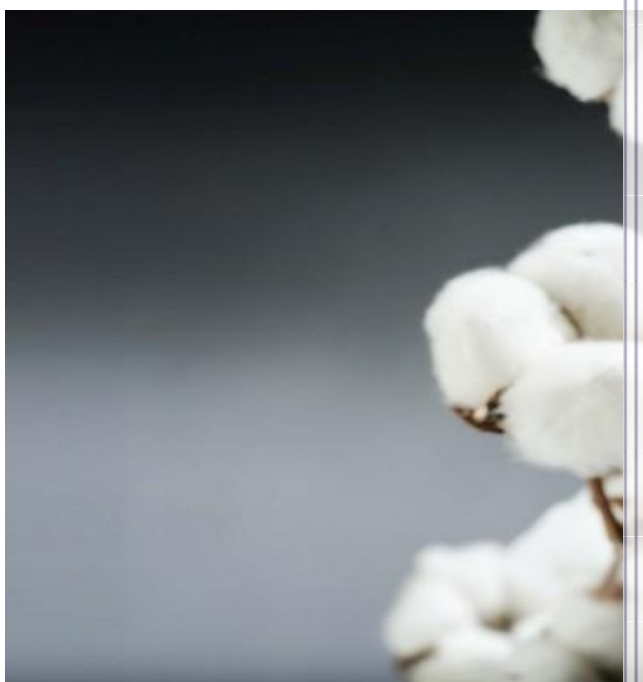


'Cotton Ginning'



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This report contains market research and proposed banking products, based on primary research survey results and secondary sources, carried out for SME segment "Cotton Ginning" by Corporate Development Partners (CDP).

The purpose of this research report is to provide segment specific credible information for the commercial banks to facilitate them in designing and delivery of banking services to small and medium enterprises (SMEs) in a responsible, profitable and sustainable manner.

Table of Contents

1	Guidelines for using this Research Report	1
1.1	Market Assessment	1
1.2	Product Suite	1
1.3	Marketing and Distribution	1
2	Introduction & Objectives	2
2.1	Limitations of the Study.....	3
2.2	Sampling Plan.....	4
3	Economic Overview	8
4	Cotton Ginning Industry Overview.....	10
4.1	Demand	11
4.2	Supply.....	11
4.3	Key Players.....	13
4.4	Trade Body	13
4.5	Recent Developments.....	13
4.6	Future Developments.....	13
4.7	Cotton Ginning Process	14
4.8	Success and Survival of the Businesses in this Sector	16
5	Market Assessment	17
5.1	Market & Demographic Profile	17
5.1.1	Market Sizing and Lending Potential	18
5.1.2	Segment Demographics	19
5.2	Owners Profile	20
5.3	Business Linkages	21
5.4	Business Cycle	23
5.4.1	Working Capital	24
5.5	Financial Assessment and Profile	25
5.6	Financial Information.....	26
5.7	Indicative Business Requirements	28
5.8	Financial Need Analysis.....	29
5.9	Usage of Banking Products.....	31
5.10	Segment Risk Considerations.....	32
6	Proposed Banking Product Suite	34
6.1	Product Features	34
6.2	Eligibility Criteria for Asset Products	40
7	Distribution and Communication Considerations	41
7.1	Marketing Objectives of Banks.....	41
7.2	Promotional Activities by Banks	41
7.3	Distribution Strategy for Banks.....	41

Index of Tables

<i>Table A:</i> Sampling Plan.....	4
<i>Table B:</i> Economic Considerations	8
<i>Table C:</i> Summary of Industry Overview	10
<i>Table D:</i> Cluster Locations for Cotton Ginning Mills	18
<i>Table E:</i> Stake Holders and Their Interests.....	21
<i>Table F:</i> Cotton Ginning Raw Material	22
<i>Table G:</i> Sector Financials Snapshot.....	25
<i>Table H:</i> Indicative Equipment Requirement	28
<i>Table I:</i> Working Capital/Overdraft Finance Facility.....	35
<i>Table J:</i> Cotton Ginning Machinery Leasing.....	36
<i>Table K:</i> Bill Discounting Facility	37
<i>Table L:</i> Industrial Power Generator Leasing	38
<i>Table M:</i> Export Refinance.....	38
<i>Table N:</i> SME Business Bank Account	39
<i>Table O:</i> Other Products	39
<i>Table P:</i> Asset Products Criteria	40

Index of Figures

<i>Figure 4.7-a: Cotton Ginning Process</i>	<i>15</i>
<i>Figure 4.8-a: Indicators of Business Success.....</i>	<i>16</i>
<i>Figure 4.8-b: Key means of survival as an SME</i>	<i>16</i>
<i>Figure 5.1-a: Number of years in operation</i>	<i>19</i>
<i>Figure 5.1-b: Location of businesses.....</i>	<i>19</i>
<i>Figure 5.2-b: Age group of business owners</i>	<i>20</i>
<i>Figure 5.2-a: Education level of business owners</i>	<i>20</i>
<i>Figure 5.2-c: Number of employees under business owners</i>	<i>20</i>
<i>Figure 5.2-d: Ownership type</i>	<i>20</i>
<i>Figure 5.3-a: Communication with customers</i>	<i>21</i>
<i>Figure 5.3-b: Number of Suppliers</i>	<i>22</i>
<i>Figure 5.3-c: Supplier Relationship</i>	<i>22</i>
<i>Figure 5.4-a: Business Model.....</i>	<i>23</i>
<i>Figure 5.4-b: Repayment terms offered by suppliers</i>	<i>24</i>
<i>Figure 5.4-c: Repayment terms offered for customers.....</i>	<i>24</i>
<i>Figure 5.6-a: Business Assets.....</i>	<i>26</i>
<i>Figure 5.6-b: Capital Expenditures</i>	<i>26</i>
<i>Figure 5.6-c: Total Revenue</i>	<i>27</i>
<i>Figure 5.6-d: Annual Expense.....</i>	<i>27</i>
<i>Figure 5.6-e: Net Income</i>	<i>27</i>
<i>Figure 5.8-a: Business Funding Needs</i>	<i>29</i>
<i>Figure 5.8-b: Fixed Assets Financing Requirements</i>	<i>30</i>
<i>Figure 5.10-a: Business Expansion Restraints</i>	<i>32</i>
<i>Figure 5.10-b: How Business Risk is Addressed</i>	<i>33</i>

1 Guidelines for using this Research Report

The 'Cotton Ginning' Segment Research Report provides indicative business and financial characteristics based on the information derived from a sample of business owners via primary research survey. It can be used by Banks/DFIs as a starting point for development of program based lending products for tapping the underutilized potential for providing financing products to small business owners.

The 'Cotton Ginning' Industry overview is developed by using information obtained from secondary and tertiary sources, including industry associations and data available in public domain.

1.1 Market Assessment

This section contains analysis based on primary findings of survey exercise conducted in major cotton belt smaller cities of Pakistan, mainly Rahim Yar Khan, Vehari, Hyderabad, Sanghar and Multan. The survey information can form the basis of identifying the characteristics of a typical business entity in the segment.

1.2 Product Suite

Proposed banking product suite provides a number of potential core banking products templates that can be used by Banks/DFIs to design appropriate banking products for gaining access to the particular segment. However, it is highly recommended that product development undergoes the usual general practice and protocols employed by the bank. It is also recommended that the product development and the business line team work together to conduct a quick market research of a small sample in order to validate the results of this study.

1.3 Marketing and Distribution

Marketing and Distribution considerations are indicative and have been based on the assumption that banks will employ their individual marketing and distribution strategy for product development. However, information presented can be utilized by banks for developing certain hypothesis to be validated for developing their marketing and delivery strategies.

2 Introduction & Objectives

According to the latest data cited in SMEDA and Economic Survey Reports 2010-2011, Small and Medium Enterprises (SMEs) account for approximately 40% to GDP contribution of Pakistan and play a major role in spurring economic activity with a contribution amounting to 80% of non-agriculture GDP of Pakistan. Majority of the businesses in this segment have used banks for business needs but remains largely unsatisfied, with few using it as a source of business fund, owing to the following impediments:

- A different risk profile
- Lack of substantial collateral
- Conservative approach adopted by financial institutions
- Lack of awareness and willingness of banks/DFIs

SMEs present immense business opportunities for financial institutions from the perspective of increasing book size while generating strong risk adjusted returns, however there is a strong need to understand the dynamics of this segment in order to enable financial institutions to structure products that meet overall risk management guidelines and facilitate the growth of this SME segment.

In this context, State Bank of Pakistan (SBP) has mandated Corporate Development Partners to conduct a secondary research and a primary survey of ten major SME subsectors of Pakistan to determine banking and financial needs of the sectors.

This research report contains findings pertaining to the segment of "*Cotton Ginning*" which includes cotton ginning factories in Sindh and a major portion covering Punjab areas.

At present, the agriculture segment in Pakistan is relatively unorganized with low growth momentum, which is a serious blow to the economy as it supports 43.7% of the country's labor force. Government has played a supportive role in providing technological assistance to this sector but since weather plays a pivotal role in its performance, the growth in agriculture was only 2.12% against last year's growth of 2.88% (Economic Survey of Pakistan 2013-14).

2.1 Limitations of the Study

- The sample may not be geographically exhaustive.
- The sampling plan may not suit the requirements of every bank.
- Some of the recommendations are not backed by quantitative primary research but are based on knowledge of the market and best practices.
- Some of the questions in the questionnaire, especially in the financial information section were considered too personal by many business owners; therefore, many of them refused to answer. Hence, the responses in this regard may be evasive and cannot be verified with respect to their accuracy.

