative survey with business owners, see next section – it may not be realistic, as several structural obstacles still undermine the functional capacity of this institution:

- **No executive power:** However, if the *Hoqooq* is actually entitled to play a pivotal role between traditional and formal dispute resolution systems with the specific function of facilitating the adjudication of civil and commercial cases, they have no executive power and they cannot enforce any decision. Plaintiffs can always choose to go to the local provincial court if they are not satisfied with the outcomes of the mediation.
- **Lack of skills and nepotism:** Based on the 40 interviews we had with *Hoqooqs*, it clearly appears that *Hoqooq* representatives (at least in the four targeted provinces) lack the basic legal and commercial skills to deal with complex commercial cases. Their appointment is almost exclusively based on local personal and political affiliations, as suggested by most of the company representatives we interviewed in our focus groups: “*Hoqooqs are white*

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<sup>24</sup> See *Afghanistan: The Mirage of Peace*, Chris Johnson and Jolyon Leslie, 2008, Zed Books, pages 41-42.

<sup>25</sup> Based on additional focus groups in the four-targeted provinces, it seems that the usual commission is around 10% of the value of the case. These figures were generally confirmed by the *Hoqooqs* who accepted to answer our questions.

*beards with no skills. They are friends with the Russians, the Mudjahedeens, the Talebans, and now the Americans. But they don't work for Afghan people and they don't have enough skills and honesty to solve private companies' cases" (Maqsood, IT Company, Taloqan).*

- **Poor image among the population:** Whereas they often benefit from an overlooking positive image among international organisations, *Hoqooqs* have a very poor image among Afghan companies: *"If there's a dispute between companies, they can decide to go to the Hoqooqs. In most cases, however, they solve it by themselves, through unions or courts to reach long-term arrangements. People, and especially private companies, don't trust Hoqooqs, which are considered as a corrupted [...]. In other words, as a company, if I am in a city I go to the court; if I am in a district, I will negotiate locally" (NRC, Legal Expert, Kabul).*
- **Sustainability issue:** Most of the international organisations (aside from GIZ, see the interview below) that have tried to work in close collaboration with the informal judiciary have focused on one strategy almost exclusively: pouring money into the traditional justice system to create additional *shuras* and parallel informal systems, providing incentives for the *Hoqooq* departments, etc. There are, however, ten years of evidence to show that financial reward can create perverse incentives and systematically undermine the very aspects of traditional justice that make it legitimate. Moreover, such a short-sighted policy raises another issue: who will pay after the international funding runs dry?

### Interview with the Head of the *Hoqooq* Department (*full transcript*)

(*Baharak district, Badakhshan – Date: 28-03-2011*)

#### 1. Can you describe your activities as *Hoqooq* department?

We are solving three kinds of cases. People come to see us to discuss property and land disputes, family conflicts, or commercial disputes. We have a few cases of families that are not able to reimburse their loans, because of high interest rates – more than 15% sometimes. However, almost three-fourth of the cases are related to land issues. Here in Badakhshan, there is no good land available and it is a huge concern for many people. People are eager to get their own land, which is natural, which is normal, but creates a lot of trouble within the community. In the meantime, there are a lot of returnees from Pakistan who left during the Taliban regime and who want their land back. There is no moral solution to this and it's also hard to find an acceptable legal one. Most of the time, people who are not satisfied with our opinion, as *Hoqooqs*, go to the court to have a different decision.

#### 2. What are the main obstacles to your activity?

We start from scratch. People not have information about the law and more than 90% of them are illiterate. Moreover, we don't have basic equipment such as desks, tables, chairs, cupboards or computers. There is no way to archive the decisions we make, which strongly weakens our capacity here. Lastly, I think that we cannot really enforce the law, as we don't have any real executive power.

#### 3. Do you mean that only legal courts have this authority?

Not exactly: legal courts do have a formal authority, but in practice, most decisions depend on the local commanders. They know exactly who is doing what in our community and they make all the decisions.

#### **4. According to you, are medium businesses registered in your district?**

Most of them have to be registered with the municipality and pay small fees and taxes for this. But they cannot get registered with other agencies or departments, as most of these institutions are not present here. People don't know them and most of them could not understand why they should pay additional taxes without anything in return.

#### **5. More generally, what is the relationship between businesses and legal authorities here?**

It depends not only on the authorities or the institutions. We are in Afghanistan and it mostly depends on the people you have in front of you: some of them are corrupted and some of them are honest.

#### **6. Do you think medium businesses need legal assistance in your district?**

It is necessary for them because they do not have information about commercial legal procedures. This is the main problem: people are ignorant and don't understand their rights and duties. It is true for individuals and companies. If they had more information about it I am sure they would not create problems and solve their disputes by themselves.

#### **7. Does your department receive training from international organisations?**

We only have relationship with GIZ, which provides us with legal training sessions. We got workshops on property law, family law, and land legislation. These training are useful.

#### **8. Do you think people would be ready to participate in legal assistance workshop?**

People are willing to participate and contribute. Both individuals and companies would like it and get a lot from legal training, workshop or advices. However, they are not ready to pay anything for it, as they consider it as a normal service.

## 4.2. Perception of Commercial Laws and Legal Assistance

To practically assess the nature of the relationship between surveyed companies and formal and informal legal bodies, respondents were asked to indicate: 1) their knowledge and opinion on commercial laws and regulations; 2) their perception of legal assistance (opinion and needs).

