

‘Leather Products’



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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 "Leather Products" 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 '*Leather Products*' Segment Research Report provides indicative business and financial characteristics based on the information evident 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 '*Leather Products*' 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 Karachi and Lahore 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. Many businesses in this segment use banks but few are satisfied in using banks for their business needs, 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

SMEs present immense business opportunities for financial institutions from the perspective of increasing book size while generating strong risk adjusted returns, however a deeper understanding of the dynamics of this segment will assist 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 "*Leather Products*" which includes leather goods units mostly scattered in the main cities such as Karachi, Lahore, and Sialkot.

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

The leather goods making units are spread all over Pakistan but the highest concentration is in Sialkot and Karachi. Raw material reserves, which are livestock, are mostly located in NWFP and also in other areas mostly rural; however leather goods units acquire their raw material from leather tanners which are located in main cities and easily available. This sector has great potential for growth in exports; therefore, mostly requires investment and loan for their raw material supplies to enable them to produce reasonably priced products for the international market. Adequate and timely financing from financial institutions will enhance growth within this sector.

2.1 Limitation 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 classified as medium enterprises 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	<ul style="list-style-type: none">▪ 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
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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 'Leather Products' Industry Overview

Table C: Summary of Industry Overview

Factors	Comments
Demand	Leather industry is the second largest industry in Pakistan but due to high prices of the finished goods, the leather industry has been losing its international market share rapidly.
Supply	Due to smuggling of livestock from the country and deteriorating energy, water and gas crisis, this sector is facing decline in supply of raw materials and shut down of leather units, therefore, failing to reach its potential capacity.
Key players	A.T.S Synthetic (PVT) Ltd., Al-Muqheet Enterprises, Amin Feroz Group, Jafferjees Leather Goods, Leather Expressions, A.Z Group
Trade Bodies	<ul style="list-style-type: none">• Pakistan Leather Garments Manufacturers & Exporters Association• Pakistan Tanners Association
Regulatory Body	Ministry of Industries
Recent Developments	The government has given leather sector the priority status, through which its exports will surge by 200 percent to USD 3 billion, from the current USD 1 billion, in the next three years, according to Pakistan Tanners Association (PTA).
Future prospects	Ministry of Commerce has formulated Strategic Trade Policy Framework (STPF) 2012-15 in which ad hoc relief to the tanning industry would help this energy crisis hit sector to overcome present decline in exports.

4.1 Demand

Demand for leather products is mainly associated with urban population growth, income rise and the efforts made in penetrating the export market. The leather industry of Pakistan has been facing a continuous decline in its share of the international market.



Leather tanning and leather products manufacturing is labor intensive and causes great harm to the environment due to which the leather industry is shifting from the industrialized world to the developing countries like Pakistan, India, Bangladesh, Sri Lanka and Thailand. This provides an opportunity for Pakistan to capitalize in this sector and expand its international market share.

Unfortunately, tanned leather industry is facing continuous decline in the exports of finished leather. By the year 2013, Pakistan's leather export declined by 14 percent in the last five years, reaching USD 1 billion, according to Pakistan Tanners Association¹. This has been mainly due to electricity crises and gas shortage.

Pakistan's main competitors in leather industry are Turkey and Bangladesh with Turkey being top in providing good quality leather products at cheap price. However, due to weather changes and changing trends for the past few years, with warmer winters, both Korea and Japan have reduced the volume of their imports of leather garments while other South Asian countries where currencies were devalued are selling leather garments cheaper than Pakistan. Therefore the sector is losing valuable export orders from foreign buyers and customers, which is hurting the sector's foreign exchange.

Also when compared to leather products of other competing countries in the international market, products in Pakistan are more costly, resulting in lesser export orders. The manufacturers and exporters now are unable to offer better and competitive prices of finished leather, leather garments, products and made-ups in the wake of high fuel prices, interrupted supply of electricity and gas, unavailability of basic raw materials as well as unfavorable law and order situation in Pakistan.

Pakistan has no leather industry development plan and as a result of this Pakistan has lost its market share to other countries, especially to South Asian countries. All countries, including China, have recorded growth in exports of leather products. The only country falling back is Pakistan. With limited animal population, Italy also enjoys a 13 percent share in the global market.

4.2 Supply

¹ <http://www.dailytimes.com.pk/business/27-Jun-2014/leather-products-export-declines-by-14-in-2008-13-india-bites-share>

Though leather manufacturing factories are present all over Pakistan like Kasur, Lahore and Multan, around 90% of products/ garments are made in Karachi and Sialkot. Almost all of these leather products are exported with very few sold to the local market. Apart from earning huge amount of foreign exchange for the country, leather industry provides employment



opportunities to about 0.3 million people². Further, availability of livestock population in Pakistan ensures consistent supply of raw material to the leather industry. With all these favorable conditions, leather industry of Pakistan should have flourished with huge earning of foreign exchange for the country, but the real picture is far from it.

Despite ample availability of livestock, supply of raw material is severely affected due to smuggling of live animals to other countries. According to Pakistan Tanners Association, the export quota of live animals fixed by the government will cripple the leather industry with huge number of live animals exported to Iran and Afghanistan, resulting in scarcity of raw material for the leather industry. Further, severe energy crisis has caused serious damage to hides and skin, being a major raw material for leather industry. According to Pakistan Tanners Association (PTA), load shedding is not only causing serious damage to leather manufacturing process but also adversely affecting quality of the leather. The skin, being perishable, cannot be stored without first being processed, which requires uninterrupted supply of electricity and gas.

This raises the price of skin and other raw materials, which results in high production cost and therefore has led to the shrinking of this sector. These production costs are further raised by importing raw material to meet the local demand, as higher quality leather are mostly exported which reduces value addition to the local leather product manufacturing and thus losing its export shares to other countries selling cheaper products of better quality.

Energy crisis, especially in Punjab, has caused substantial damage to one of the major foreign exchange earning leather industry in many other ways. As the sector has become less competitive both locally and internationally, majority of tanning units are facing complete closures due to low availability of gas and prolonged power breakdowns in the province, as use of furnace oil for boiler heating has become unviable.

Exports of leather industry have also been jeopardized due to suspension of water supply in the Tannery Zone of Korangi Industrial Area where the major leather and leather goods exporting units exist.