2.2 Sampling Plan

The primary research exercise conducted for identifying the financial needs of the SME segment was based on the following sampling methodology.

Table A: Sampling Plan

Particulars	Criteria	Rationale
Size	<ul style="list-style-type: none"> 1,000 detailed one-on-one interviews for 10 sub-sectors 100 SMEs surveyed within each sub sector. 	<ul style="list-style-type: none"> Sample size is sufficient enough to gather relevant qualitative and quantitative information on each sub sector Increase in the sample size will only add marginal value to the overall information collected from the survey exercise <p>Change of Definition of SME by SBP</p> <ul style="list-style-type: none"> Small enterprises are defined as those businesses that have employees up to 20 and annual turnover up to PKR 75 million Medium enterprises are businesses with more than 20 employees and turnover above PKR 75 million and up to PKR 400 million for the purpose of classification and segmentation by banks For the purpose of this research, the small portion of medium entities that we have reviewed include entities that have revenue up to PKR 150 million (i.e. two times the sales of Small Enterprises)

Particulars	Criteria	Rationale
Status	<ul style="list-style-type: none"> At least 60% will be informal businesses At least 20% will be formal businesses 	<ul style="list-style-type: none"> Informal businesses would be entities that do not have formal accounting and book keeping system. They do not get their accounts properly audited and are normally not registered under an official trade/regulatory body. A wide majority of businesses operating in Pakistan are informal businesses in terms of their quality of record keeping and accounting information, in the absence of which banks do not offer them any credit based products. A study of informal businesses enables us to gauge the reasons of these proprietors to remain within the informal segment and still compete in the market with formal business enterprises within the same industry segment. Moreover as per revised SME Prudential Regulations, Small businesses are allowed financing up to PKR 15 million without the audited financials. This regulatory change will enable SMEs to qualify for a structured lending product by maintaining the basic system of book keeping and accounting. Formal businesses are those entities that are relatively larger in size and have a proper book keeping system. These are also registered businesses that are operating either under an association of businesses or under a formal regulatory license, with a fair amount of transparency in their accounting and book keeping systems Including the above businesses give us a fair representation of entities that are eligible for all financial services being offered by banks and their extent of using banks as their main financiers and other service providers or only for holding their business operating accounts Formal businesses have more structured requirements than those who use banks only for products such as fund transfers

Particulars	Criteria	Rationale
Turnover	<ul style="list-style-type: none"> At least 50% with turnover less than PKR 75 million At least 20% with turnover more than PKR 75 million 	<ul style="list-style-type: none"> The corresponding sample mix has been adopted to ensure majority coverage of small businesses in the overall sample size since these would be the primary candidates for programme lending products However, for the purpose of understanding the financial needs of medium sized entities that are close to the threshold point of small and medium, we have covered a minor portion to understand their requirement for structured loan products as well as other financial services generally required by businesses that are relatively mature and larger sized than small enterprises
Employees	<ul style="list-style-type: none"> 60% will have less than 20 employees 40% will have more than 20 employees 	<ul style="list-style-type: none"> SMEs that are not in the manufacturing segment are relatively understaffed owing to the small size of their business and ease of management Moreover, businesses that have more than 20 employees are classified as medium sized hence we have covered a small portion of such entities as well

Particulars	Criteria	Rationale
Banking history	<ul style="list-style-type: none">▪ At least 70% with banking history▪ At least 10% with no banking history	<ul style="list-style-type: none">▪ As per SBP prudential regulations any business operated by an individual as a proprietor, but meets the classification criteria of the regulations will be termed under SME▪ On account of above a majority of sample in the market are operating their businesses through a bank account (either in the name of the proprietor or in the name of the business)▪ Most of the financial needs and preferences that are objectives of this assignment, have been obtained from the above sample who are using a bank for their businesses operating needs▪ However, a very small portion of the totally unbanked SMEs in the sub-sector is also covered during our survey to understand their reasons for not availing the banking services and fulfilling their needs for financial services through other, more expensive, informal channels

3 Economic Overview

Pakistan's economy has shown resilience despite challenges which include domestic factors such as political instability during the last few years, security situation and international financial crisis, in addition to an unprecedented rise in food and energy prices. As per the Economic Survey of Pakistan (2013-14), after a period of slow growth due to floods and law and order crisis, the economy showed a significant growth in 2013-14 on the back of immense recovery from the industrial sector along with moderate growth in agriculture and service sectors. With industrial sector expanding by 5.84% when compared to last year figure of 1.37%, while the economy grew by 4.14% in FY-2014.

Table B: Economic Considerations

Positives

- Heavily populated, (over 180 MN people) translating into strong future potential for improvement in work force as well as purchasing power, leading to growth in consumer related segments.
- Despite many challenges faced by the country, Pakistan has performed better than many developing countries with the GDP growth rate of 4.14% in FY 2014 which is highest in the last three years when compared with GDP growth in FY 2013 and FY 2012 of 3.7% and 3.84% respectively.
- Rising rates of urbanization – with the UN forecasting the proportion of city dwellers climbing from 34.9% of the population in 2005 to more than 50% by 2035 – should continue to serve as a key driver of economic growth.
- The industrial sector showed a huge growth of 5.84% compared to previous year of 1.37% which has been a huge boost to the economy as it contributes to 20% of the GDP. It is also a major source of tax revenue.
- Investment activities are continuing to take place, backed by the fact that public investment has recorded a remarkable growth of 17.12% while last year it had a negative growth of 0.35%.
- Foreign Direct Investment (FDI) has also shown a remarkable increase from USD 1,277 last year to USD 2,979 in the period July – April 2013-14, an increase by 133%. Major portion of FDI was for oil & gas exploration, electricity & power, financial business and chemicals.

- Positive trend of remittance over the last 10 years has greatly supported the country's balance of payment position.

Challenges

- National saving is showing a decline, with 12.9% of GDP in FY14 while in FY13 it was reported 13.5% of the GDP. Covering the saving-investment gap remains to be a challenge.
 - The FY 2013-14 has shown slight improvement in fiscal deficit which reduced by 3.2% compared to previous year. Structural weakness in tax system however still prevails with low tax to GDP ratio while the expenditures continue to exceed the revenues.
 - Balance of payments has shown a surplus of USD 1,938 million compared to last year deficit of USD 2,090 million in FY 2013-14. However despite that, the current account balance further showed a deficit of USD 2,162 million in July-April 2013-14 compared to last year in the same period.
-

4 Cotton Ginning Industry Overview

Table C: Summary of Industry Overview

Factors	Comments
Demand	Due to low production of cotton this year (2013-14) and high cotton prices in the domestic market compared to international prices, the demand for cotton exceeds the production. With 5% custom duty imposed by the Government (April 2014) the import of cotton yarn and overall import of cotton declined by 31% this year.
Supply	Unfavorable weather, water shortages and low profits had been the main reason behind many farmers showing preference of cultivating other crops instead of cotton, which resulted in lesser land cultivated for cotton production. Despite these hurdles, Pakistan managed to export cotton yarn worth \$1.072 billion during the first half of FY 2013-14.
Key players	Roomi Cotton Ginning Industries (Pvt) Ltd, Mashallah Cotton Ginning Mills, P.I.D.C Cotton Ginning Factory (Pvt) Ltd, H&H Cotton Ginning Factory and Oil Mills
Trade Body	Pakistan Cotton Ginners Association (PCGA)
Regulatory Body	Ministry of Industries
Recent Developments	5% custom duty has recently (April 2014) been imposed by the Government on the import of cotton yarn which has brought relief to the local cotton ginning sector. In the start of the year 2014, Pakistan became eligible for GSP Plus trade status with the EU which is anticipated to increase cotton import and textile export. This may however result in higher quality stock being preferred by the local mills, provided the quality of local cotton does not improve.
Future prospects	The segment has shown significant progress over the years and is expected to continue to reflect growth in the coming years due to high prospects in increased production.

4.1 Demand

Pakistan is the world's fourth largest cotton producer and third largest cotton consumer with domestic consumption fluctuating between 14 million to 16 million bales on average. In order to meet its local cotton demand, Pakistan needs to import nearly 2 million cotton bales per year as per Pakistan Cotton Ginners Association.



Ginning sector has been adversely affected by electricity crisis which in itself has been one of the most critical prevailing problems faced by the country. Also, the cotton produced in Pakistan is of lower quality due to impurities and contamination, hence unable to meet the international standard required for exporting cotton. Pakistan's cotton import, therefore, depends upon the size of the domestic crop production and the export forecasts of the growing textile sector in the country. Generally cotton imports are about 20% of the country's cotton demand, with Pakistan's textile sector being the largest customer of the Cotton Ginning sector. Most of the imports are of cotton that is of higher quality in order to meet the textile industry's need.

In FY 2013-14, cotton imports have shown fluctuations with slow imports in the first few months because of higher import cost due to continuous appreciation in dollar value against rupee at that time. Later, the recovering of rupee in its value as well as low stock of quality raw cotton in domestic market led to a surge in the imports. About 2.5 million cotton bales were expected to be imported by the end of 2013-14 from which 1.2 million cotton bales have already been imported from India, the second biggest cotton producer, as it provides cotton bales at a cheaper prices, lower interest and higher quality¹. The other countries Pakistan relies on for cotton imports are US, Argentina and Central Asia.