### 4.2.1. Perception of Commercial Laws and Regulations

On average, over a sample of 621 company representatives, it is quite striking to see that most medium-sized business owners know about the key laws and regulations that constitute the commercial law framework: for instance, 98.0% said they had heard about the labour law and regulations, 88.1% about the law on private investment, 85.7% about the company registration law. On the opposite, interviewees seemed less aware of the existence of the intellectual property law (50.2%), the procurement law (47.4%), the commercial code (35.9%), and – less surprisingly – the international trade (19.2%). Last, “only” 74.8% of the respondents said that they knew the “Land and Property Law”, which is surprising if we consider that land claims form the majority of civil and commercial cases in Afghanistan<sup>26</sup>.

Of course, the fact that such a significant majority of interviewees answered positively does not necessarily mean that they have a clear understanding of the *content* of the commercial laws; however, it may indicate whether they have heard or not about each of those laws. From this point of view, the additional focus groups that were organized to control the actual understanding of the existing commercial laws and regulations are quite instructive: in Faizabad, Balkh and Kunduz (where more specific focus groups were done on this topic), none of the participants was able to provide us with any specific content detail. But focus group participants unanimously insisted on the significant role played by the commercial laws:

- *“It is indeed quite important to know that there are commercial laws because it prevents people from inappropriate business attitudes” (Baz Mohammad, Transportation, Focus Group in Kunduz);*
- *“The law is necessary. It is not like the government. We can live without the government but we cannot live without the law. I can do business without governmental representatives but I need rules and regulations to make sure that the deal is fair” (Allah Mohammad, Construction, Focus Group in Kunduz);*
- *“There are a few things I know about the private investment and the registration laws. I know that you cannot run a company in Afghanistan without being registered and I know how to do it with the AISA and the MoC. But most of the things that are in the laws and regulations are unclear to me. It is necessary to have them, even if they are unclear to us, because they show us that sellers and buyers are on the same page” (Shafiqullah, Telecom, Focus Group in Balkh);*

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<sup>26</sup> Land and property cases account for more than 70% of the cases dealt by *Hoqooqs*, *shuras*, or formal courts: “Major obstacles to restoring land and land-related resources are different land policies pursued by various regimes, most of which have rewarded their supporters through land allocations, often of land from which the formerly rightful owners have fled. Ownership often cannot be verified since the national land registration (cadastre) system is incomplete. Even where the courts, public authorities or customary dispute resolution mechanisms issue fair decisions there is no guarantee that these can be enforced” (in Sheila Reid and Conor Foley, “Land and Property: Challenges and Opportunities for Returnees and Internally Displaced People in Afghanistan”, NRC, 2009).



- “We need customary and formal regulations. Commercial laws are necessary to start your company and make it work; customary laws, negotiations, and unwritten rules are necessary to do business” (Abdul Basir, Construction, Focus Group in Faizabad).

To corroborate these first assumptions, it is worth noticing that interviewees almost unanimously said that the commercial laws and regulations they knew were useful, as shown in the second row of the table below: only an insignificant proportion of respondents considered that commercial laws and regulations are useless (between 0.1% and 1.4% for commercial laws that regulate local exchanges, and only 3.4% for international trade laws).

**Table 33: Commercial Law Awareness**

<b>Commercial Laws and Regulations</b>	<b>I know it</b>	<b>I know and it is useless</b>
<b>Labour Law</b>	98.0%	0.1%
<b>Law on Private Investment</b>	88.1%	0.4%
<b>Company Registration Law</b>	85.7%	0.8%
<b>Company Law</b>	79.9%	0.8%
<b>Land and Property Law</b>	74.8%	0.7%
<b>Banking and Secured Transaction Law</b>	69.5%	1.4%
<b>Laws on Commercial Arbitration</b>	60.0%	0.6%
<b>Intellectual Property Law</b>	50.2%	1.3%
<b>Procurement Law</b>	47.4%	0.7%
<b>Commercial Code</b>	35.9%	0.9%
<b>International Trade Law</b>	19.2%	3.4%

#### 4.2.2. Perception of Legal Assistance

One of the key findings – from both qualitative and quantitative components of the assessment – was respondents’ strong mistrust with regards to the legal system as well as legal advisors and counsellors. If we first have a look at the quantitative results, it is worth noting that only a very reduced percentage of medium-business owners or managers reported having requested the assistance of an expert to help their company with legal issues: on average, only 4.7% of the interviewees and, more interestingly, only 4.8% of Balkh respondents answered positively. If we consider that Balkh is the city that benefits from both the most dynamic socio-economic environment and the easiest access to legal counselling, it is quite symptomatic of medium-companies’ owners’ lack of information on, understanding of, and/or interest for legal counselling. To sort out the reasons for such a poor demand, the review team organized focus groups in Taloqan and Mazar with business owners whose companies had faced legal problems in a recent past. The dialogue clearly showed that:

- Legal counselling was *a priori* considered as unnecessary by most focus group participants, as it is an additional cost with no guarantee of success: “Why would I give money to someone who cannot ensure that I will actually win the case? It’s better to fix it directly and talk to the judge or the elders” (Esmatullah, Tailor, Mazar-e-Sharif).
- Legal counselling did not benefit from a good image among company owners, as there was a relatively poor performance feedback from other business owners who had requested the support of legal experts: “Unless the lawyer is a close friend of the judge, he will only irritate the court with his questions. Legal experts do not understand what real business life is” (Hanif, Construction, Taloqan).