² <http://weeklypulse.org/details.aspx?contentID=2112&storylist=16>

4.3 Key Players

A.T.S Synthetic (PVT) Ltd., Al-Muqet Enterprises, Amin Feroz Group, Jafferjees Leather Goods, Leather Expressions, A.Z Group

4.4 Trade Bodies

- Pakistan Leather Garments Manufacturers & Exporters Association – PLGMEA was formed in November 2001 to protect, promote and develop the Pakistan Leather Garment Industry.
- Pakistan Tanners Association - was established in late 1950s representing the leather industry and dealing with the members' problems at Federal level. PTA is now functioning as a renowned trade body duly licensed by the Ministry of Commerce under Trade Organizations Ordinance/Rules 2007, registered with the Security & Exchange Commission of Pakistan and a bonafide member of the Federation of Pakistan Chambers of Commerce & Industry.

4.5 Recent Developments

In order to increase the pace of earning valuable foreign exchange, the government has awarded the leather sector a priority status through which it is expected that the exports will surge by 200 percent to USD 3 billion from the current USD 1 billion in the next three years, according to Pakistan Tanners Association (PTA)³.



4.6 Future Developments

Ministry of Commerce has formulated Strategic Trade Policy Framework (STPF) 2012-15⁴ in which ad hoc relief to the tanning industry has been proposed which would help this energy crisis hit sector to overcome present decline in exports. It is a positive step to increase the country's exports after the implementation of various decisions taken in the trade policy.

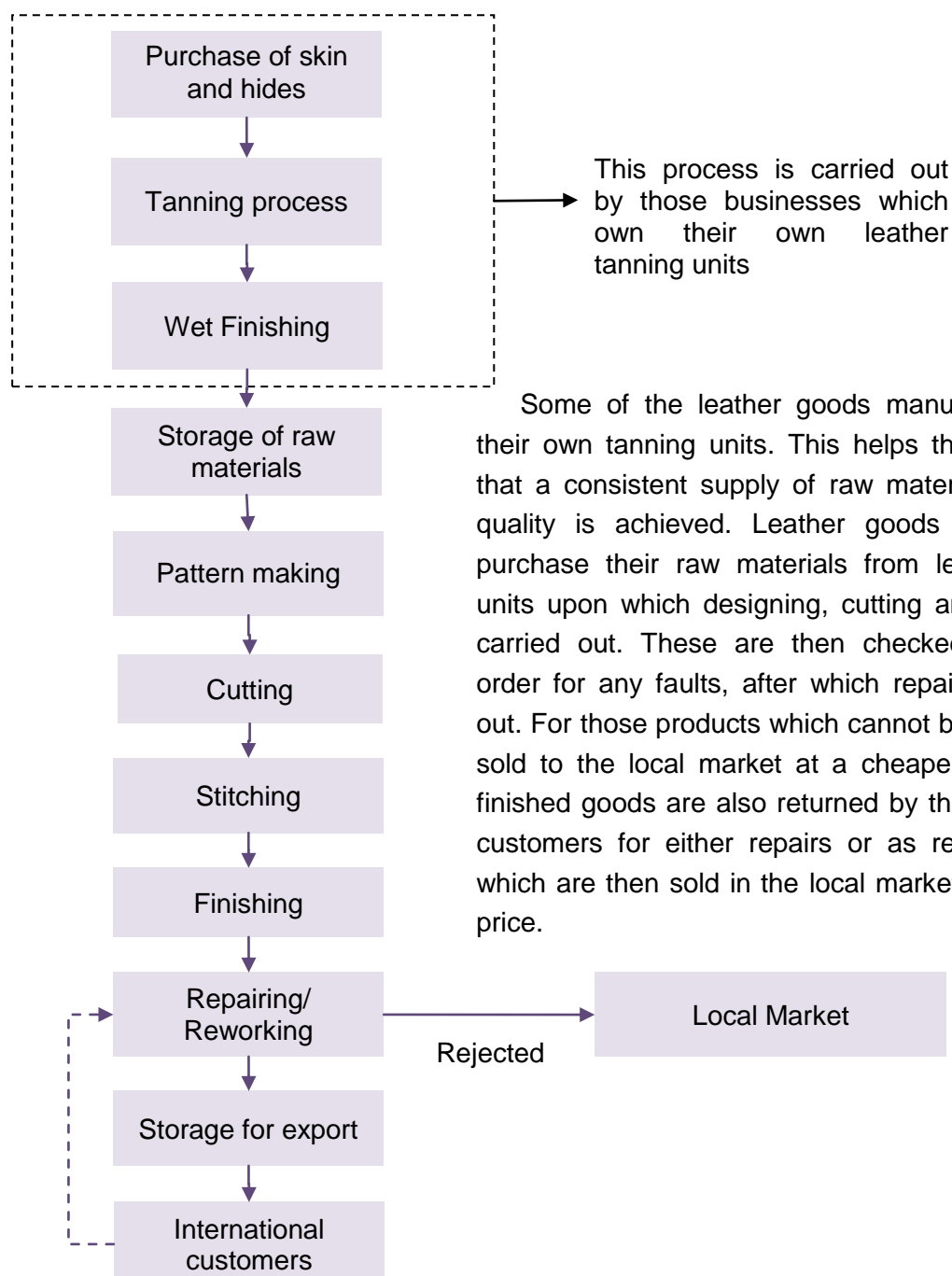
Sri Lanka has expressed that there is potential for export of cheaper hides of buffalo and cows to Pakistan which can be availed by leather industry of the country.

4.7 Leather Product Making Process

³ <http://archives.dailytimes.com.pk/business/30-Dec-2012/govt-awards-leather-sector-priority-status>

⁴ http://www.commerce.gov.pk/wp-content/uploads/2014/09/STRATEGIC_TRADE_POLICY_FRAMEWORK_2012-15.pdf

Figure 4.7-a: Leather Product Making Process



Some of the leather goods manufacturers own their own tanning units. This helps them to ensure that a consistent supply of raw material and target quality is achieved. Leather goods making units purchase their raw materials from leather tanning units upon which designing, cutting and stitching is carried out. These are then checked against the order for any faults, after which repairs are carried out. For those products which cannot be repaired are sold to the local market at a cheaper price. Some finished goods are also returned by the international customers for either repairs or as rejected goods, which are then sold in the local market at a cheaper price.