The overall raw cotton import has however declined by 31% in the first 10 months of FY 2013-14², according to official statistics quoted in Business Recorder, due to high import of cotton yarn (9.2 million bales, as cited in Cotton and Products Annual Report 2014³) from India. This was due to cheaper rate offered by India, who has been dominating international cotton market. This resulted in a large quantity of raw cotton still lying as finished goods in the local mills due to its low demand.

4.2 Supply

¹ <http://www.thenews.com.pk/Todays-News-3-234654-Country-likely-to-import-25m-cotton-bales>

² <http://www.brecorder.com/cotton-a-textiles/185:pakistan/1188409:raw-cotton-import-declines-by-31-percent/>

³ [http://gain.fas.usda.gov/Recent GAIN Publications/Cotton and Products Annual Islamabad Pakistan 3-21-2014.pdf](http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Cotton%20and%20Products%20Annual%20Islamabad%20Pakistan%203-21-2014.pdf)

Pakistan reported a decline in its cotton production in the FY 2013-14 by 2% compared to previous year. Wet weather conditions during planting season and tight water conditions with hot dry weather during sowing stages led to replanting of the cotton seeds by the farmers. Also low quality seed further affected the population of the plants as well as the quality of the crop.



Low cotton production in FY2013-14, has resulted in not being able to meet the target of 14.1 million cotton bales⁴. Also due to pricing and quality reasons, many farmers showed preference of other crops to sow over cotton, which resulted in 2.5% less area cultivated for cotton compared to previous year. This year the production stood at 12.8 million cotton bales, a decline of 9.2% against the target, according to the Economic Survey of Pakistan 2013-14.

The low production of cotton has led to an increase in the domestic price compared to the international market. Hence more preference was given by the ginners to sell cotton bales in the local market than to export.

Despite these conditions, Pakistan has managed to export cotton yarn worth \$1.072 billion during the first half of FY2013-14, with a slight decline of 3% in its exports compared to previous year⁵, according to Business Recorder 2014.

Ginning industry operates on seasonal basis due to lack of storage facilities. The absence of warehouses leads to dust and moisture content being absorbed in cotton bales which in turn causes moths, and production of bad color lint, which is then priced very low. In terms of advancement, lack of incentive/demand for clean cotton has translated into poor factory infrastructure, low quality machines, poor picking, transport, storage and ginning practices.

Cotton ginning process produces cottonseed as a by-product, which goes to oil mills for extraction of oil, which is further processed into edible oil and cotton seed cake (used as animal feed). The ginners therefore operate as processors as well as traders concurrently, selling cottonseeds to oil mills through commission agents. The cotton seeds are sold to the oil mills through commission agents.

Pakistan's cotton does not attract high value and fetches significantly lower prices than cotton of similar grades in other countries, due to high level of contamination, inappropriate moisture content and mixing of different grades of cotton. This causes a serious issue in targeting higher sales in international market.

⁴ Economic Survey Of Pakistan 2013-14-Agriculture

⁵ <http://www.brecorder.com/cotton-a-textiles/185/1153567/>

4.3 Key Players

The major key players of the cotton ginning sector are Roomi Cotton Ginning Industries (Pvt) Ltd, Mashallah Cotton Ginning Mills, P.I.D.C Cotton Ginning Factory (Pvt) Ltd, H&H Cotton Ginning Factory and Oil Mills.

4.4 Trade Body

Pakistan Cotton Ginning Association (PCGA) is the representative body of over 1,200 ginning factories all over Pakistan and has been working towards the betterment of cotton ginning industry since 1958.

4.5 Recent Developments

With the start of the year 2014, Pakistan became eligible for GSP Plus trade status with the EU⁶, which is likely to have a positive impact on the industry with increasing higher textile export but also increase in cotton imports to meet export demands. If the quality of the local cotton does not show any improvement, local mills are likely to prefer imported cotton. Therefore it is of utmost importance to reduce contamination and improve the storage infrastructure in this sector.



On the other hand the government has imposed a 5% custom duty on the import of cotton in April 2014 after exemption of custom duty since 2009⁷, as specified in Business Recorder. The step was taken after high import of cotton yarn from India, which was hurting the local cotton ginning industry severely. This may help the local ginners in the near future.

4.6 Future Developments

This segment has a strong dependence on stable economic environment and favorable weather conditions to prevail in order to achieve high growth levels. Currently the Cotton Ginning industry is suffering from low production due to various internal and external factors as discussed above. Some business owners are also concerned regarding the power shortages that they believe is the main underlying reason for performing below capacity.

⁶ [http://gain.fas.usda.gov/Recent GAIN Publications/Cotton and Products Annual Islamabad Pakistan 3-21-2014.pdf](http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Cotton%20and%20Products%20Annual%20Islamabad%20Pakistan%203-21-2014.pdf)

⁷ <http://www.brecorder.com/cotton-a-textiles/625:/1176865:five-percent-duty-imposed-on-cotton-yarn-import/?date=2014-04-26>

Many steps are being taken for performance improvement and growth of Cotton Ginning Sector such as;

- Ministry of Textile Industry will organize training programs for cotton ginners in Multan, Bahawalpur and Sukkur to equip them with better understanding and skills in producing better quality of cotton, as current quality of cotton suffers immensely due to lack of proper warehousing and storage facility and out dated technology.
- Pakistan is likely to get maximum tariff concessions for its export oriented industry and will extend non-discriminatory market access (NDMA) to India which will result in increased trade between the two countries.
- Pakistan Cotton Ginners Association (PCGA) plans to cooperate with several multinational companies for importing good quality seeds and transfer of technology for ginning industry. This will lead to increase in the production of cotton as local seed suppliers in the country provide substandard and less germinated seed to farmers at high rates, which has resulted in higher loss of production output.

4.7 Cotton Ginning Process

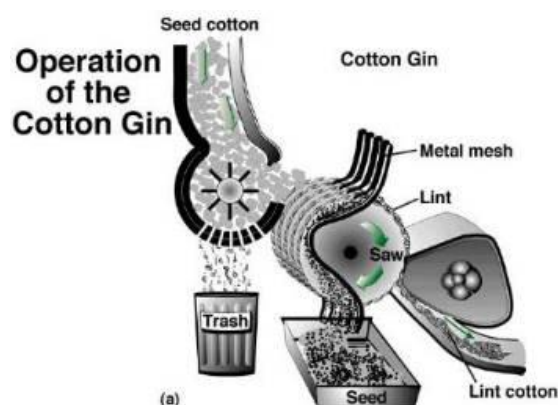
Raw material for ginning factory arrives as phutti in large trailers or modules used for hauling it from the field and for storing it until ready for ginning (**Figure 4.7-a**). From the storage area, conveyor pipes transfer it to various stages of the ginning process, using large volumes of air to make the flow of the cotton easier and faster, which is first dried in dryers to reduce moisture.

Cylinder Cleaner: It removes leaves and other small trash from phutti by shaking it with spiked cylinder.

Stick Machine: Removes large sticks or hulls with revolving channel saws. These saws grab the seed cotton and whip it over metal bars to sling off its trash.

Humidifier: With unusually dry cotton, gins will skip the drying stage and will, at times, add moisture to it with a special humidifier that blows warm, humid air through the gin's conveyor pipes.

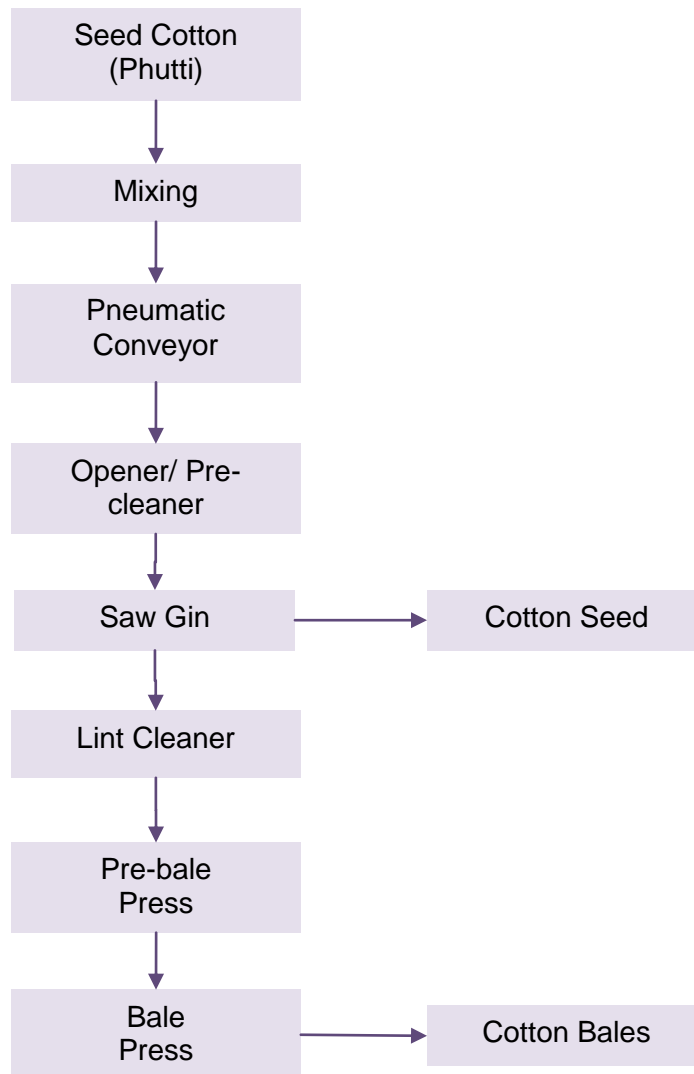
Saw Gin: The seed cotton is now ready for ginning. Pima cotton is conveyed to the roller gin, while upland cottons are conveyed to the saw gin for separation of seed and fiber.