- Correlatively, legal experts suffered from a perceived incapacity to meet the actual demand of the “legal marketplace”, as their knowledge of commercial rules and commercial was described as irrelevant in the local context where “it is more important to show people that you are not a trouble-maker rather than to argue with books and technical speeches” (Ehsanullah, local NGO worker, Mazar-e-Sharif).

*Table 34: Legal Assistance Needs (breakdown per province)*

Have you ever requested the assistance of an expert to help your company with legal problems?			
Provinces	Yes	No	Total
Badakhshan	4,0%	96,0%	173
Balkh	4,8%	95,2%	167
Kunduz	3,3%	96,7%	180
Takhar	7,9%	92,1%	101
TOTAL	4,7%	95,3%	621

Moreover, if we now shed more light on the 4.7% of business owners who reported having requested the assistance of a legal expert, it is worth noting that most of them are *in fact* relatives or friends (19 out of 29). In practice, when asked whether these relatives or friends had any specific knowledge of commercial laws and regulations, almost all the 19 interviewees said that the main asset of these so-called “legal experts” was their social network (with local commanders, *shuras*, or courts).

As such, less than 2% (10 out of 621) of the respondents actually requested the services of legal experts in the four-targeted provinces: 2 companies (from Kunduz and Balkh) went to their local *Hoqooq* Department and 8 companies (from all the targeted provinces) to a private lawyer. When individually asked to give their feedback on the services provided by the legal expert they had consulted, it is striking to note that only the 10 respondents almost unanimously said that they had not been satisfied with that legal assistance:

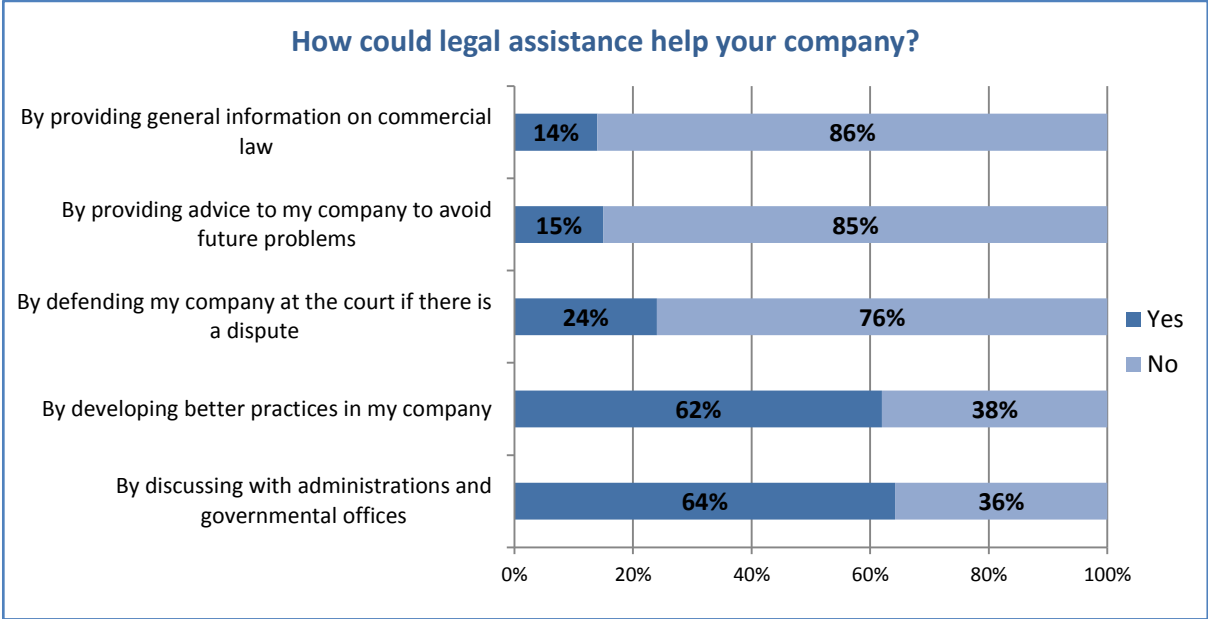
*“Lawyers and Hoqooqs only want to make money with companies’ problems.”*

(Haj Noorullah, Retailer,  
Mazar-e-Sharif)

*“We paid money to them, fees or bribes, and they did not help solve our problems. It is much better to discuss legal issues with our community leaders so that the decision is made in an open and acceptable way. Lawyers and Hoqooqs only want to make money with companies’ problems”* (Haji Noorullah, Retailer, Mazar-e-Sharif).

Correlatively, when asked how legal experts or assistance could help their company, most respondents (55.5%) decided not to answer the question as they were generally considering that “most legal experts are not aware of the reality of our business and of our community” (Noorullah, Motorcycle mechanic, Taloqan). As for the 44.5% of interviewees who accepted to answer the question, it also seems that they do not associate legal assistance with legal dispute resolution: if a majority of respondents said that legal assistance could help them through the facilitation of their discussions with administrations (64%) and the development of better practices within their company (62%), only 24% mentioned dispute resolution and 15% practical legal advice.

