

# CPAU-International



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## The Rationale for Establishing a For-Profit Enterprise

The decision to establish a for-profit (FP) enterprise is based on four key rationales:-

1. **To Provide CPAU with institutional stability and sustainability:** One reason that NGO's look to income generated work is to ensure that the organisation can continue to retain staff and core activities between funding cycles. This provides stability to the NGO activities and helps to avoid a chaotic scramble for fundraising when projects are finishing. The contribution of earned income into a clearly defined contingency fund will therefore enhance the opportunity for CPAU to be more sustainable. This is particularly vital in the current context of Afghanistan where international development funding is uncertain.

2. **There is a demand for quality research and responsible investment facilitation in Afghanistan:** Increasingly international companies are looking to invest in Afghanistan, particularly in the primary resources sector. In order to do so, they will require research such as risk assessments and facilitation to ensure that that companies can make decisions based on sound information and have in-country facilitation that will ensure a responsible approach to their investments.

3. **CAPU International's ability to service the market demands:** In terms of providing high quality and appropriate research, CPAU (the NGO) has long term experience in conducting community level analyses and risk assessments. CPAU-I can draw on this long term experience. Importantly, in Afghanistan due to a weak rule of law, doing business will require substantial understanding of local customs, systems and working with local-level power brokers. Due to CPAU's long standing work at community level, it is able to provide this facilitation at a sub-national level. This is particularly the case in northern Afghanistan.

CAPU-I already has the legal infrastructure in place to begin to meet the market demands. CPAU-I is registered with the Afghanistan Investment Support Agency (AISA). CPAU UK is also reregistered as a for-profit organisation which will provide a European platform for CPAU-I to reach out more substantively to European companies looking for investment opportunities in Afghanistan.

4. **Global trend for social entrepreneurship linking non-for-profit (NFP) and for-profit organisations:** In both developed and developing countries there is a growing trend for charitable organisations and NGO's (NFPs) to partly support these activities with income generated via for-profit work. There is a long standing tradition of this approach in South Asia where handicraft activities have been promoted by NGO's as a means for vocational training and livelihood support and then the products are sold commercially to raise profits for the development activities. In Afghanistan, large NGOs such as

Coordination of Humanitarian Assistance (CHA) and the Afghan Development Association (ADA) have also established for profit enterprises, albeit using different models (described in Section 2).

## **2. Hybrid Models for Linking For-Profit and Non-Profit Work**

“Hybrid model” is a term that is increasingly used to describe an organisational set-up that combines for-profit and non-profit entities. Most commonly, the two entities are separated financially and through different governance boards. However, they are interlinked through a shared core ethical vision and the fact that both organisations require something from the other. The recent global trend towards hybrid models means that there are a plethora of different configurations. These configurations are a result of the different legal and regulatory frameworks that exist in each country. In some countries in Asia and Africa where regulatory frameworks are less constricting (compared to the USA, for example), there is more scope to develop a bespoke hybrid model that fits the desired social and economic visions of the founders.

Below are some examples of hybrid organisations in the developed and developing world, including Afghanistan.

### **A. Examples in Afghanistan**

#### **A.1: Coordination of Humanitarian Assistance (CHA)**

An example of a well-defined hybrid model between NFP and FP activities is CHA. CHA is the umbrella organisation which has separately registered non-profit and for profit subsidiaries. There are two for-profit enterprises. The first is CeReTechs which is an information and communication technology (ICT) service provider that was established in 1996. In March 2002, CeReTechs became the first licensed internet service provider in Afghanistan. CeReTechs is registered with the Afghanistan Investment Support Agency (AISA). The second for-profit subsidiary is the Afghan Management and Marketing Consultants. The non-profit organisations are Great Idea, SABA Media and the Organisation of Human Resource Development. Although

all of the organisations are registered as separate entities they are bound by the development vision of CHA. There is also a clearly defined and regulated division between the organisations, but they are able to share resources such as an office complex in Kabul.

## **A.2: Afghan Development Association (ADA)**

In 2008, ADA established the Environmental Assessment and Study Team (EAST). This is a for-profit initiative which “provides a variety of cost effective services to its clients regarding environmental assessment, conservation and improvement. These are mostly conducted through environmental assessment, environmental conservation & improvement, and training & capacity Building.”<sup>1</sup> EAST is an integrated for-profit unit *inside* ADA NGO rather than being a separately registered FP entity with the AISA. Unlike CHA, the FP work is not clearly articulated on the ADA website and NGO documentation.

## **B. Examples in the Asian Region**

### **B.1 Industree Crafts Pvt Ltd (FP) and Industree Crafts Foundation (NFP): India**

Industree Crafts was established in 1994 as a private limited firm selling contemporary products, mainly home accessories, designed by them but made in villages. They worked through established NGOs and self-help groups, sold through Industree-branded stores. Industree Crafts has now expanded into the export market.

Industree is a hybrid social enterprise based in Bangalore supporting livelihoods of rural producers and agricultural workers all over the country. They produce contemporary items using raw materials and traditional craft techniques. Industree connects two ends of the spectrum - the producer and the market, for this there are two entities, Industree Crafts Pvt Ltd with the Mother Earth brand and Industree Crafts Foundation.

Industree Crafts Foundation was set up in 2000 to concentrate on its work with rural producers on developing design, technical and skill initiatives in the natural fibre sector. The work focused

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<sup>1</sup> EAST brochure

on creating considerable value addition for agricultural by-products and other natural fibers in terms of product diversification, design, simplification of labour and time intensive process.

It is to be noted that Industree Crafts has chosen a model whereby the two structures share a common brand.

## **B.2 BASIX Social Enterprise Group (India)**

BASIX combines many facets of a typical hybrid organisation in India which includes a NFP wing with social goals combined with banking and microfinance institutions.

The Holding Company of the BASIX Group is called Bhartiya Samruddhi Investments and Consulting Services (BASICS Ltd.) which started operations in 1996 as India's first "new generation livelihood promotion institution". It set up two fund based companies – Bhartiya Samruddhi Finance Ltd, a micro-finance NBFC in 1996 and Krishna Bhima Samruddhi Local Area Bank Ltd in 2001.