Lint Cleaner: It removes the small trash from the ginned lint left behind by the cylinder cleaner and stick machines. Lint cleaning of roller ginned cotton usually involves a combination of three machines: a cylinder cleaner, an impact cleaner, which uses cylinders to agitate and release the trash from the lint, and an air-jet cleaner which removes the trash from the lint using high velocity air.

Hydraulic Cotton Baling Press: compresses the ginned lint into bales that weigh between 450 and 500 pounds. These bales are then wrapped with a protective cover, ready for delivery to the warehouse from where they are sold to various textile mills.

Figure 4.7-a: Cotton Ginning Process



4.8 Success and Survival of the Businesses in this Sector

From the survey interviews (**Figure 4.7-a**), almost half of the business owners felt that good relations with the suppliers (46%) and timely delivery of the finished goods (53%) were the major success factors for the businesses in this sector as this ensured consistent supply of raw material and so no loss of orders.

In order to survive as an SME (**Figure 4.8-b**), 60% of the business owners believe that experience was the most essential element, followed by education, by 36% of the business owners. However, 19% of the business owners also felt that due to favorable government policies their SME businesses managed to survive.

Figure 4.7-a: Indicators of Business Success

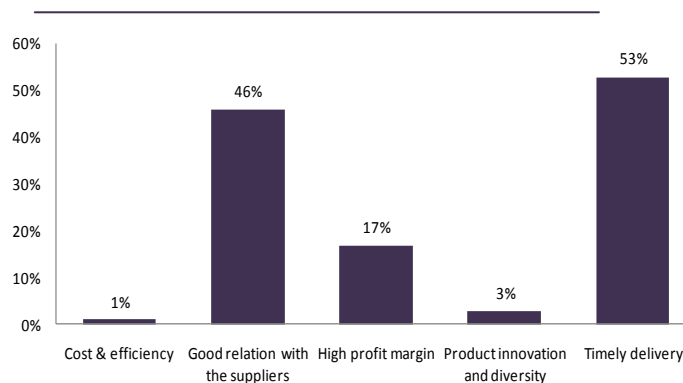
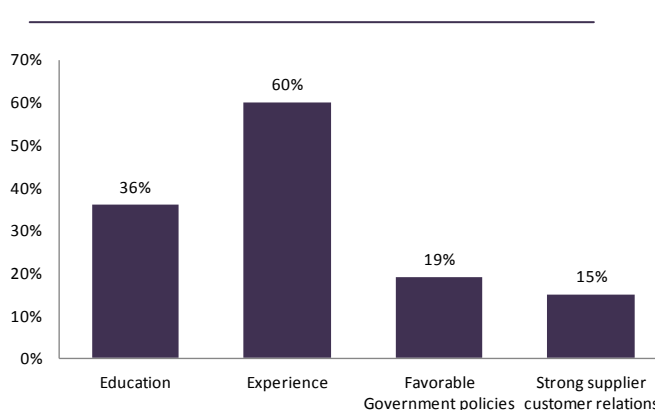


Figure 4.8-b: Key means of survival as an SME



Source: Survey Findings

5 Market Assessment

5.1 Market & Demographic Profile

Cotton production plays a significant role in Pakistan's agriculture and economic growth. According to Economic Survey of Pakistan 2013-14, cotton has a share of 1.4% in Pakistan's total GDP and a 6.7% share in agriculture.

Cotton production is mainly concentrated in two provinces: Punjab and Sindh, therefore majority of ginning units are established there for easy availability of raw material. There are over 1,200 cotton ginning units with approximately 60% ginning units located in Punjab and 40% units in Sindh. Many of these units (around 20%) are non operational due to various factors but mostly due to low availability of cotton and power shortages. Most businesses are either family owned or established by the owners themselves. Underlying issues inherent to this segment include:

- 1) Inability to assemble and deploy intellectual, human and financial resources effectively
- 2) Lack of vision for growth
- 3) Limited perception of business requirements
- 4) Restricted funding sources
- 5) Inability to identify and explore new ideas
- 6) Lack of technical institutions and skill development programs
- 7) No quality certification and testing facilities

The businesses use outdated technologies with only few large manufacturers using sophisticated technology whereas, small and medium sized manufacturers employ limited technology. The main reason for lack of automation and mechanization in this segment is due to unavailability of funds to the small manufacturers for purchase and installation of such machinery.

5.1.1 Market Sizing and Lending Potential

Businesses in the segment are widespread throughout various locations in rural areas (**Table D**). The Rahim Yar Khan and Multan clusters are highly decentralized and vary in terms of sizes. The small and unorganized units are located in congested areas mentioned below which is not accurate but an estimate. "Others" include many small cities with very few mills established but the combined numbers are large.

Table D: Cluster Locations for 'Cotton Ginning' Mills	
Area	No. of establishments
Rahim Yar Khan	149
Vehari	92
Multan	76
Khanewal	50
Muzaffar Garh	43
D.G khan	33
Lodhran	52
Sanghar	87
Hyderabad	35
Nawabshah	42
Mirpurkhas	31
Others	564



Source: Trade Associations and Industry Sources



5.1.2 Segment Demographics

The segment is widely spread out across various regions in the country with highest concentration in Punjab. Demographic information is obtained from industry sources and primary research conducted using a selected sample of businesses in major cities of Pakistan. Majority of the businesses in our survey (40%) have their businesses serving all over Punjab while 12% and 10% businesses are in Multan and Vehari respectively (**Figure 5.1-b**).

40% of the businesses have been in operation between 5 to 10 years while 25% have been operating for more than 10 years, with the businesses either being established by the owners themselves or run as a family business (**Figure 5.1-a**).

Figure 5.1-a: Number of years in operation

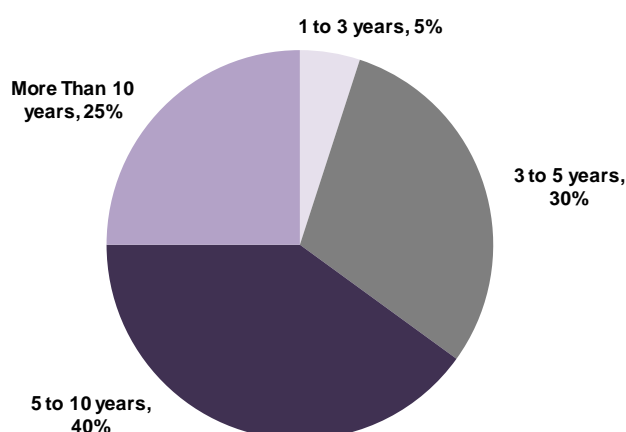
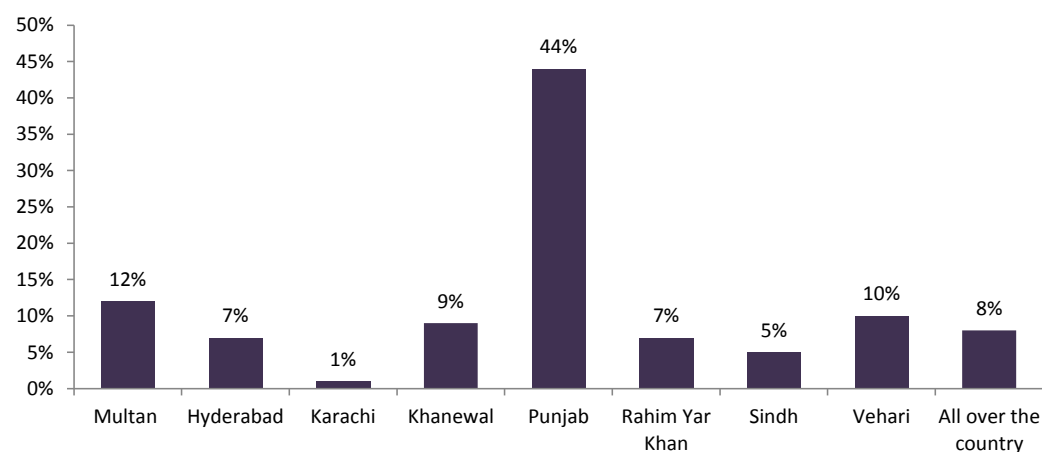


Figure 5.1-b: Location of businesses



Source: Survey Findings

5.2 Owners Profile

Majority of the business owners' fall in age group of 31-40 years (48%) and between 41-50 years (47%) respectively (**Figure 5.2-b**). Leading drawbacks of this industry is the lack of skill and technical knowledge and therefore there is a need to bring improvement in the techniques for better quality of cotton production. The highest level of education for 67% of the business owners is high school while only 26% have college/bachelor degree (**Figure 5.2-a**).

47% of the businesses in our survey consist of 10-24 number of employees while 24% of businesses only have between 5-9 employees (**Figure 5.2-c**). It can be deduced from this that business size in this sector mostly vary between medium to small with 75% of the businesses running as individual/proprietorship while 23% as partnership (**Figure 5.2-d**).