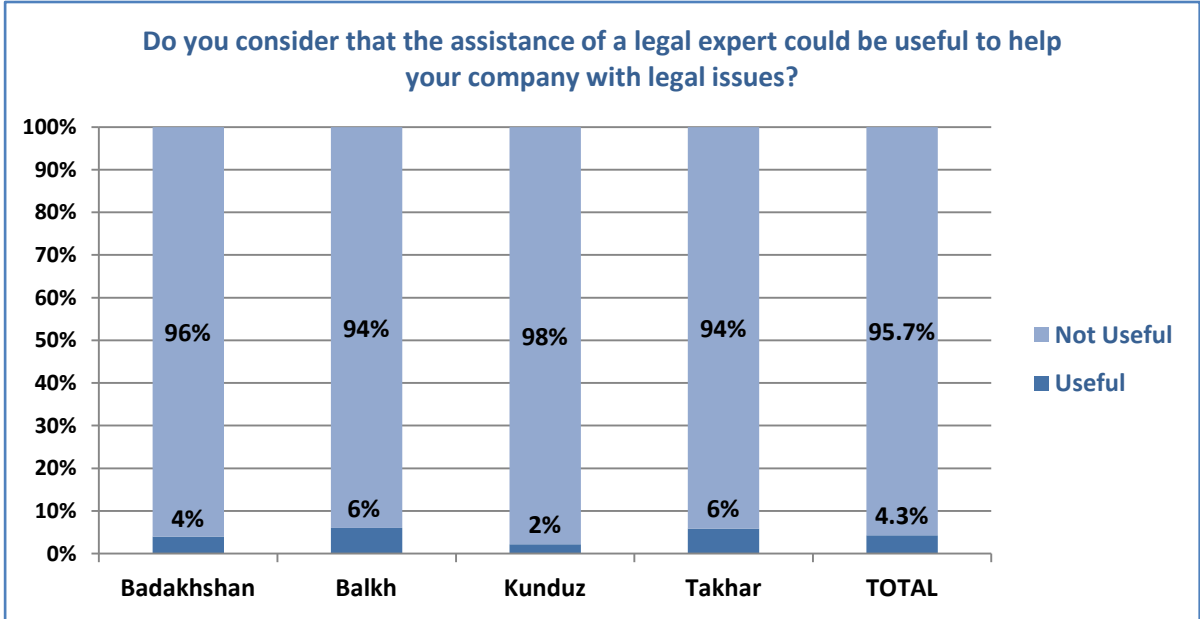
Chart 12: Legal Assistance Impact (perception)



Such a negative perception (and experience, to some extent) of legal assistance was finally confirmed when respondents were asked if the assistance of a legal expert could be of any help to their company in the future: on average, only 4.3% (27 out of 621) of them answered positively (with no significant difference between the surveyed provinces or districts), as shown in the chart below. Moreover, none of the 10 companies that had requested the assistance of an expert before answered positively, which clearly shows that:

- The perception of legal assistance is clearly negative among medium-companies;
- The experience of legal assistance has not been positive so far;
- Legal assistance is considered, at best, as a facultative service that should not be expensive (out of the 27 interviewees who said that legal expertise could be useful to their company, only 12 were ready to pay for this service in the future).

Chart 13: Legal Assistance Impact (perception)



There is a strong prejudice against legal advisors or assistance in all the surveyed provinces and districts (rural or urban). This point is of course crucial and may explain the reason why so many legal assistance initiatives have been unsuccessful in the past few years: *“We started a free program with young and skilled Afghan lawyers in Mazar-e-Sharif four years ago. After a few months, we realized that people were reluctant to request any help from the program. In fact, our approach was fundamentally flawed as we did not take into account the cultural and social prejudice that most companies and people have against experts and legal assistance here”* (USAID Advisor, Kabul).

*Picture 6: Family-owned metalworking company in Taloqan*



## 5. Recommendations

Finally it seems that, aside from the social and market markets, a sound and sustainable strategy for medium-sized businesses in the four targeted provinces should: 1) take the economic and political context into account, as there is a clear risk of state insolvency with a projected financing gap of 25% of GDP by 2021/22; 2) develop a resilient network of public and private sector actors by strengthening the capacity of the local chambers of commerce; 3) promote an advocacy strategy to create a network of formal and informal actors. On the long-run, the main conclusion of this study is to prioritize sustainability over short-term objectives: building the capacity of public institutions (DoJ and MoC) is of course a necessary objective, but when the international funds run dry, only a multi-lateral strategy emerging from the private economic sector as well as formal and informal actors, is likely to succeed.

### 5.1. Economic context: the sustainability issue

**Context** – International organisations working on humanitarian or development initiatives in Afghanistan have generally sought to strengthen their collaboration with local governmental authorities. Such a necessary collaboration is of course a requirement to promote a sustainable political, social, and economic development in the country.

However, we also strongly believe that international organisations should take the worsening socio-economic context into consideration when they design their strategies. In other words, in the light of probable state bankruptcy<sup>27</sup>, shall development programs put all their eggs in the public basket?