BASICS Ltd also started providing fee-based business right from the outset by offering consulting services in microfinance and livelihood promotion, training, HRD and institutional development (ID) and information technology (IT) applications for microfinance and livelihoods.

Indian Grameen Services, a NFP organisation, forms the research and development arm of BASIX. Besides carrying out research and development in the area of livelihood promotion, it also designs and develops financial products for extending credit, evolving distribution channels for delivery of its services and developing systems for service delivery such as accounting and MIS.

The Livelihood School is an independent society promoted for knowledge building and training of livelihood professionals in NGOs, government agencies, banks and MFIs. It also provides training to BASIX staff. It is involved in building the knowledge base required for supporting livelihood promotion initiatives.

The fund-based, fee-based and social businesses of the BASIX group have a very clear synergy and contribute to each other's growth and prosperity. The credit business enables customer acquisition, while the insurance business mitigates customer and credit risk, and the AGBIDS business enables customer retention by enhancing their incomes. The consulting and IT business allows BASIX to earn revenues from offering services that it needs for itself anyway. The social businesses enable research and development and knowledge building.

### **C. Examples from Developed Countries**

Although the hybrid model is perceived as a new way to further a social and development agenda through the mixing of for profit and commercial activities, there are some international examples of organisations which have been hybrids for many years. One such example is the National Geographic Society which has created for profit subsidiaries and entered into strategic partnerships with FP companies to exploit their assets in the market place.

More recent examples would include the US-based UniversalGiving (NFP) and UniversalGiving Corporate (FP). UniversalGiving is a website that helps people give and volunteer with social and development-focused projects all over the world. The mission is to connect people to quality giving and volunteer opportunities worldwide. The vision of this NFP organisation is to "Create a World Where Giving and Volunteering Are a Natural Part of Everyday Life." UniversalGiving Corporate is a customized service helping Fortune 500 companies scale their Corporate Social Responsibility programs worldwide. UniversalGiving Corporate handles the strategy, operations and NGO vetting for corporations, ensuring the success of their international giving and volunteering programs.

The model of generating profit through research consulting services is taking hold both in the developing world, for example EAST in ADA and also in large international industries. For example, advancing green energy is usually via hybrid organisations. Part of the NFP entity is engaged in clean energy research and the FP part provides consulting services to businesses and governments. Both wings of the organisation are trying to advance environmental

protection so they share the same purpose and they are both controlled by the same group of people.

### 3. Challenges to Hybrid Models

While there are many compelling reasons to establish this type of configuration, “hybrid models are complex – legally, financially and ethically.”<sup>2</sup> Six of the key challenges to this type of organisation are as follows:-

1. **Cultural dysfunction:** The notion of selling goods or services to generate income is at odds with the non-profit ethos.
2. **Conflict of mission:** Pursuing profit can conflict with the non-profit’s core mission, particularly if attention and resources are shifted to the new earned income activities. This can create mission drift in the longer term.
3. **Concerned stakeholders:** External stakeholders, particularly traditional donors, may become concerned about the business activities and the transparency of the relationship between profit and non-profit activities.
4. **Different service focus:** Concerns may arise from the traditional stakeholders of the non-profit in regard to shifting focus from the original constituents (beneficiaries) of the NGO to new service clients and locations.<sup>3</sup>
5. **Added complexity:** A hybrid structure can make things more complicated in terms of taxation, governance, and paperwork.
6. **Sustainability of the FP organisation:** If an enterprise is using a non-profit arm as a crutch, then one could argue that a venture is not financially sustainable. It is critical to define when a hybrid is optimizing social value versus optimizing its own financial gain.<sup>4</sup>

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<sup>2</sup> Adam Huttler, “Business Models: Possibilities and Pitfalls,” Oct 26, 2010

<sup>3</sup> Tom Triplett, “Integrating Social Enterprise with Other Revenue Streams.”

<sup>4</sup> Lindsay Clinton, “Blended Value: Weaving Profit Into Social Mission Through Hybrid Models,” (Beyond Profit, March 2010)



These challenges are not insurmountable with careful planning, a clearly articulated position to external stakeholders, and a well understood legal and financial separation between the two organisations.

Finally, hybrid models, particularly those in South Asia have been accused of ‘gaming the system’. That is, taking unfair advantage of donor funding and the private enterprise system. However, this perception is becoming increasingly outdated as social entrepreneurship becomes more internationally understood and accepted. There is now less of a perception of the black and white divisions that exist between the private sector and NGO or charitable work. A valid case for hybrid models in India has been advanced by Dhruv Lakra, founder of Mirakle, (an enterprise that generates employment opportunities for low-income deaf men and women, and works to empower and help them achieve financial independence): “You wouldn’t use a for profit company to provide HIV education to the deaf.”<sup>5</sup> A similar case can be made for CPAU-I in Afghanistan: you would be unlikely to find a for-profit consulting company that is respected in local communities and operates on principles of conflict sensitivity and conflict mitigation.

#### **4. The Model and Positioning of CPAU-I**

The CPAU-I model will most closely resemble the two hybrid models described previously. It will resemble CHA in terms of separate legal and financial identities between CPAU and CPAU-I but a shared commitment to a common mission to promote peace in Afghanistan. It will also use the model of Craft Industree in relation to the shared branding identity.

Communicating the positioning of CPAU-I both to internal and external stakeholders will be a critical initial step. Internally, staff in CPAU NGO may need an adjustment period to recognise how earned income can support a not-for-profit mission and also to feel comfortable that the new organisation will not be prioritised at the cost of the NGO work. Steps can be taken to mitigate these issues such as introducing a third party facilitator to bridge the gap between the two organisations. Another step will be to demonstrate the value of CPAU-I to CPAU through

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<sup>5</sup> Quote from Lindsay Clinton, “Blended Value: Weaving Profit Into Social Mission Through Hybrid Models,” (Beyond Profit, March 2010)

long-term fiscal projections that indicate the importance of for-profit income for the long-term sustainability of CPAU.

