

'Handmade Carpet Manufacturing'



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Address
Infrastructure, Housing & SME Finance Department,
State Bank of Pakistan
I.I. Chundrigar Road,
Karachi
Ph: 021-32455501, 021-111 -727- 111
FAX: 021-99221139

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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 "Handmade Carpet Manufacturing" 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.

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1 Guidelines for using this Research Report

The '*Handmade Carpet Manufacturing*' 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 '*Handmade Carpet Manufacturing*' 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 main cities of Pakistan, mainly Lahore, Karachi and Hyderabad among others; the 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. Very few businesses in this segment use banks for their business needs largely 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 an imminent 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 the 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 sector.

This research report contains findings pertaining to the segment of "*Handmade Carpet Manufacturing*" which includes looms scattered all over Pakistan with most concentration in Sindh. However, a better competitive advantage is achieved in the main cities such as Karachi, Lahore, Islamabad and Rawalpindi.

Manufacturing sector in Pakistan has been the major contributor towards promoting economic growth, but lack of research and development and inadequate investments have restrained this sector to reach its growth to the fullest potential.

The '*Handmade Carpet Manufacturing*' units are spread all over Pakistan but the highest concentrations are mostly in the Sindh province, followed by Punjab. Lahore, however, is considered the hub of '*Handmade Carpet Manufacturing*' in Pakistan. Ample supply of raw material is available, which is mainly wool. Quality of raw material depends upon the breed of sheep. This sector has great potential for growth in exports as demand for handmade carpets is extremely high in the international market, with Pakistan, along with India and China, being one of the leading exporters of handmade carpets. This sector is however, immensely ignored by the government; therefore, better support from financial institutions will facilitate growth.

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 gives 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 now classified as medium sized hence we have covered a substantial 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 million 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 Handmade Carpet Manufacturing Segment Industry Overview

Table C: Summary of Industry Overview

Factors	Comments
Demand	Great value is accorded to Handmade carpet manufacturing in the third world countries. However, due to child labor, government policies and poor infrastructure, the sales of hands made carpets have not reached to its potential.
Supply	More than 90% of all the Handmade carpets are exported to other countries, especially to Eastern Europe and South America. Lack of skilled manpower, inflation and high mark-up has seriously hampered the growth of this sector.
Key players	Lahore Carpet Manufacturing Co., Pak wholesale Rugs, A Aziz & Sons, Mannam Carpets, Zafar Industries, United Carpets and Company, Umer Corporations, Gaba Orientals
Trade Body	Pakistan Carpet Manufacturers and Exporters Association (PCMEA)
Regulatory Body	Ministry of Industries
Recent Developments	Recently, Chinese delegation has signed a memorandum of understanding with PCMEA to work in close collaboration in ' <i>Handmade Carpet Manufacturing</i> ' sector while also providing research and development facility.
Future prospects	This sector requires immense attention and support in order to revive the old heritage and increase its international market presence compared to its competitors like India, Iran and China.

4.1 Demand

The hand-knotted carpet industry of Pakistan has come a long way since its beginning in the early fifties. According to PCMEA (Pakistan Carpet Manufacturers and Exporters Association), hand knotted carpets are one of the major exports of Pakistan.



Pakistan's handmade carpet sector dominates the South-East Asia while great presence is also in USA and Germany. However, due to child labor still prevailing in carpet manufacturing industry, despite many steps and laws being passed against it, many countries have shown reluctance in importing handmade carpets from Pakistan.

According to PCMEA, Pakistan's carpet exports have witnessed a huge decline of more than 60 per cent during the last six years as hand-made carpets export has fallen from \$500 million to \$120 million in the year 2014¹. This massive decline in exports is not only the result of global recession but also due to less foreign visits at carpet exhibitions, leading to less product exposure and so less export orders. Bad law and order, soaring inflation, shortage of skilled labor force (reasons discussed below) and high mark-up rates have led to declining exports.

Pakistan Carpet Manufacturers and Exporters Association (PCMEA) said that industry is in dire need of government support, which can provide it at least 3 per cent ad-hoc relief on carpet export to revive the ailing industry, besides helping 0.5 million unemployed people to return to work¹.

Because of global recession and declining exports, the industry needs some concessions/subsidy from the government on bank loans. In the past, carpet sector had remained one of the main export sectors of Pakistan. It is expected, that by holding special exhibitions for the carpet industry, more international market exposure can be achieved which may increase export orders.

People working in this sector feel that if more foreign delegations are invited to carpet exhibitions or if locally made carpets are promoted in foreign exhibitions, more demand for Pakistani Carpets can be raised in international markets.

A remarkable change that has taken place is that the industry is now fully ttuned to the needs of the consumers. Previously, the industry worked on its own momentum and mostly produced, what is known as, the bazaar goods. Now large part of the production is customized according to the customers demand and specific needs. The industry has been increasingly making what the consumer wants both in regards to colors and designs. The traditional colors have been replaced

¹ <http://www.dailytimes.com.pk/business/06-Jul-2014/carpet-export-decline-deprives-500-000-people-of-their-jobs>

by the colors preferred by the customers abroad. Similarly, old designs have been modified and new ones are developed to fulfill needs of consumers.

4.2 Supply

Handmade carpet industry, as its name suggests, is a labor intensive industry and is not only a major earner of the foreign exchange for the economy but also a contributor to the poverty reduction in the rural areas. About 1.5 million people are affiliated with the industry. This industry is spread all over Pakistan with highest concentration in remote rural areas as families belonging to these areas, especially women, can easily enter this sector as an occupation, since it requires minimal infrastructural facilities. Unlike other industries, it does not require utilities such as electricity, water, phone or gas.



However, one of the major issues faced by the '*Handmade Carpet Manufacturing*' is the low wages of employees as compared to other industries that require skilled labor. Many workers are able to earn twice or thrice more in other sectors, such as construction, than in the carpet industry, due to which many workers switch over to other industries. Another drawback prevailing in this industry is the cost and time incurred on one finished product. On average a carpet takes several months to be finished, which means that every worker needs to be paid for months on one carpet before a finished product is ready to be sold in the market.

Low wages make it less feasible for male workers, which is why most families let their children and women work in this industry. About 70% of the workforce in carpet manufacturing industry consists of women working from home, according to PCMEA². This sector is known to provide direct labor to the most under-privileged and uneducated segment of the society. In some cases children are even below 10 years, which causes some serious concerns regarding child labor.



² <http://asianetpakistan.com/business-news/general-business-news/167675/handmade-carpet-industry-wants-representation-in-export-development-funds-board/>

Other than that, many workers had been afghan refugees, most of them returning back to their country after war, leaving behind lesser skilled workforce than already present. The number of carpet exporters have also shown a decline over the years³. However, the carpet export has increased from \$87.7 million to \$97.2 million in the period July-March 2013-14, compared to last year, a change by 10.8%⁴.