Figure 5.2-a: Education level of business owners

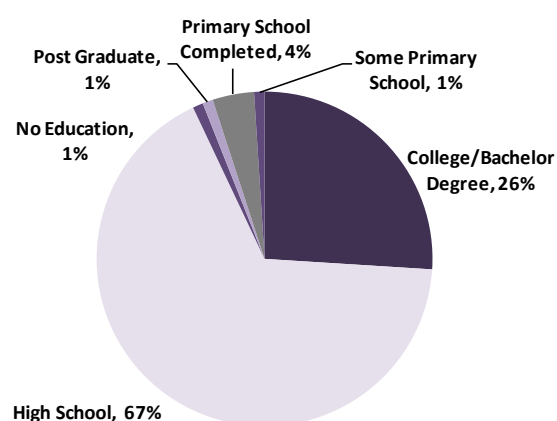


Figure 5.2-b: Age group of business owners

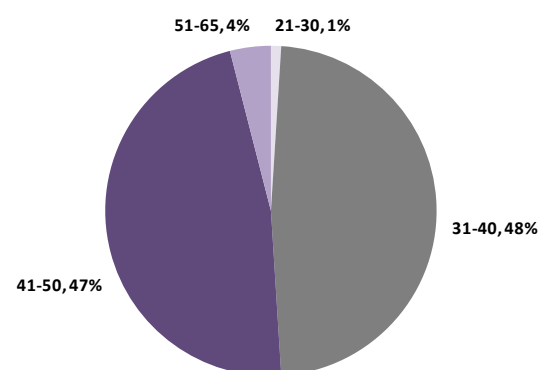


Figure 5.2-c: Number of employees under business owners

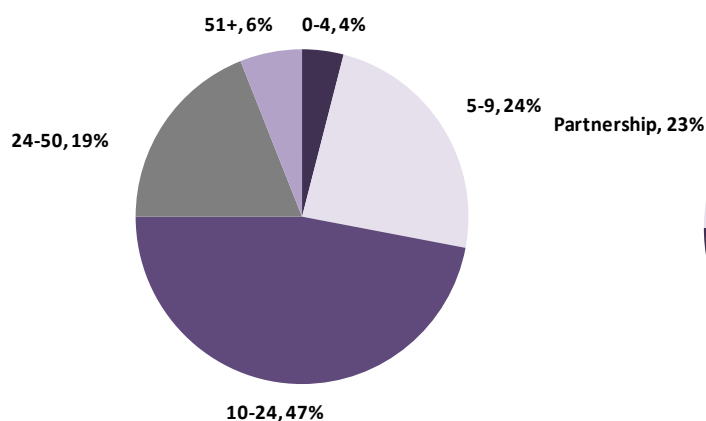
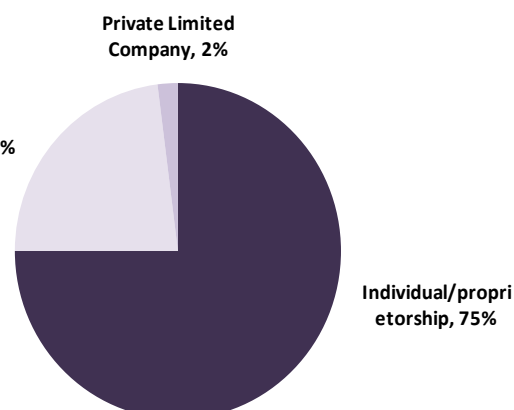


Figure 5.2-d: Ownership type



Source: Survey Findings

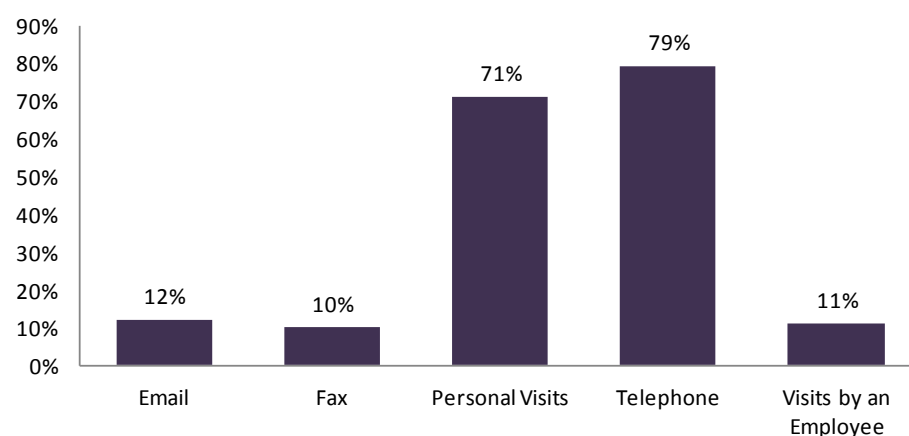
Businesses in the segment are connected to various institutions, which are directly or indirectly affected by the business operations. Primary stake holders and their interests are enlisted in the following table (**Table E**).

Table E: Stake Holders and Their Interests

Cotton Ginning	
Stakeholder	Interest
Owners	Growth, government initiative and access to finance
Suppliers (farmers)	Better terms, increased supply, consistent pricing and lower risk
Customers	Product quality and reasonable pricing
Financial Institutions	Debt servicing, new products, increase in deposits
Government	Expansion of taxation bracket, economic growth, benefit to community at large

Businesses employ various means of communication with customers however, for majority of the businesses; personal visits (71%) by customers and telephone (79%) are widely utilized (**Figure 5.3-a**). Most of the businesses survey face stiff competition with almost half of them having about four to five competitors while the remaining having more than ten competitors within their market.

Figure 5.3-a: Communication with customers



Source: Survey Findings

Major supplies (**Table F**) for segment include:

Table F: Raw Material for Cotton Ginning Sector

Raw cotton (Phutti)

Cotton seed

66% of the businesses depend on many suppliers (**Figure 5.3-c**) to meet their inventory needs while only 13% depend on the same suppliers for years which depicts difficulty for many businesses in fulfilling their material needs when required. 11% of the businesses are not consistent in their suppliers to meet their raw material requirements while 12% of the businesses need new suppliers due to inconsistent quality of stock supplied. As depicted below (**Figure 5.3-b**) 69% of the businesses depend on about two to five suppliers while 29% are dependent on more than five suppliers.

Raw material needs are mostly met through local farmers who supply raw cotton to ginning factories. Very few establishments buy from the same available farmers or require different ones due to inconsistent supplies as mentioned above. Some ginning factories in this sector have their own farms for cotton cultivation but may still depend on few suppliers for raw material to fulfill any.



Figure 5.3-b: Number of Suppliers

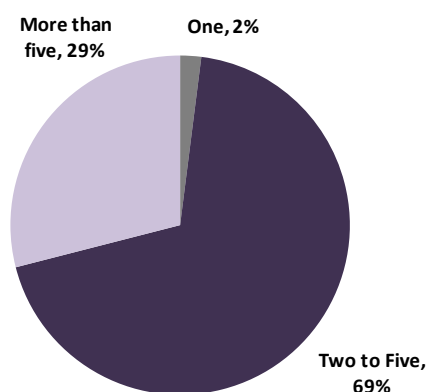
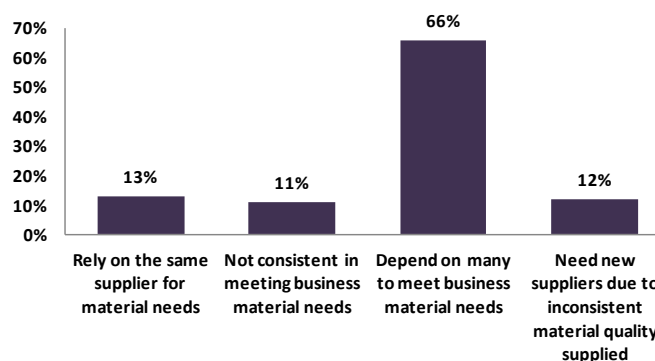


Figure 5.3-c: Supplier Relationship



Source: Survey Findings

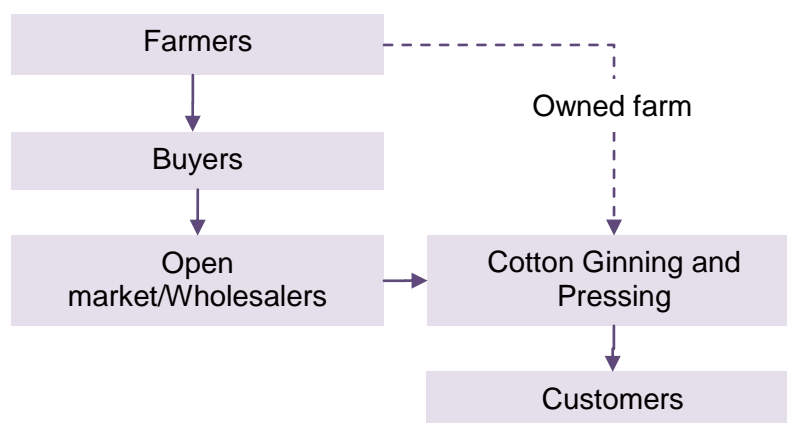
5.4 Business Cycle

The cycle from raw cotton cultivation to processing it into cotton bales and then being sold in the market is a lengthy procedure depending on many factors such as weather, government policy on import/export, quality of cotton, availability of supply, etc.

Many ginning factories rely on many farmers for their raw materials, which leads them to at times compromise on quality of raw material (**Figure 5.4-a**).

This sector is seasonal with huge dependence on favorable weather condition for high production and quality cotton. 'Cotton Ginning' mostly suffers from rising cotton prices and low cotton quality compared to international standards which results in reduced sales.

Figure 5.4-a: Business Model



The 'Cotton Ginning' segment of Pakistan consists of farmers who sell their seed cotton to village merchants or local market. The seed cotton is then grouped together to grade them, based on their quality. The cotton from different farmers may be mixed prior to transporting them to the ginning factory. The cotton bales, as end products, are then weighted and graded which are then sold to various customers. Textile factories are the biggest customers who have fixed contract with many ginning factories and so is a real source of income for the businesses in this sector.