The external positioning of CPAU-I to external stakeholders and donors will be of the utmost importance. This is particularly the case in the current context in Afghanistan where some national NGO's are perceived to blur the boundaries between non-profit and for-profit work. Initial steps to promote the role of CPAU-I transparently will be to highlight the linkages of CPAU-I and CPAU work in CPAU's new strategic plan, (2012-2015); to demonstrate how CPAU-I will promote the organisational sustainability of the NGO; and to highlight the legal, financial and human resource separation between the two organisations. Unlike organisations that exist under the umbrella of CHA, CPAU-I shares a very similar name to CPAU the NGO which may make external positioning of the for-profit brand quite tricky at first.

## 5. Core Work Areas

The four core work areas of CPAU-I have been outlined in the draft business plan of June 2012. A further core area has now been established in terms of a media production house. These core areas are as follows:

1. **Geographic and thematic assessment/analyses for investors:** Although CPAU-I believes that there is a strong market for these research products, especially economic research, in many instances, companies will favour in-house assessments. However, CPAU-I's advantage is that it can provide an authentic and balanced voice about the opportunities and impacts that economic investment could bring to Afghanistan. CPAU-I will need to spend some time promoting itself to potential clients to generate a strong reputation for this work. Therefore an inaugural product of CPAU-I will be a Strategic Economic Analysis (SEA) which will be marketed to potential investors. Funding for this initial assessment will need to be found from non-donor sources so that the for-profit work is not 'double-dipping' from CPAU donor funded projects. Likewise, existing CPAU staff will need to be formally sub-contracted to implement CPAU-I research.

The draft business plan has proposed that CPAU-I research should also be marketed to think tanks such as Chatham House in London. However, it is proposed that in terms of establishing a clear brand identity and client base in the early stages of commercial business, CPAU-I should clearly focus on a marketing strategy to business investment and create synergies between the assessment and facilitation work.

2. **Facilitate socially responsible investment, especially in rural areas of Afghanistan:**

Initial market research conducted by CPAU-I staff, for example, attendance at the Delhi Summit on Investment on Trade in Afghanistan in June 2012 indicates a demand for investment facilitation. However, The World Bank's 2012 "Doing Business Report" ranks Afghanistan at 160th out of 183 international economies for the ease of doing business overall. This ranking reflects the reality that the Afghan legal, regulatory frameworks and enforcement mechanisms are in a nascent stage. Therefore CPAU-I staff (led by the Afghan senior staff members) are well placed to facilitate investors in this climate due to their understanding of informal practices and knowledge of working with communities at a sub-national level. As such, this activity may be thought of as responsible investment facilitation and mediation. An overall assessment of the investment context in Afghanistan is provided in Annex 1.

3. **Media production house:** The establishment of CPAU as a radio production house that provides media consultancy and production services to other NGOs/firms. The radio stations can also generate income through advertising.

4. **Quarterly journal:** According to the draft business plan, this publication will attend to the shortage of academic journals that focus specifically on Afghanistan. CPAU-I will fill that void by publishing an online quarterly journal with information on peace-building, potential investment opportunities in the natural resources and minerals industry, the challenges that Afghanistan faces, and essays regarding the application of prominent international relations theories on Afghanistan. An online journal published by CPAU-I

will provide the reader with an authentic voice from Afghanistan about the challenges that the country faces, and what is currently being done to handle those challenges. It suggested in the draft business plan that the large international Afghan Diaspora would be a key market for this product.

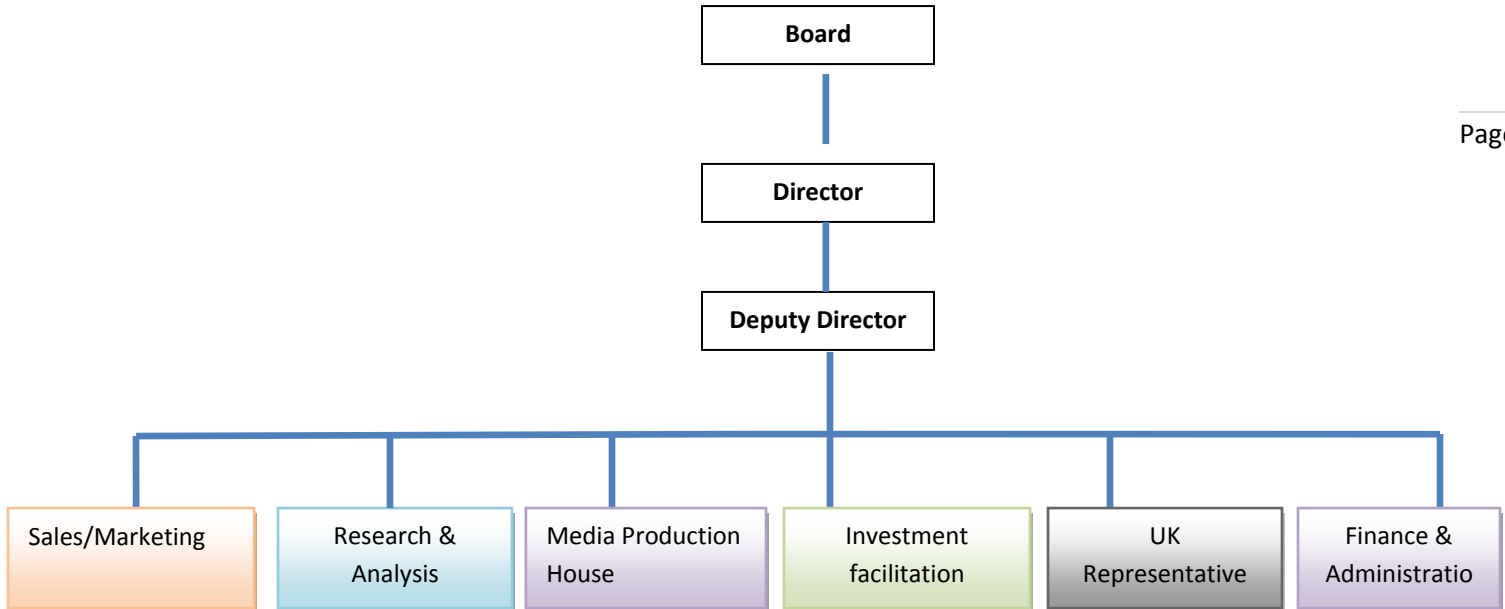
The rationale for the journal does reinforce the shared agenda between CPAU and CPAU-I on promoting peace and development in Afghanistan. It is also a useful mechanism whereby CPAU-I and CPAU can explore the wider impact of economic activities on the peace process in Afghanistan. However, the financial viability of this journal will require further testing to see whether online subscriptions and advertising could make it a viable income generating activity. The publication of an extended newsletter could be implemented as a pilot programme to test market interest and demand.