This industry is least affected from country's chronic energy crises, however, businessmen complain about high interest rates. The industry demands for the government to take more steps to revive this sector, besides restoring zero-rate facility, to be able to benefit from duty-free access to EU market.

4.3 Key Players

The key players of handmade carpets are, Lahore Carpet Manufacturing Co., Pak wholesale Rugs, A Aziz & Sons, Mannam Carpets, Zafar Industries, United Carpets and Company, Umer Corporations and Gaba Orientals

4.4 Trade Body

Pakistan Carpet Manufacturers and Exporters Association - was established in 1960 to run the affairs and work to promote carpet manufacturing industry of the country. The association is divided in two circles, Northern and Southern, with respective offices in Lahore and Karachi..

4.5 Recent Developments

In March 2014, Pakistan held carpet exhibitions to promote its carpet industry in the international market, which was attended by many foreign delegations including delegations from China⁵. The exhibition proved fruitful as it created more awareness about the quality and traditional diversity expressed in Pakistani handmade carpets. A Chinese business delegation has signed memorandum of understanding with the Pakistan Carpet Manufacturers and Exporters Association (PCMEA) to capture the growing market for handmade carpets in China while offering research and development facilities to carpet manufacturers and help the Pakistani carpet industry to upgrade its techniques.



³ Industry Ratings & Strategic Positioning Report 2013

⁴ Economic Survey Of Pakistan 2013-14-Manufacturing and Mining

⁵ <http://nation.com.pk/business/02-Mar-2014/china-trade-council-team-visiting-pakistan-from-tomorrow>

4.6 Future Developments

Despite many opportunities available in this sector and advantage of cultural heritage, this industry has been immensely ignored, with low skilled work force and old methods still adopted in manufacturing process due to which this sector has faced a huge loss of international market share. Though the demand for double knotted carpets is rising, the local industry set up has not been organized enough to cash this opportunity.



In recent times, the highly labor intensive handmade carpet industry has had to compete with the machine made carpets, and therefore, has to produce innovative products by improving the productivity and quality of associated devices. There is also the need to provide a safe working environment for its workers.

While the barriers to entry might be low in carpet manufacturing sector, there are other challenges that carpet manufacturers face.

- 1) In order to raise the demands for these carpets, proper marketing of the products will need to be undertaken by the association as well as the major players
- 2) Carpet manufacturing can be done by a single person or a unit with more than 100 workers, making carpet manufacturing a very competitive industry.
- 3) Carpet orders and preferences vary greatly amongst the customers. There will be customers, who will want only the best carpets for their homes, resulting in more business for smaller but more independent manufacturers. While, there will be other customers who will demand more quantity as opposed to quality, making bulk manufacturers more successful in this segment of the industry. Therefore there is a wide range of spectrum to operate in, for this industry.



4.7 Handmade Carpet Manufacturing Process

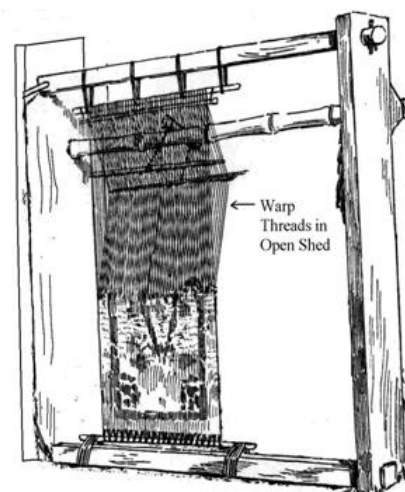
Initial designs are hand drawn on graph paper and filled in with color (**Figure 4.7-a**). The designs then go to the people who write the 'code' or special language called Talim, which tells the weaver what colors to use, on each line. The original designs are archived and copies are sent to the weavers.



Once the design is complete the yarn is dyed. Color schemes are driven by styles and trends. Carpets are woven by hand on a structure called loom. Weaving of carpets is different in many aspects from the weaving of a fabric. The carpet is generally woven in a warp, i.e. a chain of vertical threads, fixed almost vertically in front of the weaver. Required length of warp threads wrapped over upper beam is called warp-beam. The warp-beam is supported by a pair of columns, which is about 1.8 m high.



Tuft of wool or silk is inserted between two warp threads and knotted. The knotting continues along the whole row. Then, the row is pressed using a tool called beater. Carpet's knotting is carried out according to the carpet design.



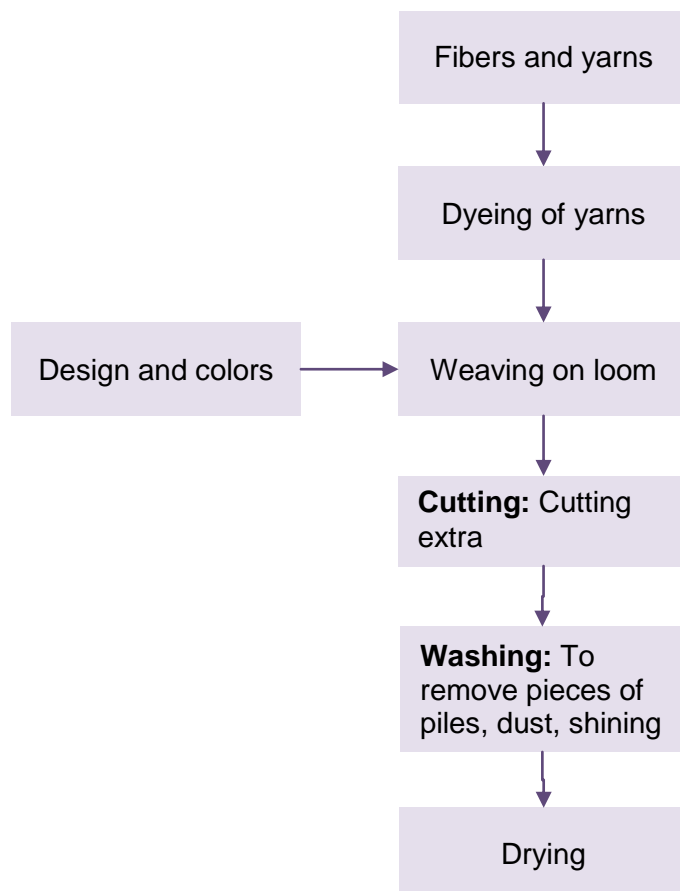
The carpets are received and inspected. They are then cleaned and scrubbed, which is either done manually using wooden plank or done by electric razors, after which, the carpets go in a tumbler that removes any excess wool that was shaved off. Many bags of shaved wool are sold to cushion makers, who use it for stuffing cushions.