4.8 Success and Survival of the Businesses in this Sector

From the survey interviews (**Figure 1.1-a**), almost all of the business owners (93%) felt that timely delivery of the finished goods was the major success factor for the businesses in this sector. 65% of the businesses also felt that good relation with suppliers proved to be real reason behind business success.

In order to survive as an SME (**Figure 4.8-b**), business owners believe that education was the most essential element by 98%, while 97% also felt experience to be a crucial factor for survival. 10% of the business owners also listed favorable government policies due to which their SME businesses managed to survive.

Figure 1.1-a: Indicators of Business Success

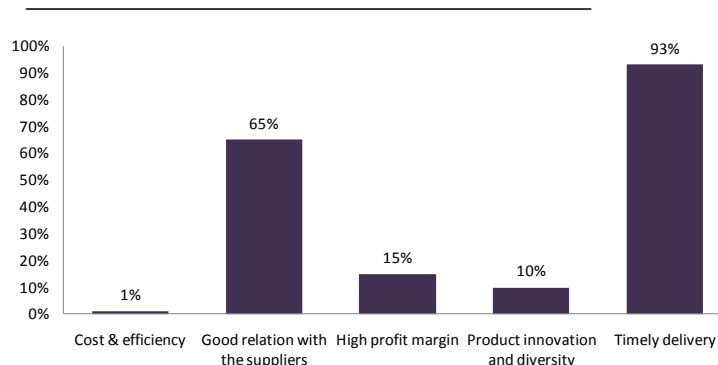
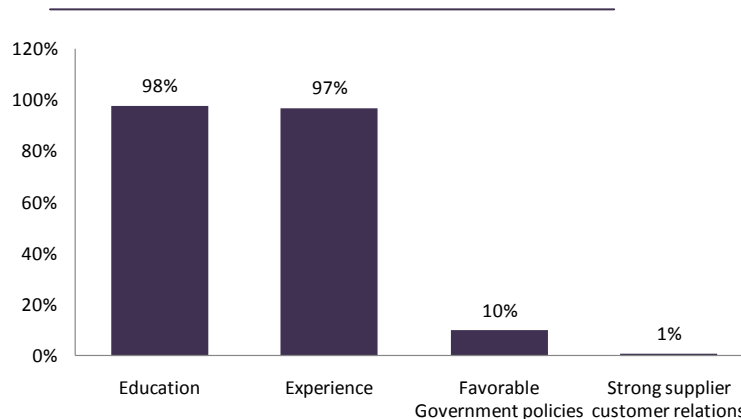


Figure 4.8-b: Key means of survival as an SME



Source: Survey Findings

5 Market Assessment

5.1 Market & Demographic Profile

At present, the retail sales segment in Pakistan is relatively organized. Majority of the businesses are family owned with members of one family serving different functions of business. Underlying issues inherent to the segment include:

- 1) Limited funding sources
- 2) Inability to identify and explore new ideas
- 3) Lack of technical institutions and skill development programs

'Leather Products' segment is largely dispersed across various cities with the biggest concentration in Sialkot as export orders are conveniently delivered. The raw materials are scattered in the rural and urban areas of the country but the greatest concentration of leather tanners is in Sialkot, where most of the leather goods processing units are located for convenience. Some businesses have their own tanning units and so require raw materials in form of animal skins which is supplied from both rural and urban areas.

This sub-sector is known to have updated technology and is one of the leading industries in terms of quality leather goods, but high production cost and energy crisis has led to decline in its production, which is resultantly causing a sharp decline in its share in the international market.

5.1.1 Market Sizing and Lending Potential

As mentioned before, the business units in this sector are scattered in the main cities with the highest concentration in Sialkot. Following (**Table D**) are the cluster locations for the leather good units which are a rough estimate of registered units.

Table D: Cluster Locations for 'Leather Products' Industry

Area	No. of establishments
Sialkot	53
Karachi	44
Lahore	9
Others	5



Source: Trade Associations and Industry Sources



5.1.2 Segment Demographics

The segment is spread out across various regions, with high concentration of customers catered by businesses in the survey in Karachi and Sialkot. However, for the survey purposes, demographic information is obtained from industry sources and primary research conducted using a selected sample of businesses in major cities of Pakistan, from which, Karachi was mostly covered since it has one of the largest leather units in Korangi area. Accordingly, leather businesses in the survey had majority of their customers in Karachi (70%), while some also had their customers in Sialkot (11%), Lahore (8%), Multan (2%) and rest of Punjab (9%) (**Figure 5.1-b**).

In survey findings (**Figure 5.1-a**), majority of the businesses in this sector have been established for five to ten years (38%) or more than 10 years (29%).

Figure 5.1-a: Number of years in operation

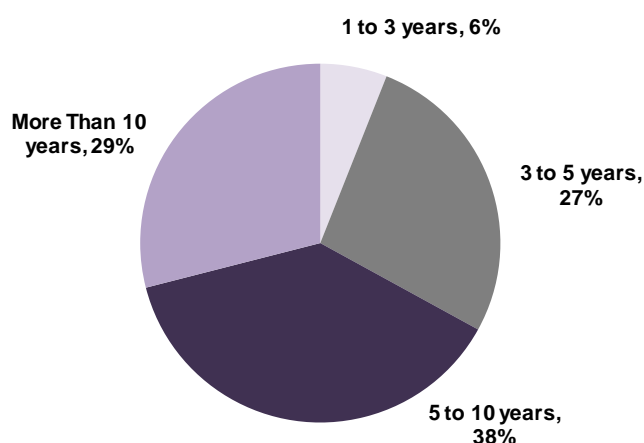
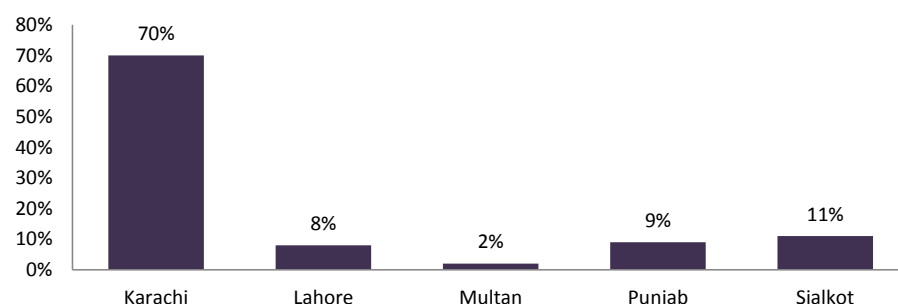


Figure 5.1-b: Customers' presence within the country



Source: Survey Findings

5.2 Owners Profile

The business owners consist mainly of people in the age group of 41-50 years (**Figure 5.2-b**) who have been working for many years as many of the businesses are established for 5-10 years or more than that. This indicates that the business owners are well experienced in their line of work. Due to nature of work it is preferable that the owners are reasonably educated however, there are also other owners with very basic education, 5% with high school while 3% with just primary education (**Figure 5.2-a**), and are running the business for many years. All the businesses in this sector under the survey are run by families with majority (53%) having workforce of 10-24 employees (**Figure 5.2-d**). 80% of the businesses are established as sole proprietors (**Figure 5.2-c**).