5.4.1 Working Capital

Working capital is dependent upon payment terms offered to customers and received from suppliers. Businesses in cotton ginning segment operate by manufacturing cotton bales for different companies.

The segment works mainly on cash basis, with most of the businesses allowing up to 1 month (84%) for large/reputable customers due to strong client/customer relationship (**Figure 5.4-c**). In some instances, as stated by 13% of the businesses surveyed, collection from the customers may take up to three months.

The credit terms provided by the suppliers (**Figure 5.4-b**) ranges from as low as 10 days to as high as 5 months. This may cause problems in cash management for some businesses where payments to be made to the suppliers are earlier than payments received from the customers.

Figure 5.4-b: Repayment terms offered by suppliers

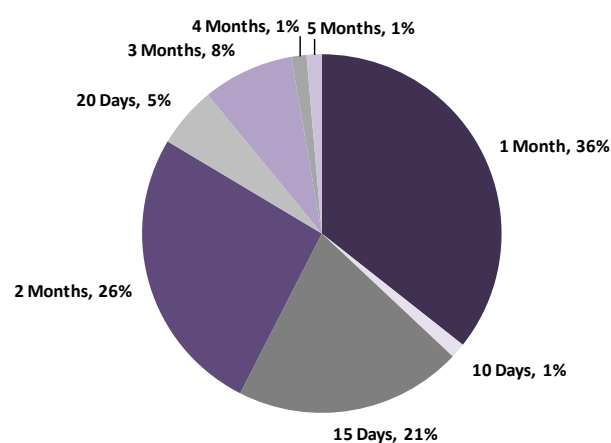
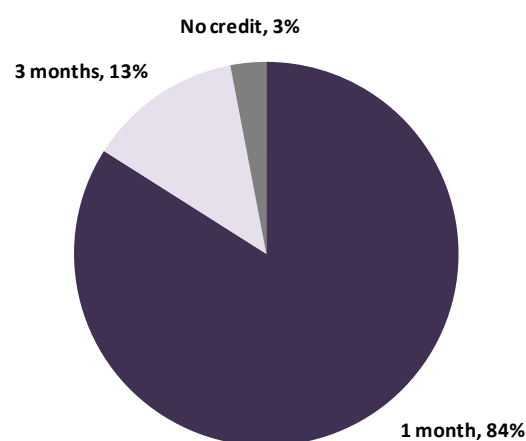


Figure 5.4-c: Repayment terms offered for customers



Source: Survey Findings

5.5 Financial Assessment and Profile

As per the survey, all the businesses in this segment prepare Financial Statements, however, only 43% of the business owners have their Financial Statements audited.

Mostly General Managers or accountants keep track of accounts of the businesses, due to their accounting knowledge and experience. A good number of businesses are getting their Financial Statements audited, which gives reliability in preparation of their accounts and ensures, to some extent, an organized track of cash movement.

From primary research and interviews conducted from trade associations, it has been identified that retailer margins are variable which in recent year has been rising, with a great number relying not only on higher sales volume for earning better profits but also giving preference to sell locally instead of export, due to lower international price.

As per research findings, none of the business owners in the sector were willing to disclose their financial data with regards to capital invested. A rough estimate was given by the business owners regarding business assets employed, annual revenue, income and expenses.

Business owners' reluctance for sharing financial information presents an issue for calculation of segment's accurate benchmark financial ratios. The following table (**Table G**) provides key financial ratios of this sector, which have been calculated on the average value of the financial range provided to us by the businesses covered in the survey. These ratios are an estimate at best and cannot be utilized to assess the performance of the businesses prevailing throughout this sector.

Table G: Sector Financials Snapshot

Financial Information	PKR
Business Assets	25,800,000
Total Revenue	104,490,000
Annual Expense	89,830,000
Net Income	14,660,000
Key Financial Ratios	
Profit Margin	14%
Operating Expenses/ Revenue	86%
Asset turnover	4.05 times
ROA	57%

Conclusively, this sector has a high asset turnover which indicates that for every one rupee invested, the business generates sales of four rupees. Further, this segment is also highly dependent upon machinery and equipments updation, the investment in which, can increase the profitability of the businesses by many folds. The banks can pay special focus on devising banking products for financing equipments for this sector.

5.6 Financial Information

Primary survey findings reflect the Total Average Capital, Assets, Revenue, Expenses and Income under the selected sample for the segment.

Survey findings demonstrate 79% of businesses are operating with Capital (Net Worth) and Total Assets between PKR 10-50 million (**Figure 5.6-a**). This exhibits a relatively high initial investment for startup. Total assets comprise of plant and machinery, land and building, inventory and receivables. Liabilities constitute trade payables and borrowing for working capital finance.

Business related assets constitute manufacturing equipment, specialized machinery and office equipment. More than half of the businesses (57%) in this sector have incurred capital expenditure in the past five years (**Figure 5.6-b**).

Figure 5.6-a: Business Assets

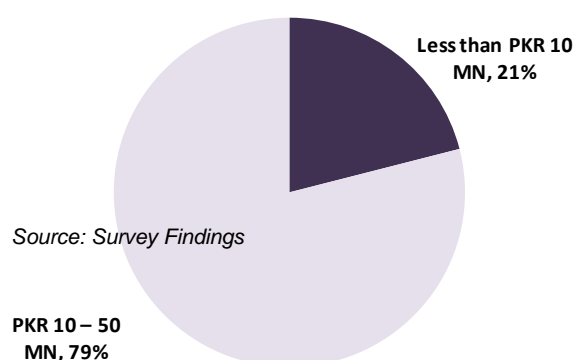
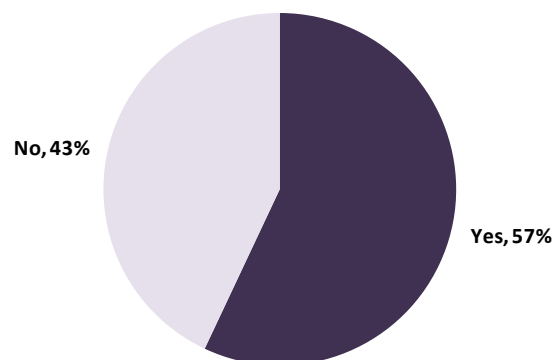


Figure 5.6-b: Capital Expenditures



50% of the surveyed entities reported annual revenue between PKR 10-50 million, while 47% entities reported their revenue of more than PKR 100 million (**Figure 5.6-c**). Expenses include material, employee cost and interest expenses against borrowings which are between PKR 10-50 million for half of the businesses while 41% have their expenses more than PKR 100 million (**Figure 5.6-d**).

Figure 5.6-c: Total Revenue

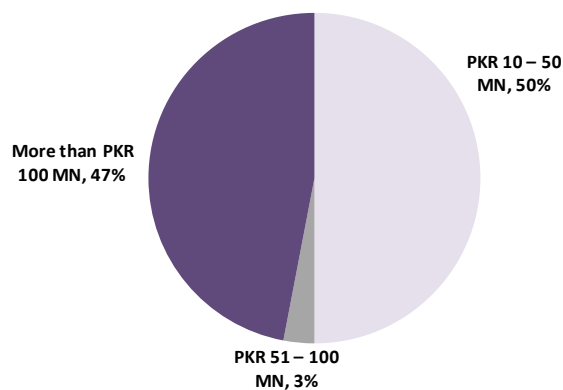
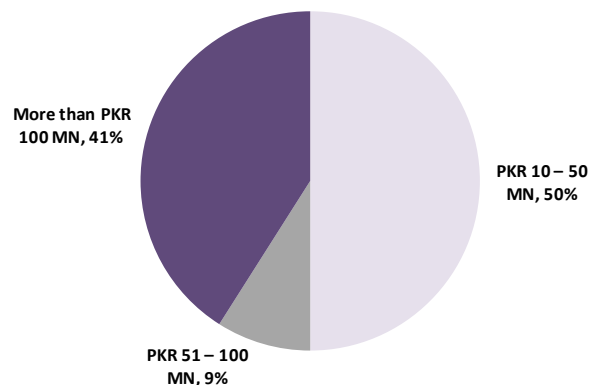


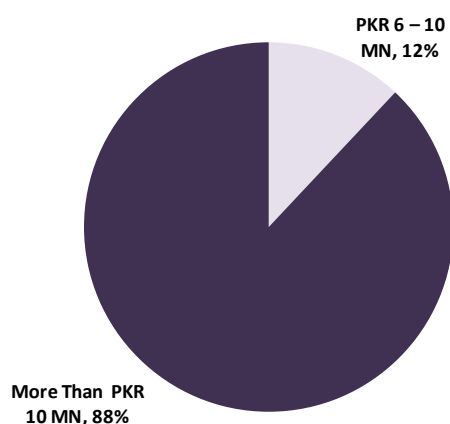
Figure 5.6-d: Annual Expense



Source: Survey Findings

All businesses display healthy earnings (**Figure 5.6-e**). Only 12% of business owners earn between PKR 6-10 million, while rest of the business owners show net earnings of more than PKR 10 million.

Figure 5.6-e: Net Income



Source: Survey Findings

5.7 Indicative Business Requirements

The following table (**Table H**) lists the business equipment required by the businesses in the 'Cotton Ginning' sector. The values provided below are susceptible to volatility in market prices. In addition, individual business owners will have distinctive requirements as per their business needs. The table below is neither comprehensive nor specific and provides only an indication as to the typical requirement for set up or the expansion needs of a small sized business within this segment.