They are then washed and laid outside in the large courtyard on clean river rocks to dry, or in some cases, hung out to dry. The backs of the carpets are hit with fire to seal the knots and keep them from becoming loose. Once they are dry, the process of getting them ready for sale begins.



They are inspected repeatedly at every step in the process. This results in finding small errors in the pattern, which are corrected by a team. The rugs are stretched to make sure they are exactly straight and true to measurements. Rows are checked to make sure they line up the way they are supposed to. They are cleaned after each process.

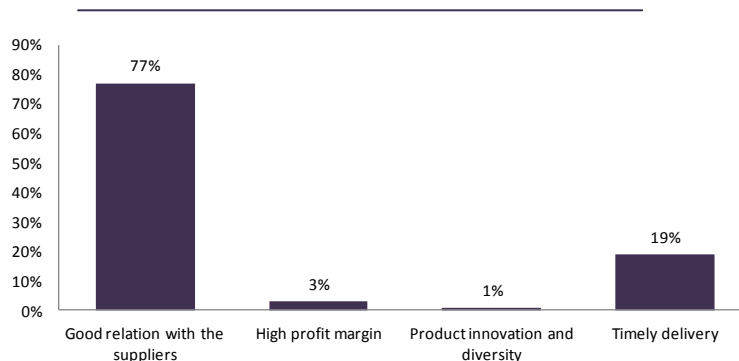
Figure 4.7-a: Handmade Carpet Manufacturing Process



4.8 Success and Survival of the Businesses in this Sector

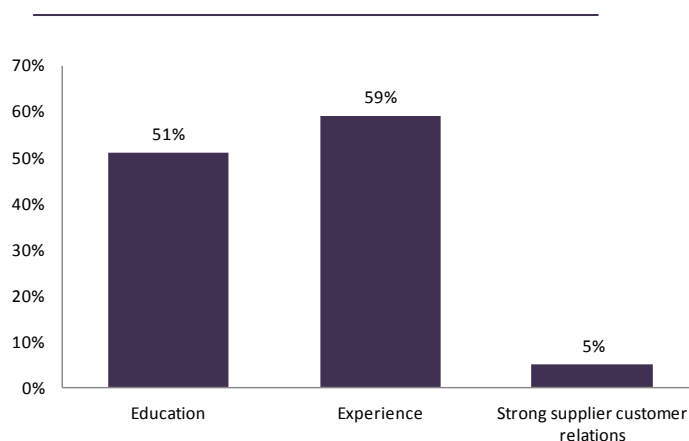
From the survey interviews (*Figure 4.8-a*), 77% of the business owners felt that good relations with the suppliers was the major success factor for the businesses in this sector, as this ensured consistent supply of raw material and so no loss of orders. 19%, however, felt timely delivery also contributed to their business success.

Figure 4.8-a: Indicators of Business Success



In order to survive as an SME (*Figure 4.8-b*), 59% business owners believe that experience was the most essential element of the business, followed by 51% business owners who believe in education. However, 5% of the business owners also felt that due to strong supplier customer relations, their SME businesses managed to survive.

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



Source: Survey Findings

5 Market Assessment

5.1 Market & Demographic Profile

Most businesses are family owned with members of one family serving different functions of business. Underlying issues inherent to the segment include:

- 1) Restricted funding sources
- 2) Inability to identify and explore new markets
- 3) Lack of Government initiative and policies
- 4) Lack of technical institutions and skill development programs
- 5) Lack of proper infrastructure

'Handmade Carpet Manufacturing' looms are scattered all over Pakistan, especially in remote rural places, but the biggest cluster is found in and around Lahore. These units are usually located where there is an easy access to the raw material, which is wool from sheep. Carpet manufacturing is carried out in homes in rural areas or loom shed / workshop. The end product is then either sold to the contractors for export purposes or is sold directly in bazaars.

This sector has huge investment potential with increasing demand in the international market as well as availability of cheap labor. Great attention, however, is required in organizing this highly informal and complex carpet industry, providing better working environment as well as better market and product promotion.

5.1.1 Market Sizing and Lending Potential

'Handmade carpet manufacturing' cluster is scattered both in rural and urban areas of the country with many working at homes in rural areas/ villages. Due to this cluster data is difficult to access and assess and therefore, the following areas (**Table D**) are listed according to their highest concentration.

**Table D: Cluster Locations for
'Handmade Carpet Manufacturing'
Industry**

Lahore
Kharan
Kalat
Quetta
Muzaffarabad
Karachi
Mirpur Khas
Thatta



Source: Trade Associations and Industry Sources



5.1.2 Segment Demographics

The segment is widely spread out across various regions, especially in rural areas of the country, with highest concentration in and around Lahore. Demographic information is obtained from industry sources and primary research conducted using a selected sample of businesses in major cities of Pakistan. 30% of the businesses covered in the survey caters to Lahore while 25% of the businesses have their customers in both Karachi and Hyderabad. 20% of the businesses have their customers in Rawalpindi (**Figure 5.1-b**).

35% of the businesses in the survey have been in operation for more than 10 years while 33% have been operating for just one to three years, indicating different levels of business experience in this sector (**Figure 5.1-a**).

Figure 5.1-a: Number of years in operation

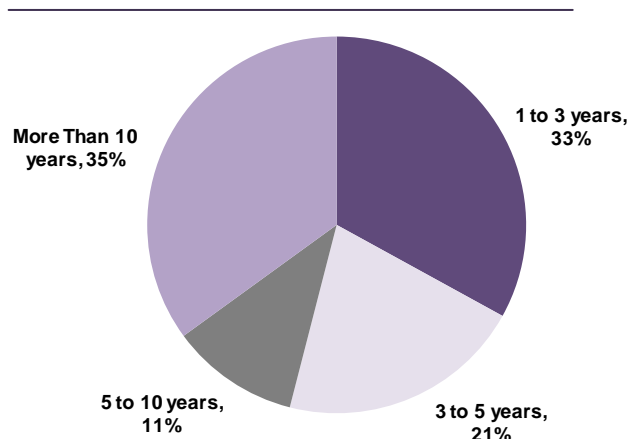
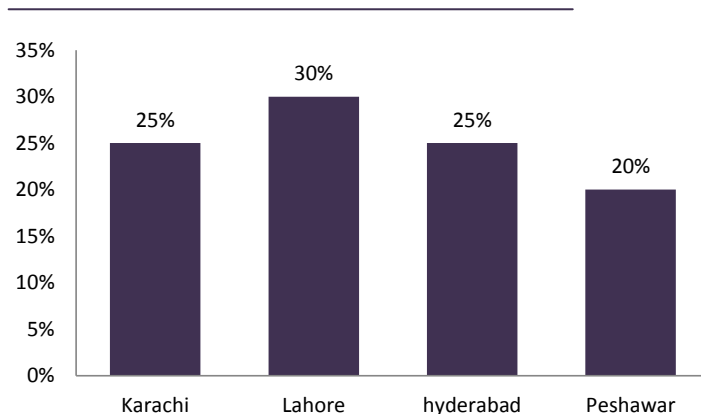