## **6. Operating Modalities**

CPAU-I has already been established as a separate financial and legal entity. It will be governed by a separate Board which is a valuable opportunity to introduce entrepreneurial expertise into the organisation. Profits generated by CPAU-I will be kept in a transparent sustainability fund to support identified CPAU core activities and staffing.

The Director of CPAU-I will be based in Kabul but it is envisaged that key departmental positions will be expected to reach out to markets in Afghanistan, Asia and Europe. The proposed organogram is shown below.

## Structure of CPAU-I



### 7. Marketing CPAU-I Work

There are many consulting companies in Afghanistan who will be looking to facilitate business investment in Afghanistan. CPAU-I has some clear advantages when positioning itself in the commercial market place:

- i. CPAU-I can use its long-term research experience from CPAU work to seamlessly supply the research, analysis and facilitation services package
- ii. CPAU-I can work at scale. The Strategic Economic Assessment will be a useful marketing tool to demonstrate the broad research reach of CPAU-I
- iii. CPAU-I staff have long term experience working at sub-national and the national level in Afghanistan
- iv. CPAU-I has an established for-profit entity in the UK where it can reach out to markets in Europe, for example, the large trade delegations in Brussels
- v. CPAU-I staff are comprised of Afghans and international staff and can communicate effectively to both national and international clients
- vi. CPAU-I shares a core humanitarian vision with CPAU NGO and is more likely to be identified with CSR values than many other consulting companies

- vii. CPAU-I staff have a large network of researchers to draw on when conducting for-profit assessments. However, CPAU NGO staff can not engage in for-profit research unless they are currently not engaged in NGO work and are contracted separately by CPAU-I

## 8. Linkages between CPAU-I and CPAU

**Vision:** Both organisations share the same core vision for peace and development in Afghanistan

**Knowledge development:** Both organisations will share and benefit from the knowledge generated through research, programming and facilitation work. For example, this will be reflected in the quarterly journal.

**Institutional stability and sustainability to CPAU** will be enhanced through profits earned by CPAU-I

**The sharing of resources between CPAU and CPAU-I.** This is in terms of the office complex and logistical facilities. The radio stations will also be used by both organisations. For CPAU this will be for the further dissemination of its peacebuilding programming in communities throughout Afghanistan. CPAU-I will enhance the financial sustainability of the radio stations through providing radio production consultancy services and generating revenue through advertising. However, transactions and arrangements will be documented and reviewed by the independent Boards to ensure that neither organisation is being used to unfair advantage by the other.

## 9. Recommendations and Next Steps

As highlighted earlier in this document, there is no one-size-fits-all model for a hybrid organisation. The more prescriptive regulatory environments, for example in the US, have led to emerging typologies such as “parent subsidiary models” and “contract hybrids.” As Clinton (2010) points out, “In environments where there are no convenient structures or labels—as is the case in many developing countries—entrepreneurs are cobbling together their own hybrid combinations, to get the best of both models. In some ways, these structures demonstrate an entrepreneur’s ability to create solutions within an imperfect system. Some would call it innovative, an example of *jugaad*—a Hindi word that roughly translates to “using the materials

at hand to find a solution.” It conveys inventiveness and assertiveness in the face of adversity.”<sup>6</sup>  
 It is the recommendation of this report that CPAU and CPAU-I develop its own hybrid system that is best suited to the Afghan context and CAPU’s core vision and strengths.

### Recommended Next Steps

Recommendations	QTR 1	QTR 2	QTR 3	QTR 4
<b>1. Determine the business model</b>				
A shared brand model for CPAU and CPAU-International (Following the model of CRAFT Industree Pvt and Industry Craft Foundation)				
Borrow aspects from CHA and India models:- Legal separation between NFP and FP organisations but under the umbrella of a shared vision of peacebuilding currently articulated through CPAU				
Consultation with chartered accountant and lawyer to instigate a legal, financial and taxation framework for both NP and NFP organisations (both Kabul-based and UK based)				
<b>2. Determining the business portfolio of CPAU-I</b>				
1. Facilitate responsible business investment in Afghanistan; 2. Provide risk and context assessments to private and public enterprises; 3. Provide media production services to organisations/NGO’s and generate funding through radio advertising; 4. Generate profit through online journal subscriptions)				
Determine the priority core business area to initially focus on				
Market research on the viability of the online journal is to be conducted by implanting a newsletter pilot				
<b>3. Establishing the hybrid model</b>				
Identification and appointment of separate Board of Directors for CPAU-I (representing a diverse skill and experience set such as private enterprise, NFP, media etc)				
Recruitment of staff for CPAU-I. As per the research findings of Noble (2011), recently graduated personnel that do not have a strong affiliation with either the FP or NFP world are best suited to offer maximum value to a hybrid organisation <sup>7</sup>				
Clear and transparent articulation of the vision, roles and objectives of CPAU and CPAU-I through the Strategic Plan, website, and conversations with CPAU donors and stakeholders				
Development of a medium/long term financial plan for CPAU-I clearly demonstrating financial relationship between CPAU-I and CPAU				
Revision of CPAU-I draft Business Plan of June 2012				

<sup>6</sup> Lindsay Clinton, “Blended Value: Weaving Profit Into Social Mission Through Hybrid Models,” (Beyond Profit, March 2010)

<sup>7</sup> Carmen Noble, “How ‘Hybrid’ Nonprofits Can Stay on Mission,” (Harvard Business School Review, October 17, 2011)