The announced and progressive withdrawal of international aid to Afghanistan, between 2012 and 2016, will immediately impact the solvency of the state on the short- to medium-run and hamper the MoF capacity to pay civil servants. In these regards, below are some of the key economic findings of a November 2011 study from the World Bank<sup>28</sup>:

- **Economic forecast** – *“The extremely high level of current annual aid (estimated at \$15.7 billion in 2010) is roughly the same dollar amount as Afghanistan’s GDP and cannot be sustained. Projections suggest that, under even favorable assumptions, real GDP growth may fall from 9% a year over the past decade to 5-6% during 2011–18 [...] However, the growth projections are based on a set of assumptions (scenarios) related mainly to security, sources of growth, aid levels, and changes in investment climate. In these different regards, deteriorating security and governance would lead to further economic decline”.*
- **Financial and fiscal situation** – *“The worst impact of transition will be on the fiscal situation with a projected financing gap of 25% of GDP by 2021/22. Even assuming ambitious targets for robust growth in domestic revenue are met (with a projected rise from 10% of GDP to more than 17% of GDP a decade from now) there will be an unmanageable fiscal gap. This gap arises primarily as a result of operations and maintenance (O&M) spending and the wage bill for security, which together will be 17.5% of GDP by 2021”.*

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<sup>27</sup> See the 2011 World Bank report, *Issues and Challenges for Transition and Sustainable Growth in Afghanistan* (Afghanistan Country Team, 2011): *“Total aid to Afghanistan was equivalent to 91% of GDP in 2010 and 2011 (...) Even under optimistic assumptions, the Afghan budget will not attain fiscal sustainability over the medium-term (...) Under conservative estimates of declining aid, the Afghan budget deficit would reach 30% of GDP by 2021 with additional operational and maintenance costs”.*

<sup>28</sup> *Transition in Afghanistan: Looking Beyond 2014*, (The World Bank, Afghanistan Country Team, November 2011).



- **Public resources** – *“Investments almost entirely funded by donors over the past decade have significantly increased access to basic services and infrastructure including in basic health and education, rural access, power and irrigation. Nevertheless, Afghanistan’s development indicators still remain among the worst in the world. Afghanistan’s public finances will not be able to absorb both the cost of operating and maintaining all of the infrastructure assets created in an often fragmented manner over the past 10 years and delivering the range of social and other services to the Afghan people currently financed through donor-funded programs”.*

In these regards and to make a long fieldwork assessment short, one could say that the most significant gap to bridge for the GIZ-RoL program is not only technical (What are the needs of medium-size businesses? How can we provide legal assistance to medium-size businesses?) but also strategic: What is the most sustainable approach the RoL program can adopt to make sure that companies will still benefit from legal assistance?

*Where we are:* GIZ has already started an in-depth collaboration with the *Hoqooq* department (especially in the five North Eastern provinces where the programme operates<sup>29</sup>), by providing its members with legal awareness training, equipment, books, and manuals on the different aspects of the legal landscape. However, the *Hoqooq* do not benefit from a very positive image among the population – and especially among company owners; another concern, as mentioned before, is the actual sustainability and long-term impact of a program that would target civil servants in today’s economic and political context.

*Where we could be:* As such, other options should be considered to tackle the lack-of-information-and-skill issue that still hampers the development of a fair local market. It is important that the GIZ-RoL program does not focus exclusively on one aspect of the judicial landscape and ties its strategy into both formal and informal judiciaries, to better mitigate the risks associated with a deteriorating socio-economic environment. As often stated in the existing literature on the rule of law in Afghanistan, the informal system is resolving civil and commercial disputes in a fairly just manner already and there is no need to permanently reinvent the wheel: *“Engaging the system and creating programs that potentially spend vast sums of money on the informal system could create perverse incentives that distort mechanisms that are already functioning effectively”*<sup>30</sup>. In the meantime, promoting links and strengthening existing relations between the state and traditional systems can help to harness the strengths of each, recognize the respective competencies of each and help build trust among communities in state justice institutions. A method is thus needed to capitalize on the benefits of traditional justice mechanisms as well as more formal bodies to resolve local commercial disputes while developing a sustainable and resilient judicial network.

As such, the objective of the two sets of recommendations below is to challenge – in a critical and constructive way – the current GIZ strategy with regards to legal assistance. The *Hoqooq* department can of course be used as a useful channel, providing that a thorough capacity needs assessment and a clear roadmap are designed for the next few years; however, it is also necessary to keep in mind that, on the long-run, private and informal actors are more likely to be resilient to a political and economic deteriorating environment than governmental agencies and public institutions.

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<sup>29</sup> Namely: Badakhshan, Balkh, Kunduz, Samangan, and Takhar.

<sup>30</sup> *“Informal Dispute Resolution in Afghanistan”*, John Dempsey and Noah Coburn (USIP – United States Institute of Peace, August 2010).



## 5.2. Recommendation 1: Strengthening the Capacity of the ACCI, using AISA as a model and coordinating with relevant partners (like AKF or NRC).

The main finding of this study is that the GIZ-RoL should prioritize long-term impact players in each of the targeted provinces. As such, ACCI, despite its structural and material issues, should play a leading role in the GIZ-RoL strategy. The current functioning of this institution is of course extremely improvable, as suggested in the third chapter of this study; however, it is probably, on the long-run, the most practical solution.