Figure 5.1-b: Customers' presence within the country



Source: Survey Findings

5.2 Owners Profile

The business owners consist mainly of people between the age group of 31-40 years and 41-50 years, with the percentage 70% and 15% respectively (**Figure 5.2-b**), with many running business for more than 10 years. This indicates that the business owners are well experienced in their industry. Due to the nature of work, high education level is not considered as a major factor for business owners, despite that 45% of the business owners have a bachelor degree (**Figure 5.2-a**). Predominantly businesses are run by families, preferring family members to undertake organizational functions, with majority (38%) having between 10-24 employees (**Figure 5.2-c**). 80% of the businesses are established as individual proprietorships (**Figure 5.2-d**).

Figure 5.2-b: Education level of business owners

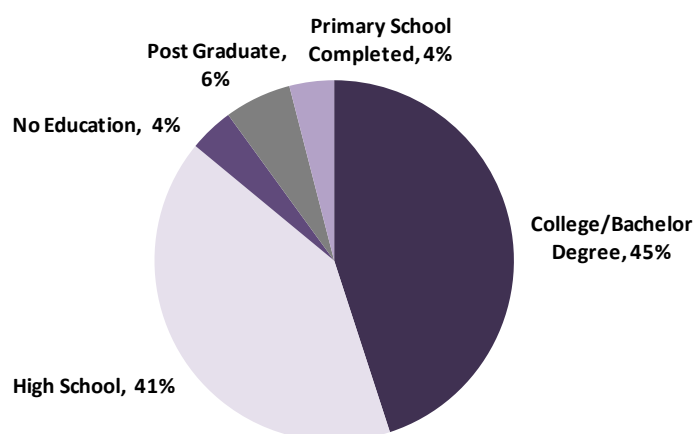


Figure 5.2-a: Age group of business owners

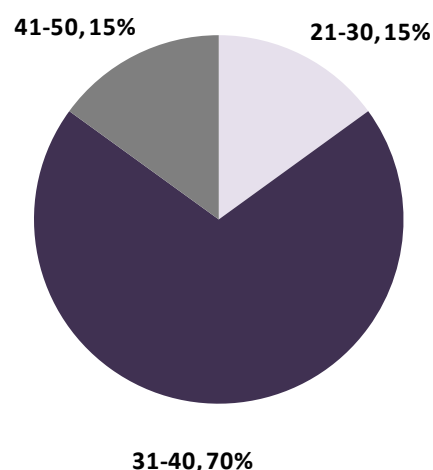


Figure 5.2-d: Number of employees under business owners

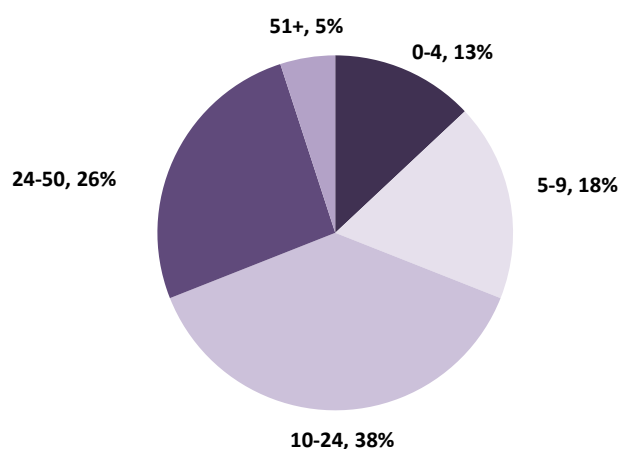
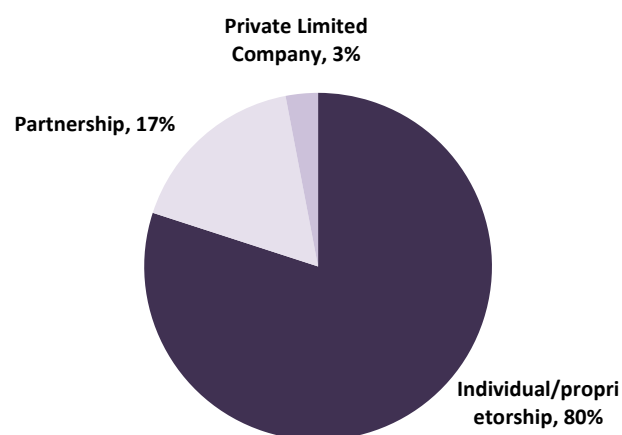


Figure 5.2-c: Ownership type



Source: Survey Findings

5.3 Business Linkages

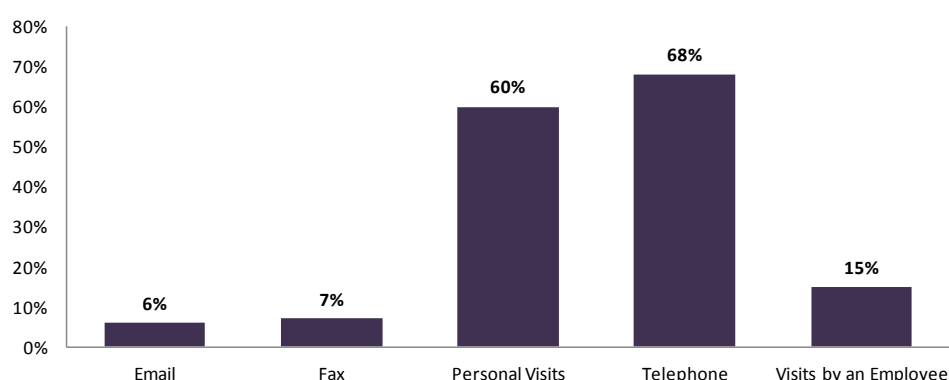
Businesses in the segment are connected to various institutions, which are directly or indirectly affected by the business operations. Primary stake holders and their interests are enlisted in the following table:

Table E: Stake Holders and Their Interests

Handmade Carpet Manufacturing	
Stakeholder	Interest
Owners	Growth, government initiative and access to finance
Suppliers (major local and few imported raw material)	Better terms and attractive pricing
Customers	Product quality, reasonable pricing, timely delivery
Financial Institutions	Debt servicing and increase in deposits
Government	Economic growth and benefit to community at large

Businesses employ various mediums as means of communication with its customers (**Figure 5.3-a**) however, due to business set ups mostly in rural parts of the cities; personal visits by customers and telephone are widely utilized. This business is moderately competitive with many business owners serving between 51-100 customers annually. Most of the customers include traders for exporting finished goods to the international market.