4. Marketing of CPAU-I services				
Promotion of CPAU-I research and risk analysis services through promotion of Strategic Economic Assessment with a clear focus on business investors				
Marketing personnel of CPAU-I promote business at appropriate trade events in Europe (through London office) and in Asia				
Media production services promoted within the development and private sector communities in Afghanistan				



## Annex 1

### 2012 Investment Climate - Afghanistan

**2012 Investment Climate Statement**  
BUREAU OF ECONOMIC AND BUSINESS AFFAIRS  
**June 2012**  
Report

The Government of the Islamic Republic of Afghanistan (GIROA) recognizes that the development of a vibrant private sector is crucial to the reconstruction of an economy ravaged by decades of conflict and mismanagement. GIROA has taken concrete steps toward fostering a business-friendly environment for both domestic and foreign investment. Security threats limit investors' opportunities to develop businesses in some provinces, and certain sectors (such as mining and hydrocarbons) still lack a regulatory environment that fully supports investment. Domestic and foreign investors also rank endemic corruption high on the list of impediments. Despite these challenges, Afghanistan's investment climate presents opportunities in all sectors of the economy. The following chart summarizes well-regarded indexes and rankings (MCC refers to the Millennium Challenge Corporation):

Measure	Year	Index or Rank
TI Corruption Index	2011	180/182 (Tied)
Heritage Economic Freedom	2011	N/A (not ranked)
World Bank Doing Business	2012	160/183
MCC Gov't Effectiveness	2012	-0.61(14%)
MCC Rule of Law	2012	-0.97 (2%)
MCC Control of Corruption	2012	-0.84 (3%)
MCC Fiscal Policy	2012	-1.6 (72%)
MCC Trade Policy	2012	69.1 N/A
MCC Regulatory Quality	2012	-0.83 (12%)
MCC Business Start Up	2012	0.972 (82%)
MCC Land Rights Access	2012	0.490 (11%)
MCC Natural Resource Mgmt	2012	3.5 (10%)

#### **OPENNESS TO FOREIGN INVESTMENT**

Official support for open markets and private sector participation is stated in the Afghanistan National Development Strategy (ANDS), which President Karzai and the international donor community endorsed in June 2008. The Afghan Constitution and the 2005 Law on Private Investment specifically prohibit discrimination against foreign investors. According to the Afghan Investment Support Agency (AISA), a quasi-government agency under the Ministry of Commerce that operates a streamlined business registration process ("one-stop shop") and conducts a host of business and investment promotion and facilitation activities, discussions are underway to improve regulations under the law. These recommendations will be submitted to the Parliament and the President for promulgation once completed.

Investment in certain sectors, such as non-banking financial activities, insurance, natural resources, and infrastructure (defined to include power, water, sewage, waste-treatment, airports, telecommunications, and health and education facilities) is subject to special consideration by the High Commission on Investment (HCI), in consultation with relevant government ministries. The HCI is GIRoA's focal point for investment policy-making and is composed of the Ministers of Commerce, Agriculture, Foreign Affairs, Finance, AISA, and Da Afghanistan (Central) Bank. Investments can be 100 percent foreign-owned and foreigners are not required to secure an Afghan partner. However, the Afghan Constitution and the Private Investment Law prohibit foreign ownership of land, which compels most foreign firms to work with an Afghan partner. Foreigners may lease land for periods up to 50 years for arable land or longer for non-arable land. Some leases have been negotiated with an automatic renewal clause for terms of up to 99 years. Many businesses cite access to land as one of the greatest impediments to investment in Afghanistan. Private investors have the right to transfer their capital and profits out of Afghanistan, including for debt service for off-shore loans.

GIRoA has adopted economic reform programs, which rely heavily on foreign experts who base their initiatives on international best practices. GIRoA has also adopted progressive policies to foster trade and investment, including currency reform, rationalized customs tariffs, and a simplified tax code. It has also set up structures to help promote investment and investment-friendly policies.

Important commercial laws currently in effect cover partnerships, corporations and limited liability companies, competition, arbitration, mediation, copyrights, trademarks, and patents. Laws modernizing legislation on trademarks, transportation, the Chamber of Commerce and competition have also been passed by Parliament and approved by the President. In March 2011, the President signed the newest Telecommunications Law, replacing the previous law enacted by decree. A related Information Communication Technology Law was submitted to Parliament and is expected to be approved in mid-2012, which will lay the groundwork for a new industry in electronic commerce and cyber security. Parliament also passed a Labor Law in 2008, but it does not meet International Labor Organization (ILO) standards. An anti-hoarding law, commercial agency law, and a contract Law are also under consideration. Accounting and standards regimes have yet to be set up. The primary challenges with the new laws and pending legislation and regulations will be their implementation and enforcement.

The Afghanistan Chamber of Commerce and Industries (ACCI) advocates for the establishment of a legal framework for private business in Afghanistan, engages with senior-level GIRoA officials, and provides an array of services to members, such as providing sector analysis and economic and trade statistical data. ACCI became a private chamber of commerce in 2008. Since then, ACCI has elected its leadership, endorsed the 2005 Private Investment Law, and established offices in 21 provinces of Afghanistan. ACCI works with Parliament, the Office of the President, and the Ministries of Finance, Commerce, Interior, Transport, Justice (among others) to bring about reform and encourage investment in Afghanistan. ACCI also has affiliations and partnership agreements with investors, business and trade associations in the United States, Tajikistan, Iran, Pakistan, Kazakhstan, China, Germany, Turkey, India, Croatia, Czech Republic, Russia, the United Arab Emirates, Italy, and many other countries.

Afghanistan's legal system is only just beginning to be rebuilt. Much of the framework necessary for encouraging and protecting private investment is not yet in place, and the existence of three overlapping systems (the Sharia-Islamic Law, the Shura-traditional law and practice, and the formal legal system instituted under the 2004 Constitution) can be confusing to both investors and legal professionals.

Although most senior Afghan government officials express strong commitment to a market economy and foreign investment, many businesses maintain that this attitude is not always reflected in practice. Many government officials -- some of whom demand bribes, levy unofficial taxes, and inflict bureaucratic delays -- are out of step with official government policy. Commercial regulatory bodies are often understaffed.