ACCI is an official governmental agency that *also* depends on independent businessmen (who select their representatives and often solve their disputes at ACCI local offices). As such, it is potentially in the interest of all ACCI members that the institution be fair, transparent, and accountable – even in a worsening economic environment. In other words, logics of private and self-interests would make ACCI the better place to promote the commercial law in Badakhshan, Balkh, Kunduz, and Takhar provinces.

However, given ACCI's lacks of capacity (see our analysis in 3.1), the GIZ-RoL should work almost from scratch to create and strengthen the capacity of the ACCI, by capitalizing on the positive experience conducted with AISA to build on AISA's structural efficiency and ACCI's historical authority among Afghan companies. The approach could be structured as follows:

- 1) **Testing** – The GIZ-RoL could start working in two provinces (namely in Badakhshan and Takhar) to benefit from AKF's deep understanding of the context there, as AKF provides a strong support to provincial chambers in Faizabad and Taloqan. Based on the lessons learned from these first two pilots, the initiative could be progressively replicated in Balkh and Kunduz;
- 2) **Training** – To improve the capacity of the provincial chambers, training workshops on organisational management, leadership, communication, negotiation skills, and commercial laws and regulations should be delivered to the management and administrative staff of each local ACCI, with the full support of the national headquarters;
- 3) **“Do not harming”** – It is recommended not to provide financial incentives to the ACCI as direct financial rewards tend to create perverse incentives and undermine the very nature of the initiative: on the medium- and long-run they have to be driven and funded by private companies to make them sustainable and to develop a different mindset among local businessmen and company owners.
- 4) **Equipping** – As such, GIZ-RoL should focus on basic equipment (computers, telephones, printers, stationery, etc.) and advocacy (newsletter, lobbying efforts with the government, new services for the private sector, exhibitions, business meetings, job fairs, etc.). In the meantime, it is crucial to keep working on the private sector network by working with international and local relevant organisations (like AKDN or FACT) and strongly developing the relationship and coordination with the AISA.
- 5) **Embedding** – Considering: 1) the negative image of both *Hoqooqs* and governmental representatives from the DoJ, 2) the sustainability issue that was raised in section 5.1, the GIZ-RoL programme should embed its legal clinics in institutions that are more likely to bridge the gap between formal and informal systems. The ACCIs could be an option, providing that GIZ-RoL develops their institutional capacity, as it still benefits from a positive image among private companies (despite their structural inefficiency). Legal clinics would

provide local companies with the free/affordable services of commercial lawyers and legal mentors on a one-to-one basis. More specifically, legal clinics would raise the awareness of local entrepreneurs and company representatives about the existing commercial laws and regulations, draft legal arguments, and tailor their recommendations to each specific commercial case.

- 6) Advocating** – However, to make sure that local companies do understand the rationale behind the legal-clinic initiative, it is necessary to: 1) assess the needs of local businessmen and entrepreneurs in terms of commercial law; 2) identify informal groups of local business community leaders (“ambassadors”) and invite them to legal workshops and workgroups; 3) create a network of “ambassadors” to lobby with other private actors (companies, institutions) and convince them to use both the business and legal services provided by the ACCI, and finally; 4) by provide legal services to businesses either free or at low-fees in order to build demand for business law services within local business communities and develop – on the longer run – better commercial practices.

This six-step path may be the most pragmatic approach to develop one-stop-shops for commercial entities willing to know more about their rights and potential business opportunities; it may also be the only realistic way to create self-sustainable legal clinics. On the long-run, the success or failure of legal clinics will mostly depend on private business owners’ trust: if they prize the organisation (for its services and performances), they will take its ownership and make it sustainable.

### 5.3. Recommendation 2: Promoting an advocacy strategy through a network of formal and informal key players, public and private actors.

**Formal and Informal Judicial Institutions:** More frequent interactions could create mutual understanding and trust between formal and informal judicial sectors. The GIZ-RoL could take the indirect lead on it, through the ACCIs, by setting neutral settings between state officials and *shura* or *jirga* leaders, to discuss about potential bridges between the two types of commercial conflict resolutions. It would lead to stronger links and cooperation between the two distinct – but potentially collaborative – systems. As such, the GIZ-RoL could, for instance, encourage joint training programs and dialogues between judges of primary courts, prosecutors, law enforcement officials and decision makers in the informal system (with an explanation of the key aspects of the 2004 Constitution; induction-sessions on each system so that each system has a basic knowledge of the underpinnings and processes of the other, and; workgroups and workshops to allow participants to exchange points of view and fuel future dialogues). One of the positive impacts that could result from an improved collaboration between formal and informal judicial systems would be to make informal justice decisions more transparent and sustainable: for instance, *“having proper formal recording and storage process of traditional justice decisions may prevent the same claims from being brought again and again, as it often happens, particularly in commercial or civil land-related cases”* (USIP, Legal Expert).