Figure 5.3-a: Communication with customers



Source: Survey Findings

Major supplies for 'Handmade Carpet Manufacturing' sector include (**Table F**):

Table F: Raw Material for Handmade Carpets Sector

Wools, yarns
Natural dyes



Majority of the businesses, almost 40%, depend on many suppliers to meet their material needs, which ensure consistent supplies are available without dependency on one supplier (**Figure 5.3-c**). 30% of the businesses however rely on the same supplier for years which in some cases may owe to good quality of raw material supplied or long term supply contract. Some businesses however, are not consistent in getting supplies of raw materials from their existing suppliers and need new suppliers, due to inconsistent material quality supplied, with percentages resting at 13% and 18% respectively.

65% of the businesses depend on two to five suppliers to meet their raw material needs (**Figure 5.3-b**). With large percentage of businesses in this sector depending on many suppliers to meet their raw material requirements, the risk of unavailability of raw material needs lessens, considering the lack of good quality locally manufactured of wool.

Figure 5.3-c: Number of Suppliers

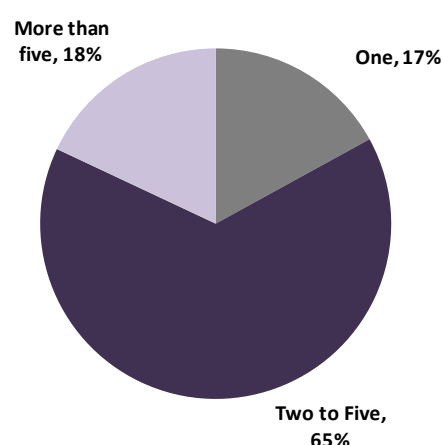
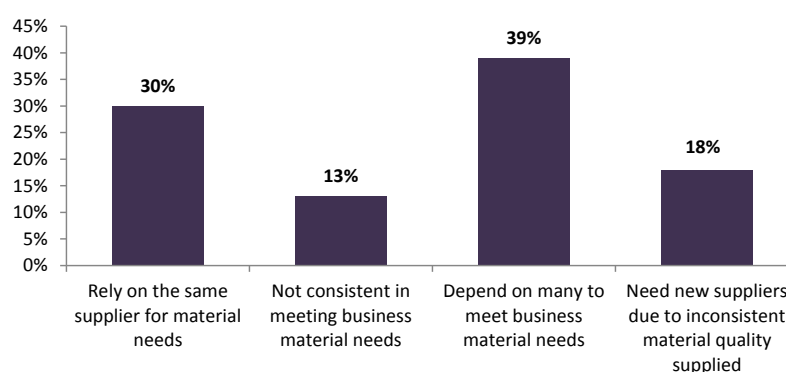


Figure 5.3-b: Supplier Relationship



Source: Survey Findings

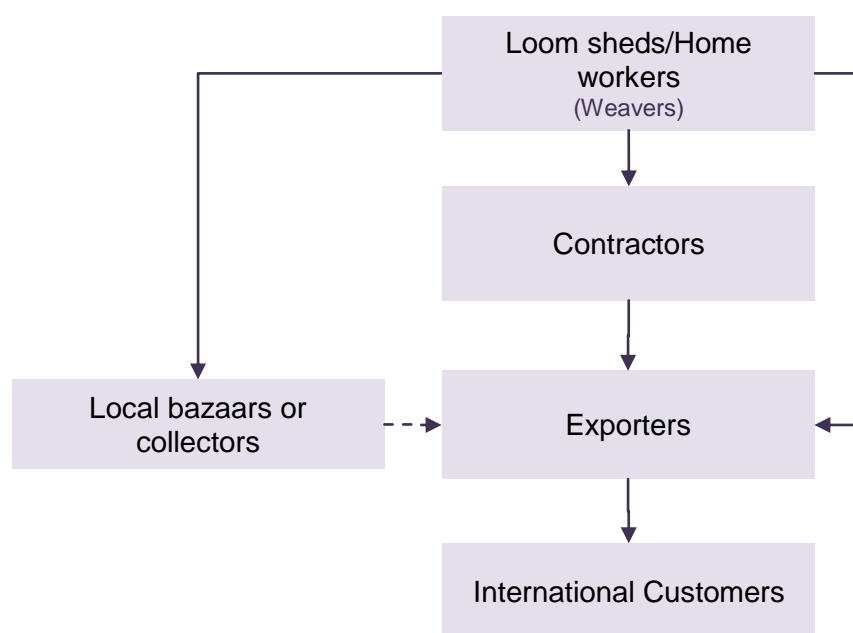
5.4 Business Cycle

This sector is not seasonal but unlike other SME sub-sectors, the whole manufacturing process to reach till the finish goods requires lengthy time, with one product taking as long as up to 8 – 9 months, or as less as few weeks for its completion, immensely dependent on the size and complexity of design.

This sector is not affected by the poor law and order situation prevailing in the country or of energy crisis and political instability, however, due to shortage of skilled labor, declining foreign trade and high cost of doing business in Pakistan, this sector has many complexities.

Carpet manufacturing is either carried out at home, mostly by rural women, or in loom sheds, which consist of about 3-40 workers (**Figure 5.4-a**). Home workers either work on orders placed by contractors or exporters, or are paid per piece rate. In places where carpet production has a long tradition, they produce carpets on their own and sell them at bazaars or to collectors. Loom shed has a very basic and informal infrastructure as a small production unit where spinning, balling and weaving is done.

Figure 5.4-a: Business Model



Contractors are intermediaries between the exporters and weavers or subcontractors and may act only as agents. In cases where exporters are the investors, the contractor then works as the supplier of raw material as well as the supervisor, to ensure good quality and progress of manufacturing. Export contractors can be international or local and place orders with local contractors. They may provide raw material and designs or buy the finished products from manufacturers directly, where they monitor the progress through contractors or collectors.

5.4.1 Working Capital

Working capital is dependent upon payment terms offered to customers and received from suppliers. Businesses in '*Handmade Carpet Manufacturing*' sector operate by processing various orders of carpet manufacturing for different customers, varying from home weavers, to collectors to contractors or exporters.

The segment works mainly on cash basis with raw materials either supplied by the contractors or bought directly. 41% of suppliers give credit terms of two weeks, while 5% suppliers provide up to 3 months credit period (**Figure 5.4-b**).

The repayment periods provided to customers are more or less consistent with the repayment period given by the suppliers, with 68% of the businesses offering one month repayment terms to customers (**Figure 5.4-c**), which corresponds with one month or earlier repayment terms offered by suppliers of the businesses. This helps the business owners in dealing with their payments to suppliers.

