USAID
FROM THE AMERICAN PEOPLE

OTF GROUP

Growth Strategy and Action Plan for the Carpet Cluster of Afghanistan
Kabul, April 2006

AFGHANISTAN CARPET COMMITTEE

Agenda

Introduction to the OTF Group & the ACP

Step 1: Situation Analysis

Step 2: Establishing Goals

Step 3: Understanding Buyer Needs

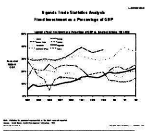
Step 4: Articulating Market Positioning

Step 5: Developing Action Guidelines

Annexes

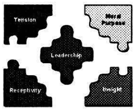
Overview of the ACP
Who is The OTF Group?

The OTF Group (On The Frontier) is a private sector consulting firm that provides cutting-edge solutions to help firms and industries in emerging markets confront the challenge of developing successful business strategies.



Analysis

- Describe the causes of underdevelopment
- Discover that simply providing the right insight is insufficient to create change



Change Process Facilitation

- Fit the preconditions for change together – through collaborative processes – to build working industry clusters

World Bank Group

Multilateral Engagement

- Help donor institutions reshape their aid programs to build competitiveness at the microeconomic level

OTF GROUP

New Economy Solutions

- Create solutions to help firms discover new export markets and become globally competitive
- The OTF Group develops industry strategies based on concepts of **"clusters"**

OTF Partial Client List

Afghanistan
US Council on Competitiveness
US States
Colombia
Ireland
Bermuda
Peru
El Salvador
Jamaica
Dominican Republic
Serbia
Macedonia
Rwanda
Gabon
South Africa
Vietnam
Thailand

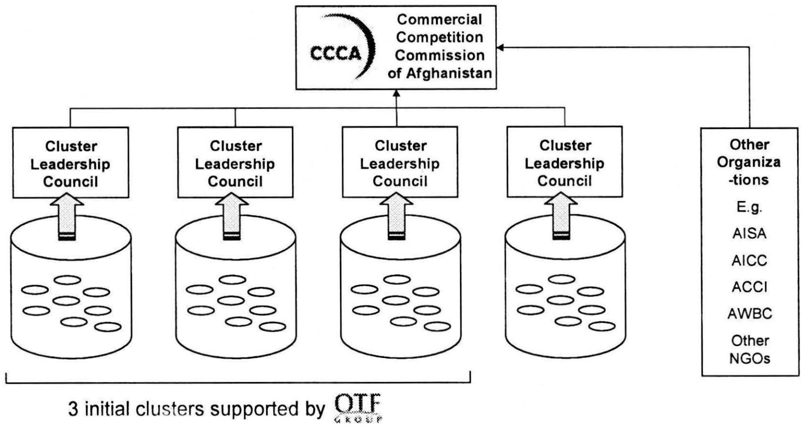
Overview of the ACP
What is the Afghanistan Competitiveness Project?

The Afghanistan Competitiveness Project (ACP) is a two-year OTF Group project that will work with 3 priority clusters and 2 enabling clusters. The ACP is funded by USAID.

The project is designed to achieve the following objectives:

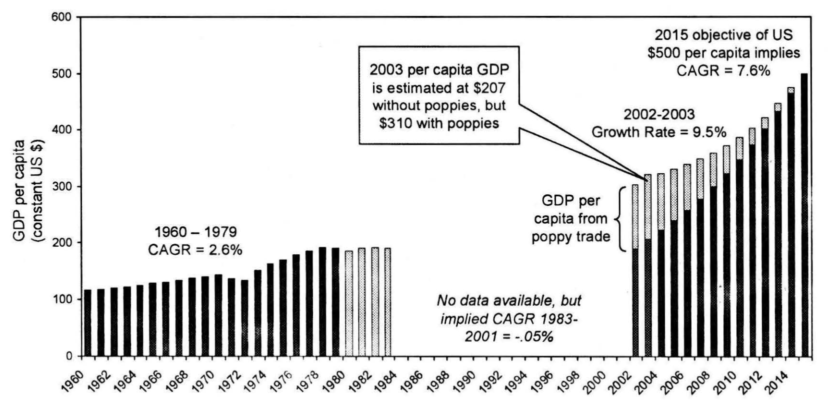
1. Improve dialogue between the public and private sectors.
2. Support local industries develop strong products and services through cluster strategies.
3. Create a sustainable platform that enables continuous improvement of Afghan products and services in the global marketplace.

Overview of the ACP
Institutional Framework of the ACP



The ACP has established an institutional framework to ensure that the ACP creates a sustainable forum for public-private sector dialogue.

Overview of the ACP
Why Focus is Important: Afghanistan's Historical GDP per capita



- ***Beginnings of agriculture-led growth***
- *Modern agricultural techniques*
- *Dominance in certain markets (dried fruits & nuts and carpets)*

- *Soviet Invasion and occupation*
- *Attempts to develop centralized economy*
- *Construction of large SOEs*

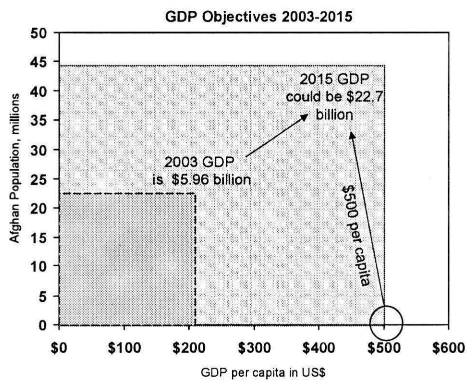
- ***Mujaheddin period & Taliban regime***
- *Minimal long-term investment*
- *Opportunistic trade*

- ***Growth based on innovation & competitiveness***
- *Focus on priority sectors*
- *Customer based development*
- *Shift economy to licit activities*

Source: World Bank Development Indicators Online, World Bank Afghanistan Country Report, Ministry of Commerce Reports

Overview of the ACP
Afghanistan's Development Objectives

Based on GDP per capita objectives and historical population growth rates, Afghanistan's economy will need to grow nearly 300% between 2003 and 2015.