While not sanctioned by law or official policy, small groups of businessmen, many of whom are alleged to have connections with current or former warlords and militias, dominate the trading market in many areas. These individuals, because of their wealth and insider access to land, credit and contacts, and their ability to manipulate prices, enjoy excessive advantages that result in a non-competitive environment in some fields, notably gem-mining, fuel transport, and construction. In addition, some industries, including money changing and carpet production, have well-organized guilds which protect existing firms and create barriers to entry.

The World Bank's 2012 Doing Business Report ranks Afghanistan at 160th out of 183 economies for the ease of doing business overall. This ranking reflects the reality that the legal, regulatory frameworks and enforcement mechanisms are in a nascent stage. USAID launched a "Doing Business Indicators (DBI) Project in January 2011 to focus on improving the business-enabling environment in Afghanistan. Minister of Commerce and Industries (MOCI) leads the initiative. Under the initiative, five working groups were created to study and make recommendations for improving Afghanistan's rating on the following selected World Bank index indicators: 1) Starting a business; 2) Registering property; 3) Protecting investors; 4) Trading across borders; and 5) Closing a business. USAID provided key recommendations for reform on five indicators and the reform activities were transitioned to MOCI's leadership. One of the major contributions of the working groups was raising awareness among GIROA and the private sector regarding the provision of accurate feedback for the 2012 Doing Business in Afghanistan Report.

On October 1, 2011, USAID signed a partnership with the World Bank/International Finance Corporation to improve business climate in Afghanistan. The project initiated with a comprehensive assessment of status of the Doing Business in Afghanistan Report in mid-September 2011. The recommendation memo is expected to be rolled out during the second half of January 2012. The next step will be the implementation of the recommendations, improve the nine regulatory areas that impact all nine indicators of the Doing Business in Afghanistan Report, and build the capacity of MOCI's Private Sector Development Director and representatives of the private sector to lead the process.

#### **CONVERSION AND TRANSFER POLICIES**

There are no restrictions on converting, remitting or transferring funds associated with investment, such as dividends, return on capital, interest and principal on private foreign debt, lease payments, and royalties and management fees, into a freely usable currency and at a legal market clearing rate. The Private Investment Law states that an investor may freely transfer investment dividends or proceeds from the sale of an approved enterprise abroad. Afghanistan does not maintain a dual exchange rate policy, currency controls, capital controls, or any other restrictions on the free flow of funds abroad. Access to foreign exchange for investment is not restricted by any law or regulation.

In practice, however, particularly in the provinces, many banks may not have the capacity to deal with foreign exchange. The large, informal foreign exchange markets in major cities and provinces such as Kabul, Mazar-e Sharif, Jalalabad, Kandahar, and Herat, where U.S. dollars, British pounds, and euros are readily available, are slowly starting to become formal markets. As of October 2010, Da Afghanistan Bank had issued 209 licenses for money service providers (MSPs) and 271 licenses for money exchange dealers in Kabul, all commonly referred to as hawaladars. It has licensed 88 MSPs and 396 money exchange dealers in the provinces. Despite these licensed service providers and exchange dealers, there are thousands of unlicensed money changers that continue to practice their trade. Non-official money service providers often cite the lack of enforcement in the currency exchange area and the resulting competitive disadvantage to licensed exchangers as a reason not to get MSP licenses. U.S. investors should only use licensed hawaladar money service providers, who are listed on the website of Da Afghanistan Bank. The only requirements placed on the outflow of funds are to prevent money laundering (and the financing of terrorism). The transport of more than AFS 1,000,000 or equivalent in

cash across the border of Afghanistan into another country must be reported in advance to Afghan Customs.

#### **EXPROPRIATION AND COMPENSATION**

The Private Investment Law states, "The State can expropriate an investment or assets only for the purposes of public interest and on a non-discriminatory basis." It further states that the "State shall provide prompt, adequate and effective compensation in conformity with the principles of international law, equivalent to the fair market value." The State may confiscate private property in order to settle bad commercial debts. The law allows a majority investor to challenge the expropriation, but this right does not extend to minority shareholders. There have been no reports of State expropriation of foreign assets, "creeping" or otherwise.

#### **DISPUTE SETTLEMENT**

While a commercial court system exists, the lack of a law on commercial agency is a significant impediment to the arbitration of commercial matters. In addition, there is a shortage of qualified legal practitioners, and corruption in the judicial system is endemic. The enactment of the Arbitration and Mediation Laws in 2007 established the foundation for an alternative dispute settlement system. Afghanistan is a party to the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States and the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards. The Private Investment Law provides for dispute resolution under these mechanisms, under United Nations Commission on International Trade Law (UNCITRAL) rules, or under any mechanism that the investor has specified in a contract with another investor. The international donor community is supporting the development of an Afghanistan Center for Dispute Resolution.

Under these conditions, the legal system plays a limited role in adjudicating commercial disputes and most businesses use informal mechanisms to resolve disputes and enforce property rights. AISA, for example, has some capability to assist investors in the mediation of certain disputes. Investment disputes are common in the areas of land titling and contracts. The lack of a comprehensive land titling database means that several individuals may hold deeds to the same property. Real estate agents are not reliable. Those foreign investors seeking to work with Afghan citizens to purchase property are advised to conduct extensive and painstaking due diligence.

#### **PERFORMANCE REQUIREMENTS AND INCENTIVES**

Afghanistan has no formal regulations or laws governing performance requirements. There are no separate investment incentives or special treatment accorded to foreign investors. There are no government-imposed conditions on investment, beyond the procedures required for establishing or acquiring a business. GIROA does not impose offset requirements on its procurements. GIROA does not apply discriminatory or excessively onerous visa, residence or work permit requirements for foreigners, but bureaucratic processing of visas can be time-consuming and there have been reports of bribes being solicited for faster processing. There are no discriminatory or preferential export and import policies affecting foreign investors. As noted above, the HCI may choose to apply terms that are different from those generally applied to investments for certain restricted sectors.