Figure 5.4-b: Repayment terms offered by suppliers

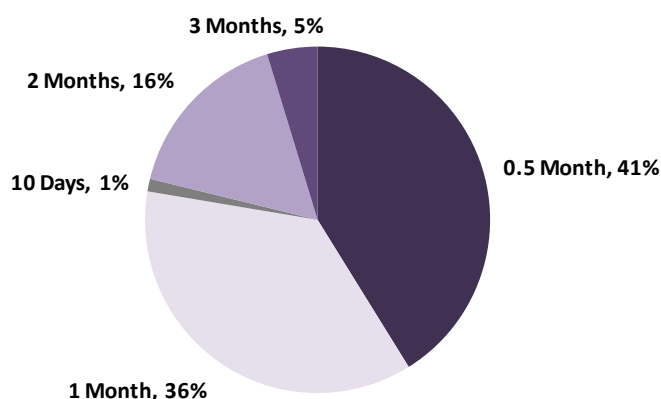
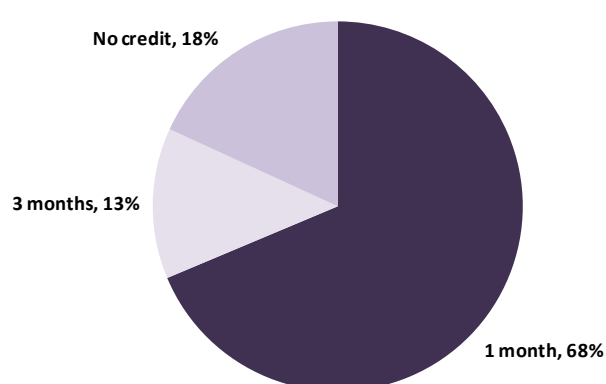


Figure 5.4-c: Repayment terms for Customers



Source: Survey Findings

5.5 Financial Assessment and Profile

All the businesses in this segment prepare Financial Statements, however only about half of the business owners have their Financial Statements audited.

Less than half of the business owners/managers keep track of accounts themselves while rest of owners have accountants to manage funds. Higher level of education is prevalent in this sector and so owners seem to have accounting knowledge and experience, which ensures to some extent that they are able to prepare reliable Financial Statements and keep a good and organized track of their cash movement.

From primary research and interviews conducted from trade associations, it has been identified that retailer margins are variable, which in recent years have been shrinking with reduced sales, due to serious reservations of child labor in the international market, which further adds on to the cost of finished goods production. Therefore greater number of businesses rely on higher sales volume for earning better profits.

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	21,860,000
Total Revenue	78,750,000
Annual Expense	74,550,000
Total Income	14,930,000
Key Financial Ratios	
Profit Margin	11%
Operating Expenses/ Revenue	94.6%
Asset turnover	3.6 times
ROA	68%

Higher expenses mostly pertain to wages on monthly basis, which may be on lower scale, but incurred separately for each product which may take months to finish. Therefore the asset turnover and profit margin are generally not very high.

5.6 Financial Information

Primary survey findings reflect the Revenue, Expenses, Income and Capital Expenditure under the selected sample for the sector.

Survey findings demonstrate 63% of businesses operating with total assets between PKR 10-50 million (**Figure 5.6-a**), which is dependent on the size of the business and the number of looms operating. Total assets comprise of plant and machinery (which in this sector consist of looms), land and building, trade receivables. Liabilities constitute trade payables and borrowing for plant & machinery and vehicles.

Business related assets constitute of land and building, hand looms for carpet manufacturing and vehicles for transport of goods, which makes a huge part of assets. 70% of the business owners in the '*Handmade Carpet Manufacturing*' sector incurred capital expenditure in the past five years which is relatively high as compared to other sectors (**Figure 5.6-b**).

Figure 5.6-a: Business Assets

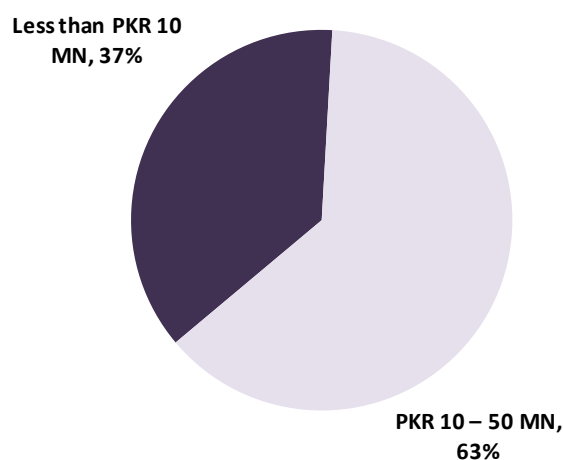
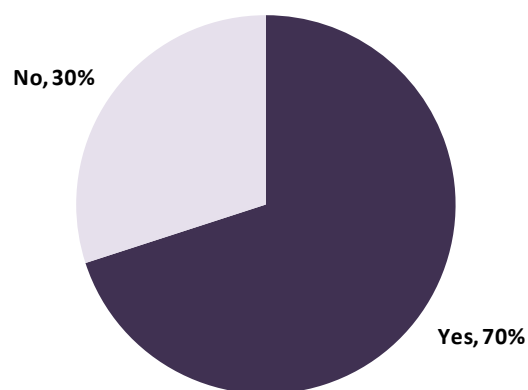


Figure 5.6-b: Capital Expenditure



Source: Survey Findings

Annual average revenue is predominantly between PKR 10-50 million throughout the sector (**Figure 5.6-c**), with percentage being 50%, while 30% have claimed to earn less than PKR 10 million. Expenses primarily represent raw material cost and workers salary. More than half of the businesses (65%) incur expenses less than PKR 10 million (**Figure 5.6-d**).

Figure 5.6-c: Total Revenue

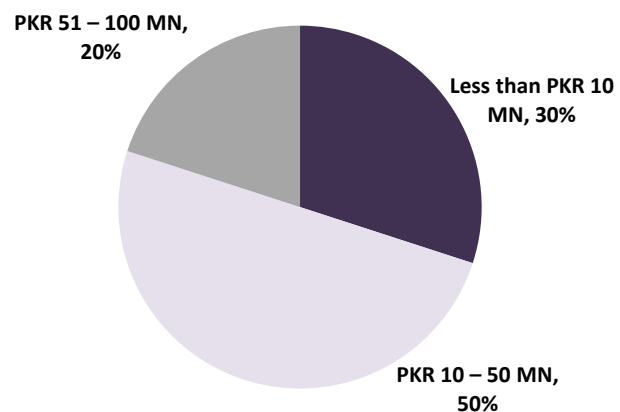
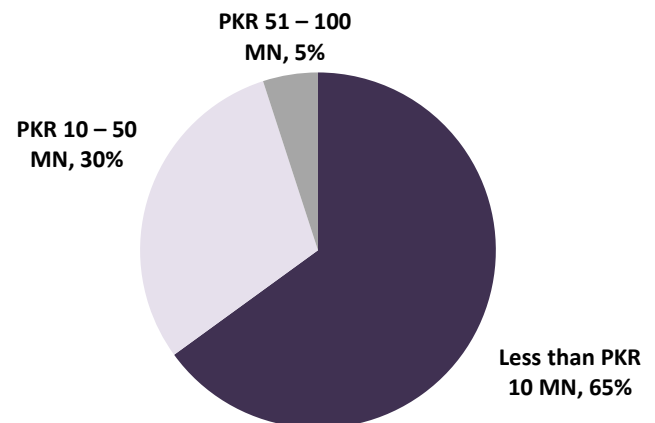