**University Students and Private Lawyers:** Based on interviews with NRC field officers, it seems that one of the key reasons why legal counselling is so disregarded in Afghanistan is the alarming level of most of the private lawyers who studied at Law Universities: *“Out of 400 interviews with Afghan lawyers, I can tell you that there is no comparison between lawyers who studied the Sharia’ Law and students from the University”* (NRC Legal Advisor). As such, the GIZ-RoL could imagine a training system that not only targets private companies or governmental representatives but also: 1) University students, and; 2) private lawyers and paralegals (3 years under a lawyer). In these regards, two initiatives could easily be undertaken:

- Establishing commercial law clinics at Afghan law faculties (in line with the ones already established at the ACCI, for instance), focusing on topics like land titling, contract drafting and interpretation and other legal services oriented towards medium enterprises could of course contribute to better link Universities with the commercial reality and legal challenges of the business world.
- Working with the Afghan Independent Bar Association to: i) create a specialized sub-association of Afghan commercial lawyers, ii) develop a core set of educational and advocacy services for members of the sub-association, and iii) provide support to local legal professionals – through AIBA and ACCI – with establishing business-law practices servicing the local business communities.

Laying such a strong emphasis on private lawyers has another advantage as, theoretically, *Hoqooqs* are not allowed to sit in *shuras* and *jirgas*, whereas private lawyers can do so: well-trained private lawyers could then solve commercial issues and shed a more formal light on local disputes. Once again, on the long-run, the private sector is probably the key to sustainability in the Northern region.

**Small and Medium-sized businesses:** A public commercial law awareness program among medium and small businesses, using provincial/national radio and television to inform local entrepreneurs and company owners about their legal rights and responsibilities, could be launched to progressively change the perception of commercial law assistance. Only an ambitious advocacy strategy, seconded by a strong awareness campaign, could change business owners’ attitude towards registration: *“if*

*[private companies] understand that they need to be registered to legally export out of this country and make more money through legal exports, they are more likely to be registered. Advocacy is the key!" (AISA Deputy Director, Mazar-e-Sharif).*

**Private Education Institutes:** The business of education – and especially of Private Training Centres and Institutes – is booming in Afghanistan, as they are the only alternative to governmental Universities. A rapid assessment of the existing private institutes in the four-targeted cities may allow the GIZ-RoL to select 1 or 2 reliable partners to initiate legal training sessions and awareness campaigns among the population (especially in business training centres, where some of tomorrow's entrepreneurs may be found). At a later stage commercial law-focused training programs or courses (with a specific certificate or diploma) could be an interesting asset.

**Other legal assistance programs:** There are not so many performing programmes in the rule of law sector. USIP has conducted interesting analyses, empirical pilot projects, and workshops on the informal sectors. More pragmatically, NRC's ICLA (the Norwegian Refugee Council's Information Counselling and Legal Assistance) programme has tried to define ways to link the formal and informal systems, while mitigating the risks of corruption and promoting a better accountability. These include registering community-based solutions in the formal court system for government endorsement and shura-based acceptance and possibly enforcement of court decisions. The GIZ-RoL already could of course benefit from developing/strengthening its relationship with such key natural partners within the rule of law sector.

## Annexes

### Annex 1: Obstacles to the development of medium companies' business activity

*Table 35: Obstacles to the development of the local business activity (Badakhshan)*

Badakhshan					
	No obstacle	Minor obstacle	Moderate Obstacle	Major obstacle	Very severe obstacle
Access to Electricity	15.0%	9.8%	9.2%	15.6%	50.3%
Access to Land	17.3%	15.6%	16.8%	12.1%	38.2%
Access to Water	58.4%	9.2%	6.4%	12.1%	13.9%
Access to Communications	71.1%	18.5%	2.9%	2.3%	5.2%
Skills of the employees	57.8%	20.8%	12.1%	4.6%	4.6%
Administration and Bureaucracy	43.9%	18.5%	17.3%	15.0%	5.2%
Labour Regulations	61.8%	23.7%	8.1%	5.8%	0.6%
Competition in your sector	56.4%	23.8%	12.8%	5.8%	1.2%
Access to credit	80.9%	9.2%	5.8%	2.9%	1.2%
Corruption	50.9%	14.5%	15.0%	9.2%	10.4%
Lack of Security (Crime, Theft, etc.)	56.1%	13.3%	6.4%	2.3%	22.0%
Taxes	54.9%	12.7%	7.5%	8.7%	16.2%

*Table 36: Obstacles to the development of the local business activity (Balkh)*

Balkh					
	No obstacle	Minor obstacle	Moderate Obstacle	Major obstacle	Very severe obstacle
Access to Electricity	25.1%	12.0%	15.6%	13.2%	34.1%
Access to Land	18.6%	9.6%	21.0%	19.8%	31.1%
Access to Water	58.7%	6.6%	8.4%	10.2%	16.2%
Access to Communications	72.5%	15.0%	7.8%	1.8%	3.0%
Skills of the employees	50.3%	25.1%	13.8%	8.4%	2.4%
Administration and Bureaucracy	29.9%	13.8%	24.6%	16.8%	15.0%
Labour Regulations	61.1%	25.7%	7.8%	4.2%	1.2%
Competition in your sector	41.3%	22.2%	22.2%	12.0%	2.4%
Access to credit	68.3%	11.4%	12.6%	5.4%	2.4%
Corruption	36.7%	18.7%	17.5%	13.9%	13.3%
Lack of Security (Crime, Theft, etc.)	54.5%	16.8%	11.4%	4.2%	13.2%
Taxes	52.1%	10.2%	9.6%	12.6%	15.6%