Figure 5.2-a: Education level of business owners

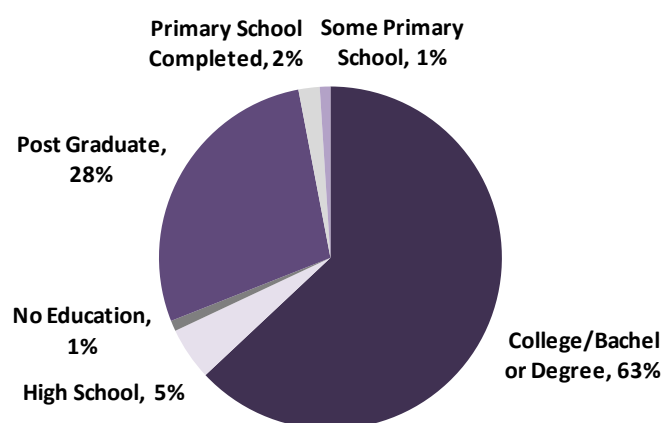


Figure 5.2-b: Age group of business owners

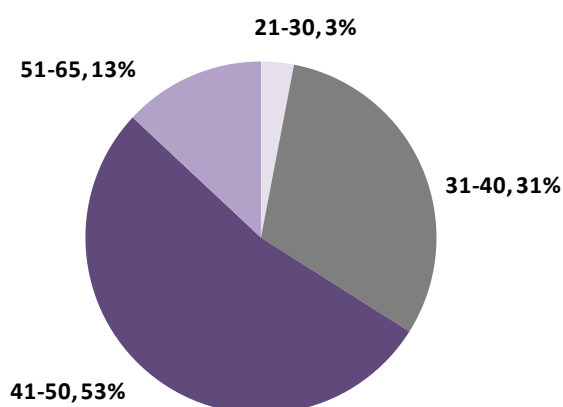


Figure 5.2-d: Number of employees under business owners

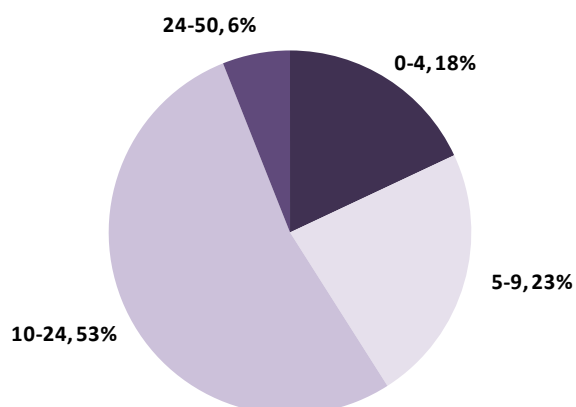
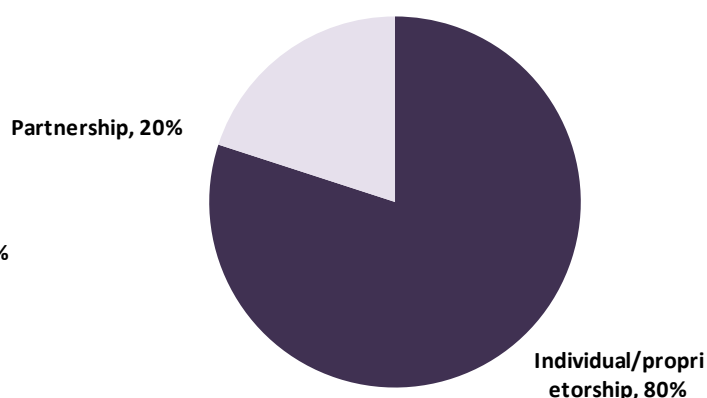


Figure 5.2-c: Ownership type



Source: Survey Findings

5.3 Business Linkages

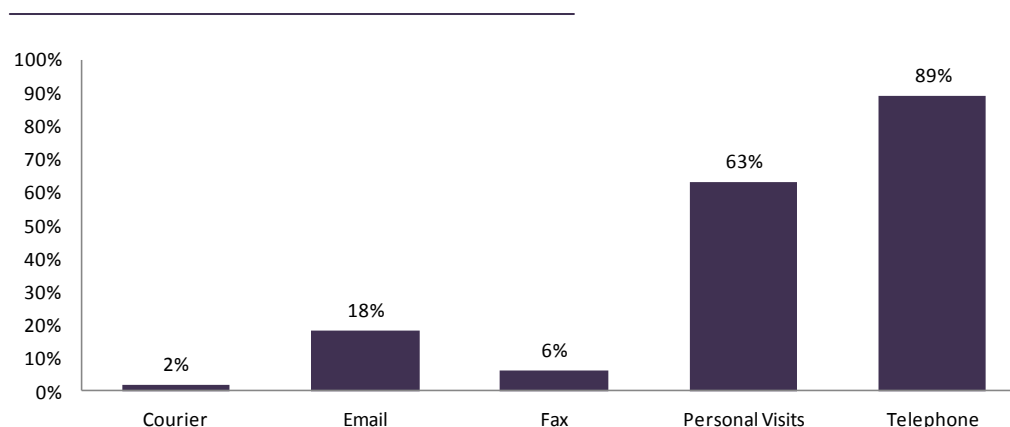
Businesses in the segment are connected to various institutions, which are directly or indirectly affected by the business operations, primary stakeholders and their interests are enlisted in the following table:

Table E: Stake Holders and Their Interests

Leather Products	
Stakeholder	Interest
Owners	Growth, government initiative and access to finance
Suppliers (Leather tanners, accessories providers; buttons, zips etc.)	Better terms and consistent pricing and lower risk
Customers	Product quality, reasonable pricing and timely delivery
Financial Institutions	Debt servicing, new products, increase in deposits
Government	Economic growth and benefit to community at large

Businesses employ various mediums as means of communication with their customers (**Figure 5.3-a**); however, personal visits by customers and telephone are widely utilized. The businesses are highly competitive with more than half having more than ten competitors. Majority of the businesses service about 51-100 customers monthly, mostly pertaining to exporters and international customers.