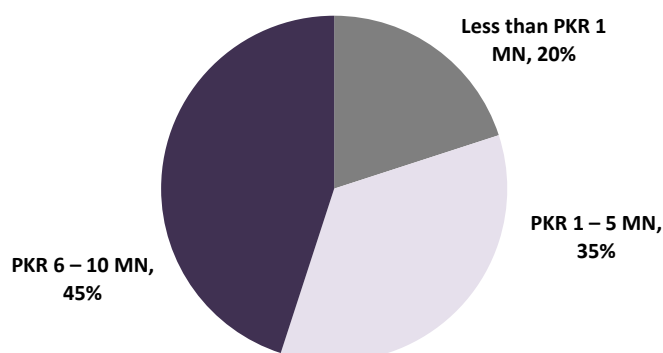
Figure 5.6-d: Annual Expense



Source: Survey Findings

Almost all of the business owners earn more than PKR 10 million while only 1% claims to earn between PKR 6 - 10 million of average income for the last three years (**Figure 5.6-e**).

Figure 5.6-e: Total Income



Source: Survey Findings

5.7 Indicative Business Requirements

'Handmade Carpet Manufacturing' sector is fully dependent on labor as the name suggests, along with few basic equipment such as mentioned below (**Table H**). This labor intensive carpet industry has to compete with the machine made carpets. Thus, it has to improve mechanical devices, which will improve the quality and rate of production. Depending on how big or small the setup is, following are the required equipment's:

Table H: Indicative Equipment Requirement	Cost PKR
Weaving loom	50,000 – 500,000
Dyeing color vacuum machine	25,000 – 200,000
Semi-automating washing machine	400,000
Embossing trimming device / Clipping machine	300,000



Financial Need Analysis

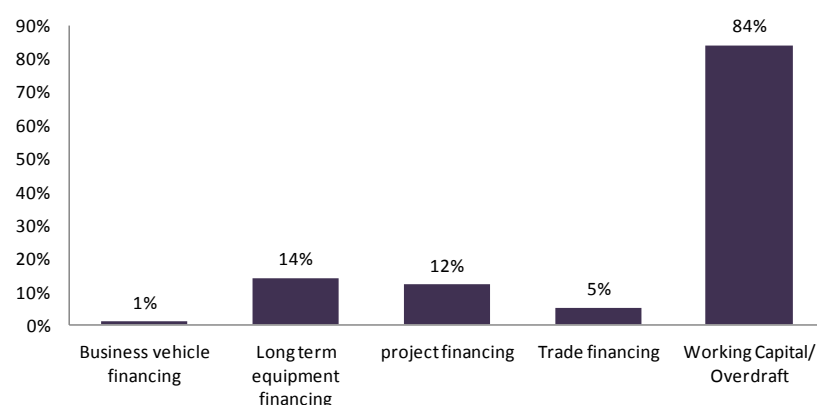
Funds are mostly managed by the accountants, while some business owners manage funds themselves as well. Mostly businesses with business assets and working capital requirements are fulfilled by cash flow from the same business while some also use their own savings or take help from their family members/friends. Many businesses also use banks to fulfill their funding requirements.

Business owners in this sector face issues in the import of their raw material for their manufacturing units as low quality of locally made wool affects the quality of the finished goods. This sector does not however require huge investments, as the only requirement is of a loom made of wood or iron which only needs to be replaced from time to time.

None of the business owners suggested business assets as their primary funding requirement but amongst fixed assets, finance requirement mainly centered around machinery & equipment and building by 84% and 38% of businesses, respectively (**Figure 5.8-b**).

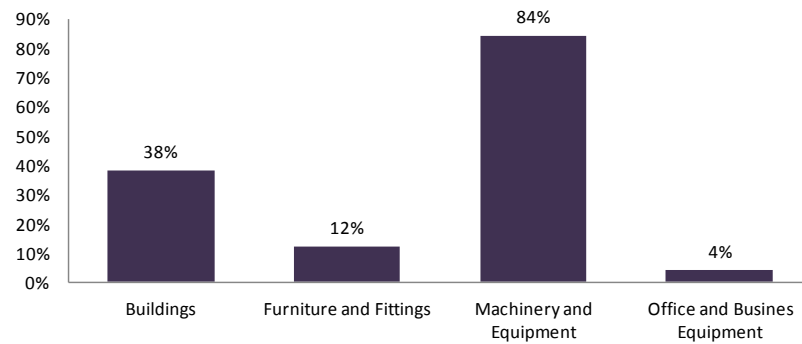
The businesses in this sector mostly use banks to fulfill their funding requirements, as mentioned above, and so present better opportunity for banks to assist the businesses in this sector in their growth. Working capital financing can provide the SMEs in this segment further room for growth as 84% of the business listed it as their major funding need (**Figure 5.8-a**).

Figure 5.8-a: Business Funding Needs



Source: Survey Findings

Figure 5.8-b: Fixed Assets Finance 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 some business owners are receptive to potential loan products offered by banks and have also availed the facility of loan products for business funding needs.

Large number of business owners use banks to meet banking and business needs availing the facility of business banking accounts. Few business owners proposed loans with lower mark up by the banks.

Around 33% of the segment is funded by Banks, which is promising for banks. The remaining business owners cited high interest rates and lack of complete documents required by the banks, as the main reason for not approaching banks for availing funds.

In addition to that it is also observed that other services such as cash management, money transfer, and payroll are encouraged by the segment. Majority of 70% showed intent to avail cash management/collection services, whereas money transfer facilities are desired by 76%, while 16% showed interest in payroll services.

Only 20% respondents do not pay for any of the proposed Insurance products; the remaining 80% has insurance for medical, legal issues, motor vehicle, office equipment, travel insurance and property insurance. However, only 12% of the business owners are interested in availing these insurance products if proposed by their banks.