*Table 37: Obstacles to the development of the local business activity (Kunduz)*

Kunduz					
	No obstacle	Minor obstacle	Moderate Obstacle	Major obstacle	Very severe obstacle
Access to Electricity	45.0%	8.9%	8.9%	11.1%	26.1%
Access to Land	21.1%	9.4%	20.0%	16.1%	33.3%
Access to Water	68.9%	4.4%	3.3%	12.2%	11.1%
Access to Communications	68.3%	18.3%	7.8%	1.1%	4.4%
Skills of the employees	55.0%	25.0%	12.8%	2.2%	5.0%
Tax Administration and Bureaucracy	33.3%	15.0%	29.4%	15.0%	7.2%
Labour Regulations	57.2%	23.9%	11.7%	6.7%	0.6%
Competition in your sector	55.9%	16.2%	18.4%	8.9%	0.6%
Access to credit	68.9%	11.7%	10.0%	7.2%	2.2%
Corruption	43.9%	18.3%	15.6%	12.8%	9.4%
Lack of Security (Crime, Theft, etc.)	40.8%	23.5%	9.5%	7.3%	19.0%
Taxes	48.3%	4.4%	13.3%	17.2%	16.7%

*Table 38: Obstacles to the development of the local business activity (Takhar)*

Takhar					
	No obstacle	Minor obstacle	Moderate Obstacle	Major obstacle	Very severe obstacle
Access to Electricity	17.8%	7.9%	5.9%	16.8%	51.5%
Access to Land	30.7%	6.9%	19.8%	14.9%	27.7%
Access to Water	72.3%	13.9%	4.0%	1.0%	8.9%
Access to Communications	69.3%	12.9%	4.0%	2.0%	11.9%
Skills of the employees	56.4%	20.8%	11.9%	5.0%	5.9%
Tax Administration and Bureaucracy	39.6%	7.9%	28.7%	13.9%	9.9%
Labour Regulations	60.4%	21.8%	10.9%	6.9%	0.0%
Competition in your sector	65.3%	16.8%	12.9%	5.0%	0.0%
Access to credit	71.3%	7.9%	13.9%	5.0%	2.0%
Corruption	35.6%	10.9%	19.8%	10.9%	22.8%
Lack of Security (Crime, Theft, etc.)	50.5%	11.9%	3.0%	4.0%	30.7%
Taxes	35.6%	8.9%	6.9%	12.9%	35.6%



## Annex 2: Information, Counselling and Legal Assistance for returnees and IDPs

The NRC (*Norwegian Refugee Council*) is providing legal services to returned refugees and IDPs living within urban districts of Kabul and a few other provinces. The core focus of the NRC's legal services is on resolving local disputes, including property disputes. The NRC's trained judges and attorneys fully rely on the *Jirga* processes of the non-governmental system of rights and legal matters by utilizing community based resources in facilitating negotiation, mediation, and conflict resolution. To a certain extent, the NRC's methods of conflict resolution involve a legal support for disputants to settle their cases via the Afghan government court system. Practically, the NRC judges and attorneys do not play the third party role; instead they provide legal assistance to the Third Party Intervener, respected members of the disputants' community.

Once a client approaches an NRC ILAC, the appointed officers will review all available evidence and evaluate statutory and Sharia legal issues looking toward a remedy. They record case history, case development, and the nature of dispute, and once they take the case, it is registered. The NRC informs the defendant of the case, and explains to the parties the availability of two options: a) solving their dispute via the traditional process of *Jirga*; or b) bringing their case to a government and settling it in a court. The NRC informs disputants about the cost and consequences of solving the cases via the local forum of the informal system, compared with reaching resolution in a government court. If disputants agree to resolve their disputes via the *Jirga* process, the NRC asks each side to choose three trusted people to represent his or her side of the dispute in *Jirga* meetings. The NRC provides the required information to members of the *Jirga* that are chosen by each side as the Third Party Intervener, and eventually the process may develop into a situation in which the parties agree on *Eslaah* (peace building and conflict resolution) with the participation and presence of the disputants. Or, they may decide to apply the *Hakam* rule, in which trustees are empowered by the parties to make a binding decision in a session closed to the parties.

From this point on, disputed parties may accept the final decision, or take the case to court. The NRC sends a delegation of three judges and attorneys to observe the process and its outcome without having a right to vote. In this regard, most of the negotiation, bargaining, and decisions are made by the representatives of both sides of the dispute, and the NRC delegation contributes if legal and procedural clarification is needed. Through the *Jirga* system, the NRC has been able to develop a network of local activists and respected individuals within city districts. In addition to playing the role of a Third Party Intervener, these local activists hold *Jirga* meetings in their homes. This local involvement among the urban population has resulted in using *Jirga* to solve 30 percent of the 317 legal disputes accepted by the NRC during the current year of the Afghan calendar, compared with only 10 percent that have been sent to the government courts.

Lack of awareness of rights and legal obligations is a substantial obstacle to popular capacity to use the formal legal institutions or to hold the informal sector to basic international standards of justice. Affecting as it does the popular relationship to both the formal and the informal legal sectors, it clearly also constitutes a substantial obstacle to the development of a productive relationship between the sectors. Most people do not distinguish between the distinct roles of police, army, local executive administrators and judges, nor is there a clear understanding of the boundaries between state and non-state power. This also plays a significant role in the popular perception of the relationship between local and national and customary and formal legal norms and practices.

*Compiled from NRC public internal and external resources.*

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