Figure 5.3-a: Communication with customers



Source: Survey Findings

ng units include (**Table F**):

Table F: Raw Material for 'Leather Products' Sector

Suede leather

Lining fabric nylon).

Zippers/ buttons/ Thread



Majority of the businesses (45%) in this sector depend on many suppliers to meet their raw material needs which ensure consistent supplies are available without dependency on one supplier (**Figure 5.3-b**). 28% 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 suppliers for raw materials or need new suppliers due to inconsistent material quality with percentages resting at 20% and 8% respectively. This indicates that some risk of raw material supplies exists in this sector.

Preference is placed on buying the material needs locally from the same location or same city from local dealers or wholesalers however, excessive export of livestock makes buying from one location difficult. As leather tanner units are mostly located near leather product making units, it is easier to procure consistent supply of raw materials. 53% of the businesses rely on two to five suppliers while 41% depend on more than five suppliers for their business needs (**Figure 5.3-c**).

Figure 5.3-c: Number of Suppliers

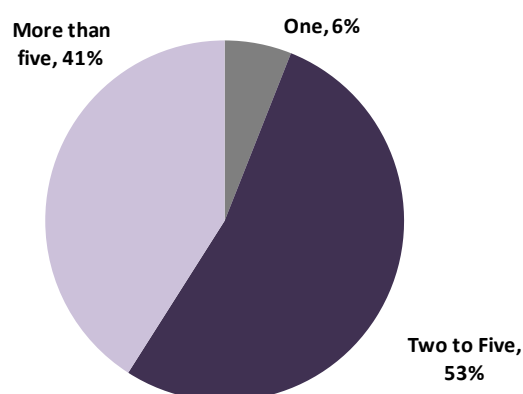
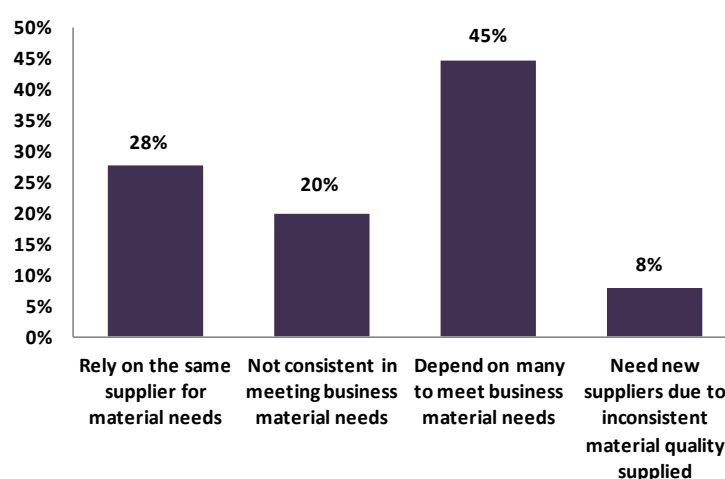


Figure 5.3-b: Supplier Relationship



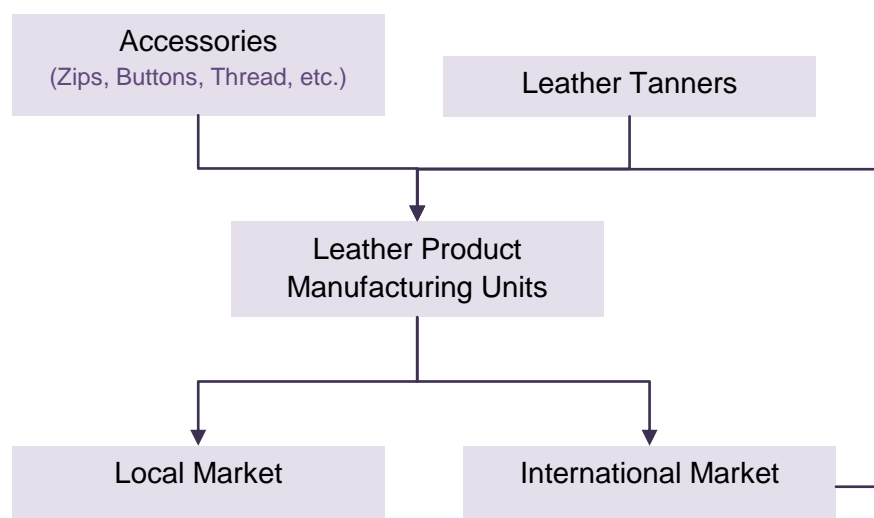
Source: Survey Findings

5.4 Business Cycle

Majority of the businesses in the survey claimed that this sector is not seasonal. This could be due to the fact that in many countries, winter stays throughout the year with the exception of couple of months with a reasonably warm weather. This sector does, however, go through favorable phase during winters for obvious reasons of high orders from Europe and other northern countries. Other than that, with the advent of Eid-ul-Adha, high availability of animal skin from the slaughtering of the animals prove to be fruitful for those businesses which also have their own leather tanning units as such times are a source of cheaper raw material.

The businesses in this sector also experience more favorable phase when higher number of orders are placed right before the start of winter season. Many leather product making units own their own tanning units for the purpose of achieving economies of scale (**Figure 5.4-a**). As mentioned before, almost all of the finished goods are exported with very few percentages for the local buyers.