#### **RIGHT TO PRIVATE OWNERSHIP AND ESTABLISHMENT**

Under the Private Investment Law, foreign and domestic private entities have equal standing and may establish and own business enterprises, engage in all forms of remunerative activity and freely acquire and dispose of interests in business enterprises.

#### **PROTECTION OF PROPERTY RIGHTS**

Property rights protection is weak due to a lack of cadastres or a comprehensive land titling database, disputed land titles, incapacity of commercial courts, and widespread corruption. The acquisition of a clear land title to purchase real estate or a registered leasehold interest is complicated and cumbersome. The World Bank estimated in its 2012 "Doing Business Report" that it takes an average of 250 days and entails legal fees of five percent of property value to register property. According to Da

Afghanistan Bank and ACCI, there is no law in force that deals specifically with bankruptcy, although the subject is discussed in some of the articles of the Banking Law. The Corporation Limited Company Law, Mediation Law and Partnership Law also discuss bankruptcy. The Law on Mortgage and Secured Transactions was approved by Parliament and signed by the President in 2009.

While Afghanistan has laws on patents and copyright, they are not compliant with World Trade Organization (WTO) standards and are in the process of being amended. A draft Law on Trademarks is also being amended to conform with WTO standards. Afghanistan is not a member of the WTO Trade Related Intellectual Property Rights (TRIPS) Agreement or the World Intellectual Property Organization (WIPO) Internet Treaties. There is not serious enforcement of intellectual property rights and pirated DVDs and software are sold throughout the country. Counterfeit pharmaceuticals and building materials are also widespread.

#### **TRANSPARENCY OF THE REGULATORY SYSTEM**

In general, the Afghan government promotes transparent policies and effective laws to foster competition, establish "clear rules of the game" and promote, rather than hinder, foreign investment. The inadequacy of the regulatory system, and corruption at every level of government create larger obstacles to investors than the transparency of the regulations. Procedures for obtaining a business license were streamlined in 2003 with the establishment of AISA, which serves as a "one-stop shop" for investors, and has greatly facilitated the process of establishing a business. Afghanistan ranks 30th out of 183 economies in the ease of starting a business, according to the World Bank's 2012 "Doing Business Report." There are no informal regulatory processes managed by non-governmental organizations or private sector associations. Parliament must approve all legislation, except that, when Parliament is in recess, the President can issue decrees that have the force of law. However, in these cases, Parliament has the right to review and amend the decrees.

#### **EFFICIENT CAPITAL MARKETS AND PORTFOLIO INVESTMENT**

Finance is Afghanistan's second largest service industry (behind telecommunications) and an important driver of private investment and economic growth. The sector has grown rapidly since the end of Taliban rule. Today, 17 commercial banks operate in Afghanistan, with total assets of \$4.1 billion (compared to assets of less than \$300 million in 2004). There are three state banks, Bank-e Milli (National Bank), Pashtani Bank, and the recently-acquired New Kabul Bank. There are also branch offices of foreign banks: Alfalah Bank (Pakistan), National Bank of Pakistan, Standard Chartered Bank (UK), Brac Bank (Bangladesh), and Aryan Bank (Iran). However, most Afghans remain "unbanked," with only five percent currently holding deposits. In addition, many Afghans continue to rely on money service providers (or hawalas) to access finance and transfer money because of the unfamiliarity with a functioning banking system and limited access to banks in rural areas. Three of the four mobile network operators – Etisalat, MTN, and Roshan – offer money mobile services. Banking remains highly centralized, with more than 75% of total loans made in Kabul Province. Bank lending is also undermined by a deficient legal and regulatory infrastructure that impedes the enforcement of property rights and development of collateral, leading banks to concentrate on short-term trade credit to well-known customers. The difficulty of accessing credit through banks and other formal financial institutions makes existing firms dependent on family funds and retained earnings, limits opportunities for entrepreneurialism, and reinforces dependence on the informal credit market.

The exposure of massive fraud in the country's largest bank, Kabul Bank, in 2010 laid bare the underlying weaknesses in banking regulation and supervision. Despite receiving significant technical assistance, Da Afghanistan Bank has been unable to match the pace of the banking sector's growth with requisite improvements in monitoring and supervision. These weaknesses have been compounded by a lack of political will in the Afghan government more broadly to enforce laws against well-connected wrongdoers in the financial sector. Credit to the private sector stands at less than ten percent of GDP, significantly lower than other countries in the region. Afghanistan ranks 150th out of 183 countries for

ease of obtaining credit in the World Bank's 2012 "Doing Business Report." Most Afghan entrepreneurs complain that the interest rate for a commercial loan from a local bank ranges from 15-20 percent. In response to this situation, investment funds, leasing, micro-financing, and SME-financing companies have entered the market; however, despite strong donor support for many of their activities, these firms have been handicapped by difficulties in securing repayment and other factors that impede bank lending.

#### **COMPETITION FROM STATE-OWNED ENTERPRISES**

In principle, government policies and regulations apply the standard of competitive equality to private enterprises in competition with public enterprises with respect to access to markets, credit and other business operations. However, in some instances, working-level government officials have exhibited anti-competitive and protectionist bias in some sectors in which state-owned enterprises (SOEs) are active. Under Presidential Decree No. 103 (2005), the Ministry of Finance has sole responsibility for assessing the economic viability of State-owned enterprises (SOEs). Since passage of the Decree, the Ministry of Finance has determined that eight of 64 enterprises should remain state-owned for the time being, while the other 56 should be divested-either through privatization, liquidation, corporatization or other mechanisms. The Afghan government has identified for divestment more than 1,400 SOE land parcels/buildings, from 44 SOEs evaluated. The Afghan government has approved 29 SOE liquidations, restructuring, and corporatization proposals. Foreign and domestic investors enjoy equal treatment under ongoing privatization programs.