Table H: Indicative Equipment Requirement	Cost PKR
Saw ginning Machines	7,000,000- 12,000,000
Lint Cleaners	1,500,000
Cotton Seed Cleaning Machine / dust Remover	5,000,000
Seed Saw tooth Delinting Machine	4,000,000 – 12,000,000
Cotton Conveyor belt	2,000,000
Hydraulic Cotton Bailing Press	7,000,000– 15,000,000
Humidifier	10,000
Weight Bridge	20,000,000 – 40,000,000
Vacuum Separator	500,000
Condenser	400,000



5.8 Financial Need Analysis

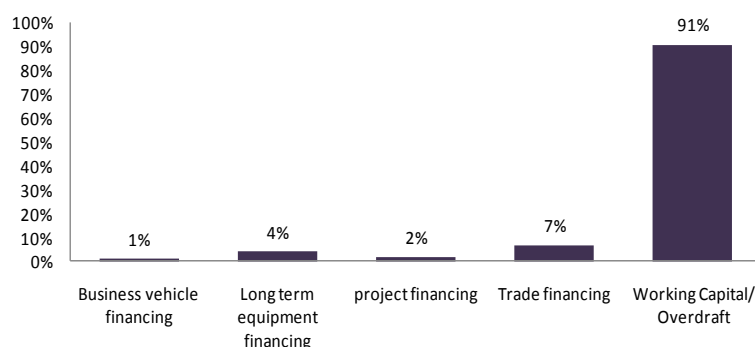
Funds are mostly managed by General Managers or accountants with very few business owners managing funds themselves. Business assets and working capital are mostly fulfilled by loans from banks or cash flow from their business. Some business owners also use their own savings to meet their funding needs. Among the fixed assets, finance requirements are mainly centered on machinery and equipment of the business, as stated by 87% of the businesses (**Figure 5.8-b**).

Almost all of the businesses (91%) opted working capital as their primary business funding (**Figure 5.8-a**) need from which Letter of guarantee (LG) for the purchase of raw materials or finished products and Finished Goods was the most preferred.

The segment is keen to use banks for routine business needs and has been using banks for certain banking products; however, the businesses operating in the segment did not have any significant awareness and therefore did not have an encouraging response towards lending products or to have a more far reaching relationship with banks and financial institutions.

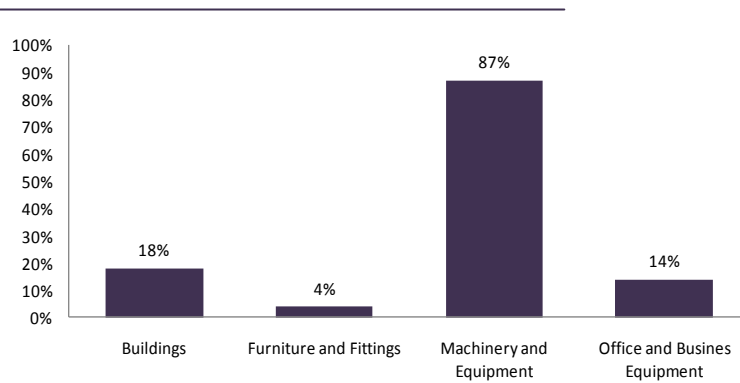
This sort of reluctance with respect to bank financing products can primarily be attributed to lack of communication between the business owners and banks, as well as limited knowledge of potential customers/business owners with respect to existing or potential products that may be offered by banks. The banks can successfully expand their target market by educating the business owners to utilize banking products. The banking products need to be customized /structured to suit the specific needs of the business.

Figure 5.8-a: Business Funding Needs



Source: Survey Findings

Figure 5.8-b: Fixed Assets Financing Requirements



Source: Survey Findings

5.9 Usage of Banking Products

The owners are mostly unaware of any SME segment specific efforts made by the Government of Pakistan; however, few business owners are receptive to potential loan products offered by banks and have also availed the facility of loan for business funding needs.

Many business owners use banks to meet banking and business needs, availing the facility of business banking accounts, but the owners are not keen to propose any feature or product to be offered by the bank.

33% of the segment use banks as their source of funding, the second most sought out preference after their own saving, which is encouraging. The remaining business owners who have never approached banks for loan cited high interest rates, strict demand for collateral, bank charges, documentation and religious reasons.

Other services provided by the banks, namely cash management, money transfer, and payroll, are also required by the businesses in this sector. Majority of businesses in the survey showed interest in availing cash management services, whereas money transfer and payroll services are desired by few.

20% of the respondents reported to have not availed any insurance for their business. The rest have insurance for motor vehicle, equipment and medical aid. More than 80% are not interested in availing any insurance product from banks in future as they prefer to avail such products directly from insurance companies.

The sector only consist of 6% of the businesses who avail advisory services and pay for it, the rest avail it from their family members and colleagues on a non-professional basis with almost half of them being satisfied with their current source of advisory services. None of the business owners are willingly to pay for such services if provided by the banks.

Banking Product	Usage Percentage
Deposit (Checking) Account	72%
Term Deposits	26%
Loan Product	32%

5.10 Segment Risk Considerations

The SMEs in this sector are highly risky as compared to some of the other businesses operating in Pakistan in terms of survival and other uncontrollable factors such as weather, as indicated through the prevailing market condition. This segment has however continued to show its presence in both the local and even the international market, the underlying reason being the country's strong agricultural base, with many established businesses generating healthy profits over the years. More than half of the owners are operating from owned factory. However, some risks that pertain to this segment are discussed below.

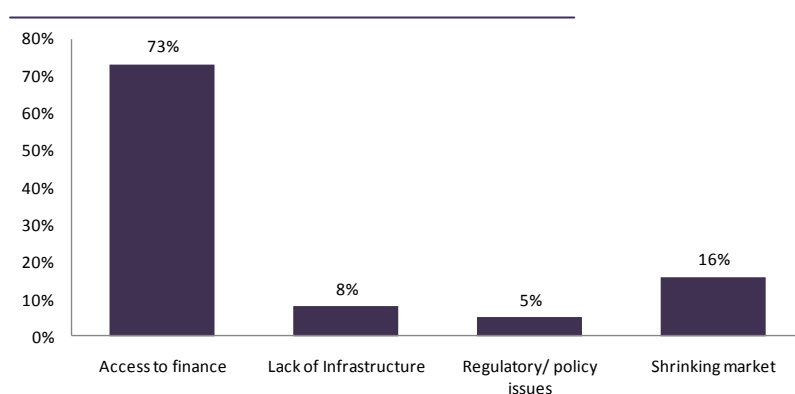
Businesses in the segment are largely individual proprietorships having this business as the only source of income. Almost half of the businesses are operating from rented premises, therefore incurring high fixed cost. The sector mostly listed non-repayment of loans taken from banks as their biggest risk to the business, followed by inflation, with the percentage resting at 64% and 34% respectively.

All businesses in the sector prepare Financial Statements but less than half of the businesses have an audit of their financial statements. The analysis also demonstrates that the segment operates in a highly competitive market with more than half of businesses having more than ten competitors. The majority of business entities in the segment rely on the same suppliers for a number of years to meet material needs; unavailability of raw material from the selected suppliers can cause a problem if required to switch to a new supplier.

More than 70% of the businesses address these risks through more capital investment (**Figure 5.10-b**), while 10% of the businesses also focus on manpower training. Due to lack of raw cotton storage facility only 6% of the businesses address their risk through inventory management. 73% of these businesses feel that lack of access to finance restricts them in business expansion while 16% felt shrinking market was also the cause (**Figure 5.10-a**).

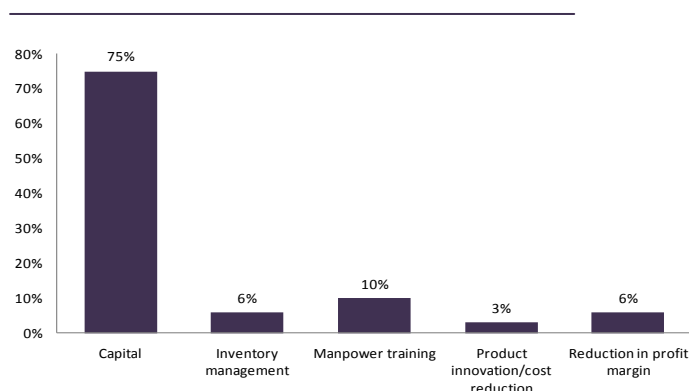
A large proportion of SMEs in the segment do not use banks to meet business funding needs and are not paying for any insurance products.