Figure 5.4-a: Business Model



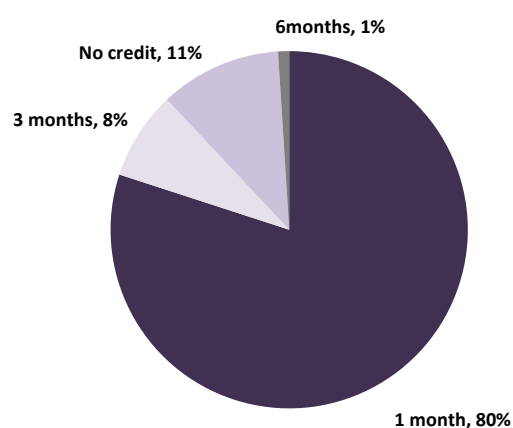
Most of the products found in the local markets are the ones which have been rejected from the international market due to low quality or stitching issues, which are then sold at a lesser price. Leather products are exported through both sea and air. Majority of the leather product making units export their products to their international clients directly without an agent involved. In many of the instances, the importers provide their own raw material for manufacturing of leather products against their order due to availability of cheap labor in third world countries and to ensure the desired level of product quality.

5.4.1 Working Capital

Working capital is dependent upon payment terms offered to customers and received from suppliers. Almost all the businesses in '*Leather Product*' sectors claim to have all their payments made instantly to their suppliers, making payments in foreign currencies to their suppliers to import quality raw material for international orders.

The repayment offered to the customers by the businesses in this sector varies from 1 month to 3 months, with percentages resting at 80% and 8% respectively (**Figure 5.4-b**). Only 1% of the businesses allow repayment terms of up to 6 months, while 11% do not provide any credit terms to their customers. This may prove to be unfavorable for the business's cash cycle as in some cases, the cash gets held up for as long as three months.

Figure 5.4-b: Repayment Terms for customers



Source: Survey Findings

5.5 Financial Assessment and Profile

All the businesses in this segment prepare Financial Statements, however more than half of the business owners stated that they have their Financial Statements audited.

More than half of the business owners/managers keep track of accounts themselves, though because of higher level of education in this sector they 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 profit margins are between 20-25%, with a great number banking on higher sales volume for earning better profits due to high cost of production. The businesses are also struggling for higher investment which is required for leather tanning and leather product making.

As per survey 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 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	24,480,000
Total Revenue	99,595,000
Annual Expense	76,880,000
Total Income	11,580,000
Key Financial Ratios	
Profit Margin	11.6%
Operating Expenses/ Revenue	77%
Asset turnover	4.07 times
ROA	47%

Conclusively, it can be said that despite many businesses reporting profit in this sector, expenses (being 77% of the revenue) are on a higher side so businesses report a lower income.

5.6 Financial Information

Due to non-cooperation of the sector businesses in disclosing their financial information, the following financial information is provided in range which may give some idea of their financial position.

Primary survey findings reflect the Revenue, Expenses, Income and Capital Expenditure of the selected sample.

Survey findings demonstrate 76% businesses operating with total assets between PKR10-50 million exhibiting a relatively high initial investment for startup (**Figure 5.6-a**). Total assets comprise of plant and machinery, land and building, inventory and receivables. Liabilities constitute trade payables and borrowing for plant & machinery and vehicles.

Business related assets constitute machinery for leather products making which mostly consists of stitching and sewing machines. 44% of the business owners incurred no capital expenditure in the past five years (**Figure 5.6-b**).

Figure 5.6-a: Business Assets

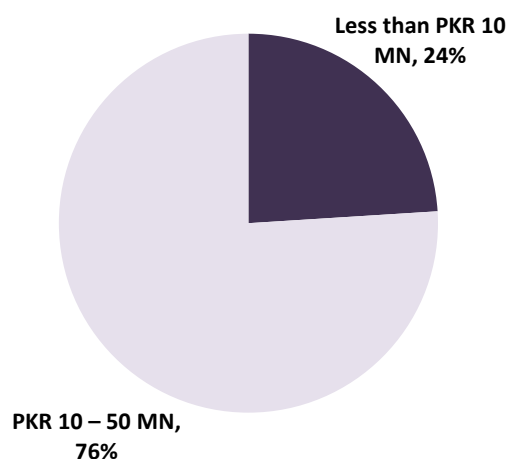
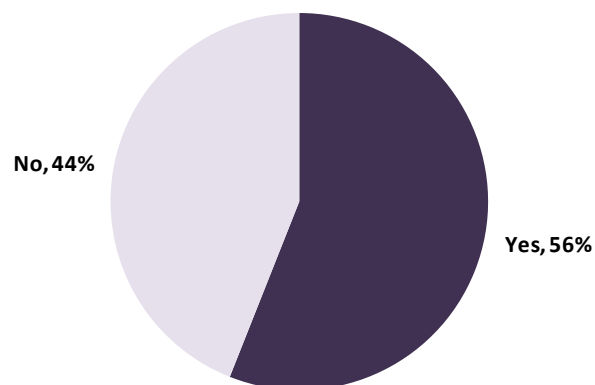


Figure 5.6-b: Capital Expenditure



Source: Survey Findings

Annual average revenue was more than PKR 100 million, reported by 47% of the businesses while 29% have claimed to have an annual average revenue between PKR 51-100 million (**Figure 5.6-c**). Expenses primarily represent material, employee cost and interest expenses against borrowings. 40% of the businesses had an average annual expenses of more than PKR 100 million while 30% had an annual average expense ranging between PKR 10 – 50 million and PKR 51 -100 million (**Figure 5.6-d**).

Figure 5.6-c: Total Revenue

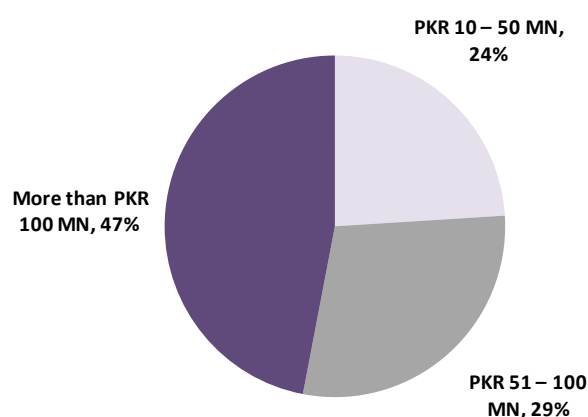
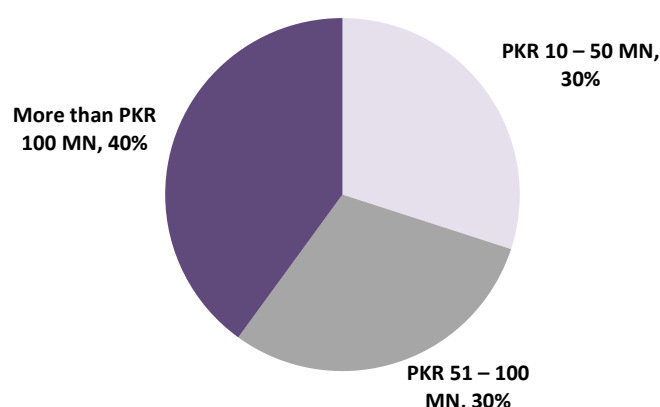