#### **CORPORATE SOCIAL RESPONSIBILITY**

GIRoA is working with large companies and foreign investors to encourage corporate social responsibility (CSR). Large mining contracts include stipulations for environmental protection and community inclusion. Afghanistan law prohibits mining that would result in the destruction of antiquities unless the mining company has prior approval from the Ministry of Information and Culture. All four competing mobile network operators in the country have well-developed CSR outreach programs that include health, education, job creation, environmental protection, and outreach to refugees. Some Afghan charities are also benefiting from CSR funds from companies outside of the country. The newly-formed American Chamber of Commerce in Afghanistan (AmCham Afghanistan) has identified CSR as one of its core areas of focus. In addition, some Afghan entrepreneurs, such as Ihsanullah Bayat, Hotak Azizi, and the Alokozay Group, have foundations that provide assistance in the fields of health, education, and the eradication of poverty.

#### **POLITICAL VIOLENCE**

Afghanistan is struggling toward political stability, but anti-government violence has constrained economic activity. The government is taking steps to extend its reach in the provinces, but the risk of violence continues to be high in many areas, and security remains a primary concern for most investors. Foreign firms operating in country report spending a significant percentage of their revenues on security infrastructure and operating expenses. The U.S. Department of State continues to warn Americans against travel to Afghanistan. U.S. citizens should review the Consular Information Sheet and Travel Warning for Afghanistan for the most up-to-date information on the security situation and possible threats.

#### **CORRUPTION**

Corruption is pervasive in Afghanistan. In 2011, the country ranked 180th out of 182 countries in Transparency International's Corruption Perception Index. Based on the Penal Code, corruption is a serious criminal act; articles 260 to 267 state that anyone accepting or giving a bribe can be charged with criminal acts. While these anti-corruption laws exist, enforcement has been very limited. President Karzai created the High Office of Oversight for the Implementation of Anti-Corruption Strategy ("HOO") to coordinate anti-corruption measures for the government; this office, however, does not control penalties and fines and has been largely ineffective. Afghanistan acceded to the United Nations

Convention against Corruption (UNCAC) in August 2008, but is not a party to the OECD Convention on Combating Bribery of Foreign Public Officials. The early 2011 establishment of the Independent Monitoring and Evaluation Committee (MEC) for Anti-corruption should assist the Afghan Government in assessing its compliance with UNCAC. However, questionable Afghan Government commitment to supporting the MEC and early administrative challenges plague the new organization.

U.S. firms identify corruption as one of the biggest obstacles to foreign direct investment and routinely report being asked for a bribe, called "sherini" or "baksheesh." Although official working-level government salaries have recently risen, many officials at all levels take small bribes for government services. U.S. companies are expected to comply with the Foreign Corrupt Practices Act, which prohibits the bribery of foreign officials.

#### **BILATERAL INVESTMENT AGREEMENTS**

Afghanistan has bilateral investment treaties (BITs) with Turkey and Germany. Afghanistan became a full member of the South Asia Free Trade Area (SAFTA) on August 7, 2011. Most products originating in Afghanistan can be imported into the U.S. duty-free under the Generalized System of Preferences (GSP) Program, and EU tariffs on Afghan products are also very low. Afghanistan is a member of the South Asian Association for Regional Cooperation (SAARC) and Central Asian Regional Economic Cooperation (CAREC). The Afghanistan Pakistan Transit Trade Agreement (APTTA) was signed by both countries in Kabul in October 2010. Once fully implemented, APTTA should cut down on transportation costs and promote trade within the region. Afghanistan signed a Trade and Investment Framework Agreement (TIFA) with the United States in 2004, but a BIT has not been negotiated. Afghanistan does not have a bilateral taxation treaty with the United States.

#### **OVERSEAS PRIVATE INVESTMENT CORPORATION AND OTHER INVESTMENT INSURANCE PROGRAMS**

The U.S. Overseas Private Investment Corporation (OPIC) has an active and expanding portfolio of political risk insurance and provides both direct and indirect financial support to private business investments in country. OPIC makes direct loans of up to 60% of long-term investments that are at least 25% owned by a U.S. investor. OPIC provides political risk insurance coverage for the U.S. equity component, as well as reinsurance support for insurance that is written in-country. Afghanistan is a member of the Multilateral Investment Guarantee Agency (MIGA).

#### **LABOR**

There is a critical shortage of skilled labor in Afghanistan. Only 30 percent of the population over the age of 15 can read and write. Decades of war, a low level of education, and a lack of training facilities have resulted in a serious scarcity of skilled technicians, qualified managers and educated professionals. U.S. companies that establish training programs for their employees should expect significant returns in enhanced productivity, but there is a risk of high turnover as skilled employees chase higher paying opportunities.

Labor-management relations are undeveloped. While there are major and smaller trade union organizations in the country, there is little knowledge or practice of collective bargaining. The new Labor Law went into effect in 2008 but it does not meet ILO standards. The law bans forced labor and child labor. It sets terms for working hours, overtime and leave, and calls for employers to provide a wide array of benefits. However, there is little awareness of its provisions in either the government or the private sector. There are no implementing regulations, and the Ministry of Labor, Social Affairs, Martyrs and Disabled lacks the capacity to enforce the law. Private sector employers report they have not been affected by the law. A regulation pertaining to foreign workers was published in 2005. While allowing for the employment of foreign workers, it requires that priority be given to Afghan workers when they are equally qualified.

#### **FOREIGN-TRADE ZONES/FREE PORTS**

Afghanistan has no duty-free import zones or ports. However, Afghanistan is considering the establishment of Trade Facilitation Zones and/or Export Processing Zones to enhance export potential.

## **FOREIGN DIRECT INVESTMENT STATISTICS**

Comprehensive foreign direct investment (FDI) statistics for Afghanistan are unavailable. Available figures are not reliable because of inconsistencies in data collection. The United Nations Conference on Trade and Development (UNCTAD) 2010 World Investment Report estimates FDI flow into Afghanistan in 2009 at USD 185 million and total FDI stocks at USD 1.55 billion, representing 10.3% of GDP. According to AISA, the top FDI destination sectors in Afghanistan on average over the 2003-2011 period, in descending order, were services (56.3%), construction (32.6%), industries (10.2%) and agriculture (0.9%). AISA also stated that in 2011, the three largest investors were the United States (\$6.5 million), Turkey (\$4.3 million), and India (\$2.6 million). AISA's data track approved, rather than actual, investment.