The sector consists of 36% of the businesses who avail advisory services from which almost half pay for it. Majority of the business owners avail advisory from their friends and family members, business colleagues and some also seek association for non-professional advisory with lawyers and professional advisors with majority being satisfied with their current source of advisory services. 31% of the business owners are willingly to pay for such services if provided by the banks.

Banking Product	Usage Percentage
Deposit (Checking) Account	66%
Term Deposits	54%
Loan Product	33%

5.10 Segment Risk Considerations

The sector is working way below its capacity and is mostly unexplored despite the fact that it is one of the largest sectors in the cottage industry in terms of exports. Main challenge is the increasing competition with other countries in Asia such as Nepal, Iran, India and China, having lower wages for the skilled labor, and conducive work environment besides discrimination in terms of child labor. Other risks that pertain to the segment are discussed below.

Businesses in the segment are largely based on individual proprietorship, having this business as the only source of income. More than half of the businesses in this sector listed non-repayment of loans from banks as their biggest risk to the business, followed by inflation.

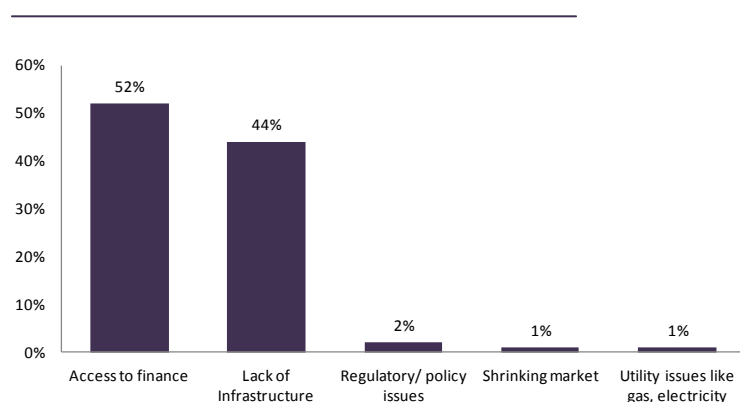
All businesses in the sector prepare Financial Statements but only around half of the businesses have them audited. The analysis further demonstrates that the segment operates in a competitive market with more than half of the businesses having around five to ten competitors.

92% of the businesses address business risks through more capital investment, if required, followed by reduction in profit and inventory management by 55% and 51% of the business owners respectively (**Figure 5.10-b**). Very few (2%) also focus on product innovation/cost reduction and manpower training.

Despite majority relying on banks to fulfill their fund requirements, there are many businesses in the survey that do not use banks to meet business funding needs. Many business owners face strict regulations and high prices of Pakistani products in international market as the major problem in exporting their products.

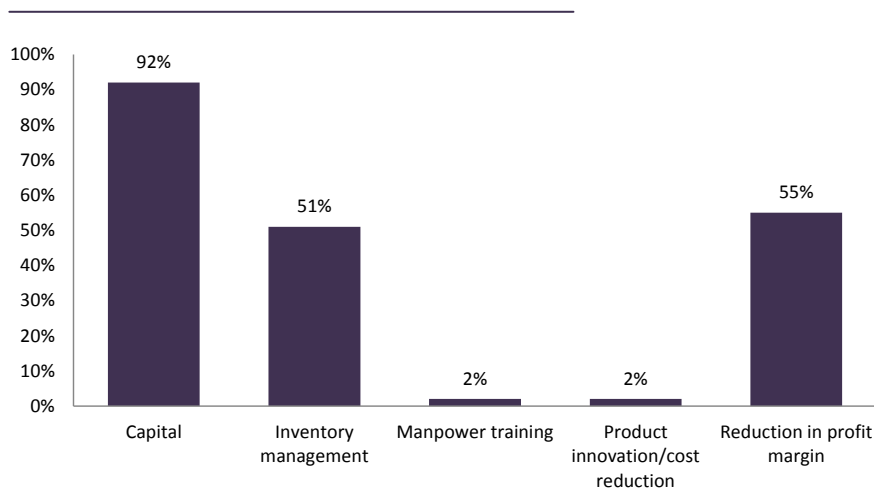
52% of the respondents listed lack of access to finance as their major hurdle in business expansion while 44% felt it is due to lack of infrastructure (**Figure 5.10-a**).

Figure 5.10-a: Business Expansion Restraints



Source: Survey Findings

Figure 5.10-b: How Business Risk Addressed



Following are the strength and weaknesses inherit in this sector:

Strengths

- High demand from both low-end and high-end segments
- Good quality and designs mark strong traditional value internationally
- Cheap labor

Weaknesses

- Unorganized and scattered industry
- High product cost compared to other competing countries
- Low wages to skilled labor
- Use of child labor discourages product appeal to international customers

Further, the risks inherent to the segment include:

- Limited resources for expansion
- Unaudited financial statements
- No proper book keeping
- Uneven cash flows

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 '*Handmade Carpet Manufacturing*' sector:

Asset Products:

- Working capital/overdraft Finance Facility
- Bill Discounting Facility

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 10,000,000 • 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 markup on quarterly basis, 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 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: 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 10,000,000 • 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 K: 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 L: 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 instant 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 M: 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>Handmade Carpet Manufacturing</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 '*Handmade carpet manufacturing*' are spread out mostly in rural cities of the country; therefore they need to be reached and targeted in major clusters to promote banking products of carpet manufacturing sector in the rural cities.

7.1 Marketing Objectives of Banks

Marketing objectives for building and promoting the brand image of SME Products for '*Handmade Carpet Manufacturing*' are as follows:

The banks may:

- Work with the Handmade carpet industry associations for events, generate better understanding of the sector and create awareness
- Educate the handmade carpet manufacturers, create awareness for financial needs and banking products in the identified market regions
- Develop strategies to attract a large number of handmade carpet manufacturers to avail banks' lending/financial products
- Increase direct interaction of Relationship Managers with Handmade carpet manufacturers to promote more direct and close communication with the business owners and to assist small businesses in navigating difficult economic and business conditions
- Provide sponsorships for trade fairs and exhibitions which link the promotion of bank's brand image with exposure and building awareness of SME businesses products locally and worldwide.

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 in coordination with Pakistan Carpet Manufacturers and Exporters Association (PCMEA) to provide more interaction to business owners with trade associations to enhance communication between them regarding industry specific issues.
- Organize promotional events in cluster locations or near businesses 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

- Involvement in trade fairs and exhibitions

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 further increases 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 '*Handmade Carpet Manufacturing*' sector through its products on national basis in major cities of the country where carpet manufacturing units or homes are located. Initially the bank will provide financing facility only for medium sized businesses in major cities; however, banks will 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 alternative delivery channel can also be adopted for distribution

- **Short Message Service (SMS):** Marketing team can send out mass messages in Urdu or English to '*Handmade Carpet Manufacturing*' segment for advertising bank's products.