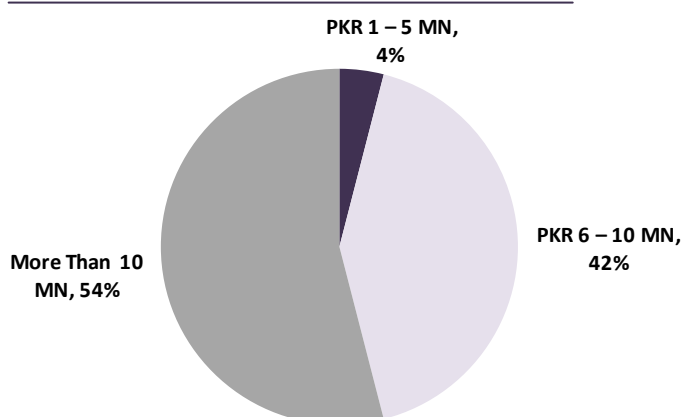
Figure 5.6-d: Annual Expense



Source: Survey Findings

More than half (54%) of the businesses owners earn more than PKR 10 million while 42% claim to earn between PKR 6-10 million of average income for the last three years (**Figure 5.6-e**). Only 4% of the business owners' show earnings in the range of PKR 1-5 million annually.

Figure 5.6-e: Total Income



Source: Survey Findings

5.7 Indicative Business Requirements

Business owners require equipment and civil works for startup or expansion. In addition, individual business owners will have distinctive requirements as per their business needs. The table below (*Table H*) is neither comprehensive nor specific and presents only to provide 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
Flatbed sewing machine	500,000
Cylinder bed sewing machine	300,000
Over lock machine (local)	50,000
Over lock machine (imported)	100,000
Dark Seam Sewing machine	150,000 – 4,000,000
Button sewing machine auto (local)	50,000
Button sewing machine auto (imported)	200,000
Button hole making machine	1,000,000
Leather skiving machine	200,000 – 500,000
Flexible dummy	200,000
Fusing Application	100,000 – 300,000
Leather stitching Machine	50,000 – 100,000
Leather Ironing Press	300,000



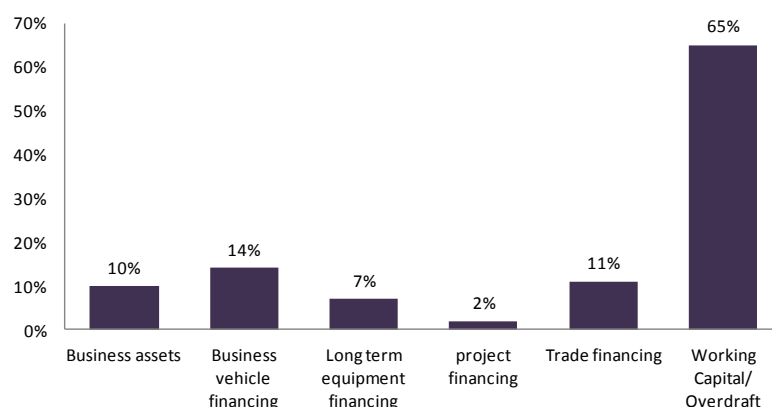
5.8 Financial Need Analysis

Funds are mostly managed by the owners themselves or by accountants with percentages resting at 54% and 34% respectively. Business assets and working capital requirements are mostly fulfilled by banks and with their own personal savings, by 38% and 49% of the businesses respectively. 26% of the business owners use cash flow from this business to overcome their funds requirement. Among the fixed assets, finance requirements are mainly centered on office and business equipment by 52% of the businesses (*Figure 5.8-b*).

Business owners in this sector face issues in meeting working capital needs of the businesses which can be linked to their business cycle where they have no credit terms with their suppliers while their customers may take up to three months, in some instances, to pay for the finished goods.

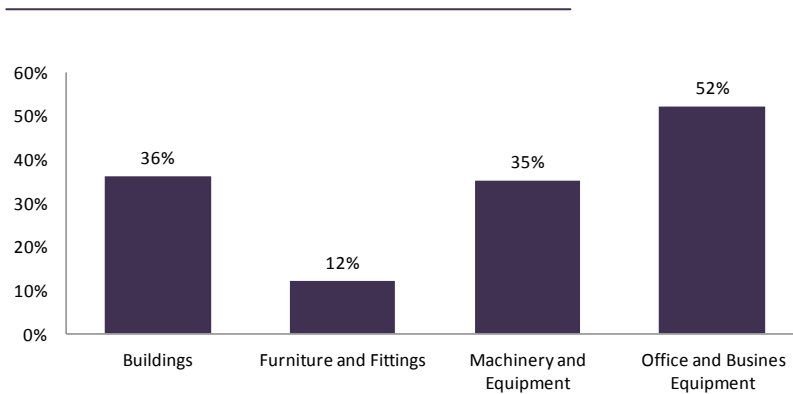
This segment shows a relatively strong reliance on banks for their funding needs. The most required instrument for business funding has been for working capital/overdraft, by 65% of the businesses in this sector (*Figure 5.8-a*), according to the survey conducted. Working capital financing can provide the SMEs in the segment to assist in further room for growth.

Figure 5.8-a: Business Funding Needs



Source: Survey Findings
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.

More than half of the business owners listed the key driver in choosing a certain bank being family bank and courteous and friendly staff. Most of the owners are not keen to propose any feature or product to be offered by the bank. Very few suggested loan with lesser mark up would be favourable for them.

Approximately 60% of the segment use Banks which is encouraging. The remaining business owners either cited lack of documentation, not having funding needs requirement or find banks to be costly as the main reason not using banks.

In addition to that, it was also observed that other services such as cash management, money transfer, and payroll are encouraged by the segment, the majority of segment showed interest in availing money transfer facility, the percentage resting at 51%, whereas cash management / collection services are desired by 40%.