**Figure 5.10-a: Business Expansion
Restraints**



Source: Survey Findings

Figure 5.10-b: How Business Risk is Addressed



Source: Survey Findings

Following are the strengths and weaknesses inherent in this sector:

Strengths

- Raw material locally available
- Strong agriculture base in the country
- High capacity for high production
- Huge export potential

Weaknesses

- Outdated technology
- No technical training institute for Ginning Industry
- High contamination in the crops
- Low pest control

Further, the risks inherent to the segment include:

- Uneven cash flows
- Limited resources for expansion
- Business uncertainty due to changing import and export policies
- Unaudited financial statements
- Employee turnover
- Lack of succession planning

Possible Mitigating Factors:

- Lending only to those businesses which have been operating for more than five years
- Proposing products to business with a verifiable banking history of more than two years
- Review of accounts and register of invoices
- Review of ownership documents of business premises

6 Proposed Banking Product Suite

6.1 Product Features

Based on our primary and secondary research we propose the following for economic growth of 'Cotton Ginning' sector:

Asset Products:

- Working capital/overdraft Finance Facility
- Cotton ginning machinery leasing
- Bill Discounting Facility
- Industrial Power Generator Leasing
- Export Refinance

Liability Products:

- Business Bank Account

Other products

- Banc assurance
- Branchless Banking (Mobile)
- Utility Bill Payment

Table I: Working Capital/Overdraft Finance Facility	
Particular	Details
Initial deposit	Minimum initial deposit of PKR 10,000
Tenure	3 years with no requirement of Annual Cleanup for principle amount. However, regular payment of markup is must for renewal of limit.
Loan Limit	<ul style="list-style-type: none"> • Minimum Limit - PKR 1,000,000 • Maximum Limit - PKR 50,000,000 • Minimum and maximum loan limits are reviewed annually <p>Total loan limit offered will not exceed an average six months of usage determined over a period of the last three years.</p> <p><i>(Maximum limit is set based on 50% mark-up of average revenue estimated for this sector)</i></p>
Documentation	One time documentation (as required by banks) for a period of three years
Repayments & Withdrawals	<ul style="list-style-type: none"> • Flexible repayment conditions: lump sum payment on the due date or partial repayments • Multiple withdrawals are allowed during the tenure of loan
Cleanup	Borrower is liable to clear the entire loan amount, both principal and markup, once in a year on a date indicated by the borrower & mutually agreed by the bank
Markup	As per prevailing KIBOR and spread
Markup charges	Mark up will be charged only on the amount utilized by the borrower
Renewal	Renewal will be on the basis of fresh application, subject to clearing of entire loan amount including markup and satisfactory credit history
Penalty	No early repayment penalty may be imposed on the borrower (subject to banks discretion)
Insurance	Mandatory insurance as per SBP guidelines
Security	Raw material stock. Mortgage of business premises for those who operate from owned premises.

Table J: Cotton Ginning Machinery Leasing	
Particular	Details
Initial deposit	Minimum initial deposit of PKR 50,000
Salient Features	<ul style="list-style-type: none"> Equipment & machinery leasing will be provided for business expansion only to businesses who have been operating for 3 or more years A list of pre-approved equipment and machinery manufacturers will be developed based on information received from trade association and market intelligence <p>Disbursement directly made to pre-approved equipment and machinery vendors on behalf of borrower</p>
Tenure	3 - 5 years
Loan Limit	<ul style="list-style-type: none"> Minimum Limit - PKR 2,000,000 Maximum Limit - PKR 50,000,000
Documentation	<ul style="list-style-type: none"> One time documentation required for a period of three years Financial Statements
Repayments & Withdrawals	Repayments will be based upon preset Equal Monthly Installments
Markup	As per prevailing KIBOR and spread
Penalty	As per existing bank policies and cost of charges
Insurance	Mandatory insurance as per SBP guidelines
Security/Collateral	5% of invoice as security deposit and hypothecation of leased assets. Provision of collateral as per satisfaction of the bank

Table K: Bill Discounting Facility	
Particular	Details
Indicative Tenure	3 years
Loan Limit	<ul style="list-style-type: none"> • Minimum Limit - PKR 1,000,000 • Maximum Limit - PKR 5,000,000 • Minimum and maximum loan limits are reviewed annually <p>Loan limit will not exceed more than six months of sales to approved vendors determined over a period of last three years. More than 50% of sales of business have to be under contract to approved vendors.</p>
Documentation	Detailed documentation
Approval	Approved on basis of business proposal and RMG guidelines
Collateral	Sales invoice payments deposited directly to Bank
Markup	As per prevailing KIBOR and spread
Penalty	No early repayment penalty will be imposed on the borrower
Hidden Charges	No hidden charges
Insurance	Mandatory insurance as per SBP guidelines

Table L: Industrial Power Generator Leasing	
Particular	Details
Down Payment	Minimum down payment of 20%
Salient Features	<ul style="list-style-type: none"> • Loan amount will be directly transferred to suppliers' accounts against invoices • Credit facility will be offered directly through pre-approved generator suppliers
Tenure	3-5 years
Documentation	<ul style="list-style-type: none"> • Business Financial Statements • Proof of business operation for last three years
Loan Limit	<ul style="list-style-type: none"> • Minimum Limit - PKR 500,000 • Maximum Limit - PKR 10,000,000
Repayments & Withdrawals	Repayments will be based upon present Equal Monthly Installments
Markup	As per prevailing KIBOR and spread
Insurance	Mandatory Insurance facility as per SBP guidelines
Penalty	As per existing bank policies and cost of charges

Table M: Export Refinance	
Particular	Details
Initial deposit	Any form of collateral/guarantee which the bank feels fit.
Tenure	Depends on the contract terms of LC
Documentation	One time documentation required for a period of three years which may include financial statements, company incorporation documents etc.
Markup	As per prevailing KIBOR and spread
Penalty	As per existing bank policies and cost of charges
Insurance	Mandatory insurance as per SBP guidelines
Security	As per the requirement and satisfaction of bank.

Table N: SME Business Bank Account	
Particular	Details
Account Type	Non- remunerative Current Account
Documentation	CNIC/smart NIC, completion of KYC requirements as per SBP Regulations
Facilities	<ul style="list-style-type: none"> • Cheque Book • Upgraded ATM facilities • Business Visa Debit Card • Phone Banking • Mobile Banking • Internet Banking • Monthly account statement

Table O: Other Products	
Particular	Details
Banc-assurance	Bancassurance products such as Business Premises Insurance, Personal Injury Insurance, Equipment and Vehicle insurance can be proposed by banks through its channels offering reasonable rates and servicing through banking channels such as direct debit
Branchless Banking (Mobile)	Mobile banking services for instance balance check, bill payment and funds transfer
Utility Bill Payment	Service for easy payment of electricity, gas, telephone and cell phone bills

6.2 Eligibility Criteria for Asset Products

Table P: Asset Products Criteria

Indicators	Description
Borrower Eligibility Analysis	During assessment of customers, take into account the total indebtedness of the potential borrower, his disposable income and ensure that the total financing to customer does not exceed the prescribed limits as laid down in approved policies of bank. Borrower should be in business of ' <i>Cotton Ginning</i> ' for the past three years and hold a valid CNIC/smart NIC.
Business Analysis	To assess the Borrower's position, verification of their revenues can be verified by the bank. Business premises ownership documents should be verified against name of the owner.
Credit worthiness	Credit worthiness of the borrower may be ascertained by collecting information from e-CIB or other credit information bureaus.
Financial parameters	To assess average expenses, income generated and repayment capacity of the borrower.
Adherence to Lending Standards	To assess that Customer/ Borrower requirements are in compliance with standards set for revolving finance scheme by the Bank and/ or Regulatory Authorities.
Banking History	Verifiable banking history of more than one year with active accounts
Business Operations	Business should be in operation for more than three years. If the business is involved in exporting their finished goods then they should be involved in export business for the last 3 years.
Trade body membership	Business should be a member of the sector's trade body.

7 Distribution and Communication Considerations

SMEs in 'Cotton Ginning' are spread out mostly in Punjab in various clusters; therefore they can be reached and targeted in major clusters to promote banking products.

7.1 Marketing Objectives of Banks

Marketing objectives for building and promoting the brand image of SME Products for cotton ginning manufacturing are as follows:

The banks may:

- Educate the cotton manufacturers, create awareness for financial needs and banking products in the identified market regions
- Develop strategies to attract a large number of cotton manufacturers interested in product schemes
- Design a comprehensive positioning strategy to create strong perception of the cotton segment lending product in the market

7.2 Promotional Activities by Banks

To create awareness of SME specific products in the target market, the banks may aggressively advertise their banking products through various promotional programs and events:

- Conduct workshops to create awareness amongst cotton ginning sector business owners with trade associations to provide maximum exposure to business owners
- Organize promotional events to build strong image of the bank among the target audiences

Banks can service these SMEs through the following proposed channels: *(Please note that this list is not exhaustive)*:

- Direct Sales Agents
- Tele Sales
- Trade association backed seminars
- Branches in cluster locations

7.3 Distribution Strategy for Banks

As primary means of customer service and sales interaction, distribution channels play a central role in the customer relationship process, which improves growth. Banks' challenge is to improve and integrate their multiple distribution channels to consistently deliver an enhanced experience and foster better customer relationships. Top priority is placed in attracting and retaining customers within and across these channels.

To reach maximum percentage of target market, Banks need to have a comprehensive distribution strategy. Banks should aim to cater banking needs of cotton ginning sector through its products in major cities of the country where cotton ginning units are located. Initially the banks may provide financing facility in main cities of the country but will however penetrate into other small business markets after establishing strong presence in major cities.

Banks may adopt following conventional channels for distribution:

- **Direct Sales Agent:** This activity may be outsourced and a trained marketing team should periodically visit identified areas within the cities, to educate potential customers and create awareness of the products and services being offered under SME Products Suite.
- **F2F interactions:** A deeper level of interaction may provide an integrated customer focus, by relationship managers involved in face to face interaction, which will become critical in helping better communication for product awareness and in addressing hesitations faced by the business owners.

Following Technology based alternate delivery channels can also be adopted for distribution

- **Internet Banking:** With technology up gradation mobile phones have become sophisticated and capable of handling advanced applications and services, so banking via mobile phones appeal to consumers on multiple fronts.
- **Short Message Service (SMS):** Marketing team can send out mass messages in Urdu or English to '*Cotton Ginning*' segment for advertising bank's products.