34% of the respondents do not pay for any of the proposed insurance products; amongst the rest of the business owners, half of them have insurance for motor vehicles. The remaining has legal expense insurance or property insurance. Almost none of the business owners are interested in availing any insurance product in future as they prefer to avail such products directly from insurance companies.

50% of the businesses in the sector were availing advisory services, from which, 26% of the businesses were paying for it, and the rest were availing the same from their family members or business colleagues. Some businesses also seek association for nonprofessional advisory with 71% being satisfied with their current source of advisory services. 14% of the business owners are willingly to pay for such services if provided by the banks.

Banking Product	Usage Percentage
Deposit (Checking) Account	61%
Term Deposits	25%
Loan Products	29%

5.10 Segment Risk Considerations

The sector is less risky as compared to some of the other businesses operating in Pakistan. The underlying reason is the country's high reserves of raw material sources. More than half of the owners are operating from owned factory. The risks pertaining to the segment are discussed below:

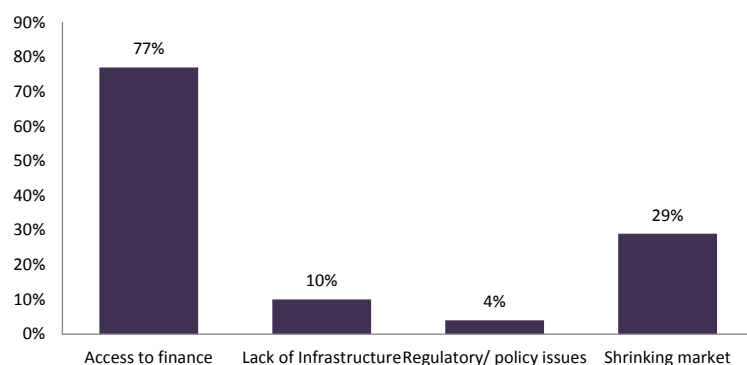
Businesses in the segment are largely individual proprietorships having this business as the only source of income. The sector mostly listed of non-repayment of loans from banks as their biggest risk to the business, followed by scarce raw material, with the percentage resting at 84% and 41% respectively. This can be due to the high smuggling of livestock leading to the need to import raw materials. This leads to incurring high cost and so making it difficult for the small businesses to buy raw material.

All businesses in the sector prepare Financial Statements but only 58% of the businesses stated that they have an audit of their financial statements. This indicates that 42% of the businesses may lack integrity and accuracy in their financial position. The survey analysis also demonstrates that the segment operates in a competitive market with more than half of the businesses having more than ten competitors. About 20% of the businesses are not consistent in meeting their material needs by any particular supplier and 8% need a new supplier due to inconsistent raw material quality.

88% of the businesses address business risk through more capital investment, followed by man power training by 33% of the business owners (**Figure 5.10-b**). Very few businesses (4%) focus on inventory management.

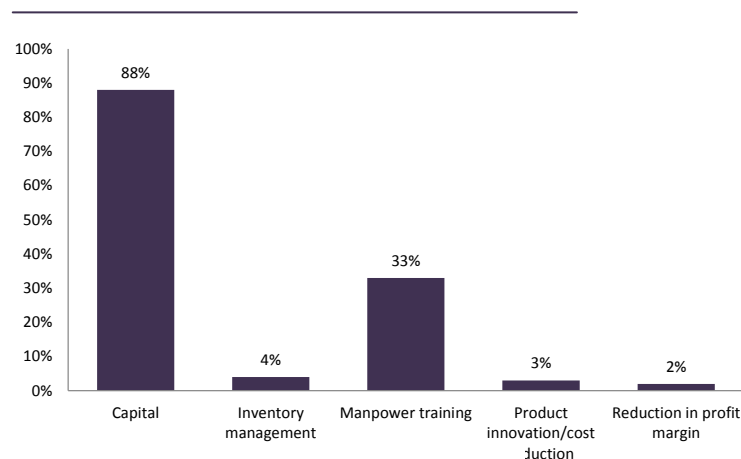
Many SMEs in the segment do not use banks for business funding needs, which is mostly due to lack of awareness regarding banking products and service charges. In terms of export, 80% of the business owners have mentioned strict regulation as the major problem they face in exporting their products. 77% of the businesses felt that due to lack of finance, they faced difficulty in their business expansion while 29% felt it was because of shrinking market (**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 strengths and weaknesses inherent in this sector:

Strengths

- High quality of leather production
- High capacity for increase in production
- Huge export potential
- Easy availability of labor

Weaknesses

- Low supply of raw material
- Low productivity
- High cost of production
- Export of low value added products
- No waste management policy

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
- Lack of succession planning

Possible Mitigating Factors:

- Lending only to those businesses which have been operating for more than three 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
- Review to export and import registration documents

6 Proposed Banking Product Suite

6.1 Product Features

Based on our primary and secondary research we propose the following for growth of '*Leather Product*' sector:

Asset Products:

- Working capital/overdraft Finance Facility
- Leather good processing machinery leasing
- 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 2,000,000 • 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: Regular quarterly payment of mark up. lump sum payment of principle 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 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: Leather Product Making 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 expansion capital 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 reputation <p>Credit facility will be offered directly through pre-approved equipment and machinery vendors</p>
Tenure	3 - 5 years
Loan Limit	<ul style="list-style-type: none"> Minimum Limit - PKR 5,000,000 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: 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 L: 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 M: 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

Table N: Export Refinance	
Particular	Details
Initial deposit	Any form of collateral which the banks feel fit.
Tenure	Depends on the contract terms of LC
Documentation	One time documentation required for a period of one years which may include financial statements, company legal registration 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.

6.2 Eligibility Criteria for Asset Products

Table O: 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>Leather Product</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 '*Leather Products*' are spread out mostly in urban cities of the country; therefore they can be reached and targeted in major clusters to promote banking products of leather product processing segment in the urban cities.

7.1 Marketing Objectives of Banks

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

The banks may:

- Work with the leather industry associations for events, generate better understanding of the sector and create awareness
- Educate the leather product manufacturers, create awareness for financial needs and banking products in the identified market regions
- Develop strategies to attract a large number of leather product manufacturers to avail banks' lending/financial products
- Increase direct interaction of Relationship Managers with leather 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 Leather Garments Manufacturers & Exporters Association and Pakistan Tanners Association 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 leather product sector through its products on national basis in major cities of the country where leather manufacturing 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 '*Leather Products*' segment for advertising bank's products