GDP Growth

- Afghanistan's economy will need grow nearly 4 times to achieve the objective of $500 per capita by 2015.

Population Growth

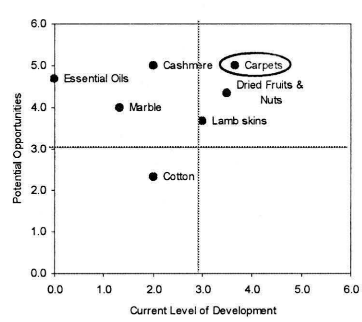
- Average population growth for the past ten years was 3.86%.
- At this growth rate, Afghanistan's population will increase by 50% between 2003 and 2015.
- Despite possibilities to influence family planning, economic objectives should assume higher-end demographic projections

Source: WDI Online, Afghanistan Ministry of Commerce Reports

Overview of the ACP
Why Focus on Carpets?

Afghanistan can capture up to 2 times more value by conducting more trade-related processes in-country. This will allow it to relaunch its brand, focusing on differentiating itself in a highly competitive market based on high quality, original carpets.

Base/Size	Afghanistan has a strong base from which to build, with carpets being its largest official export at $140 M in 2005.
Growth	Repatriation of production from Pakistan alone could almost double the size of the sector.
Value-add	Increased processing will open up end-market wholesaling options for Afghan traders. This will increase value captured by many multiples.
Branding	There are advantages in being a relatively novel brand, but these can be lost if quality is not assured throughout the value chain.
Receptivity	The sector has a positive history of change and is already making highly customized carpets.



Based on OTF multi-sector analysis, *OTF Findings of Industry Research on Afghanistan: Presentation to Private Sector Development Donor Roundtable*, November 2004. This analysis formed the foundations for OTF's choice of target clusters.

Overview of the ACP

The OTF Group 5-Step Process for the Carpet Cluster

	Step 1	Step 2	Step 3	Step 4	Step 5
	Situation Analysis	Carpet Cluster Goals	Understand Carpet Buyers' Needs	Articulate Afghan Carpet Market Positioning	Develop Action Guidelines
Analytical Agenda	• Export value estimated at >$140 M • Market: Increasingly competitive with top 5 buyers accounting for 70% of demand; prices moving downward • Domestic bottlenecks: Cutting and washing, access to finance, transportation, market knowledge and linkage • Differentiation: Important to build strong brand based on quality products	• Grow cluster export value at 11% annually; total export value of >$350 M by 2015 • Grow volume 5% • >80% of exports cut and washed in Afghanistan and sold direct to end-markets by 2015 • Develop new products • Increase productivity and raise wages • Increase local wool use from 33% to 65%	• Brand identity: product's aesthetics, quality of inputs, and value • Size matters more in the US; weave and price more in Germany • Afghanistan is well positioned with hand-knotted, naturally dyed carpets, such as *Chob Rung* carpets • Contemporary design market is an untapped opportunity	• Afghanistan should pursue a differentiation-based strategy • This will require concerted focus on developing a quality product (design, inputs, value) and fostering reliable, high-trust relations with buyers • A strong brand will be required to support this differentiation; labor issues will likely be important	• Afghanistan will likely pursue two production models: an Integrated Production Facility (IPF) and a Distributed Production Network (DPN) • Total NPV of 10 year cluster cash flow $84.8 M; required investment of $83.8 M • Public financing will be required to support market access, design diversification, and maintenance of cluster leadership institutions
Institutional Process	• Form and engage private-public cluster leadership group, the Afghanistan Carpet Committee • Agree on a working schedule with Carpet Committee	• Identify core cluster members of groups as well as subject matter experts • Build sense of shared vision within cluster • Initiate issue-specific working groups	• Form a research plan based on initial hypotheses • Leverage *OTF Insight* to conduct international carpet market research	• Use cometitor findings to stimulate discussion around priority areas within cluster group • Involve all subject matter experts in clarifying potential issues	• Engage Afghanistan Carpet Committee in process of strategy vetting, buy-in and implementation • Lead a campaign to inform all stakeholders of strategy implication

Agenda

Introduction to the OTF Group & the Afghanistan Competitiveness Project

Step 1: Situation Analysis

- **Product Introduction: Handmade Carpets**
- International Carpet Market
- Afghanistan's Carpet Cluster

Step 2: Establishing Goals

Step 3: Understanding Buyer Needs

Step 4: Articulating Market Positioning

Step 5: Developing Action Guidelines

Annexes

Situation Analysis

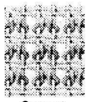
The OTF Group 5-Step Process for the Carpet Cluster

	Step 1	Step 2	Step 3	Step 4	Step 5
	Situation Analysis	Carpet Cluster Goals	Understand Carpet Buyers' Needs	Articulate Afghan Carpet Market Positioning	Develop Action Guidelines
Analytical Agenda	• Export value estimated at >$140 M • Market: Increasingly competitive with top 5 buyers accounting for 70% of demand; prices moving downward • Domestic bottlenecks: Cutting and washing, access to finance, transportation, market knowledge and linkage • Differentiation: Important to build strong brand based on quality products	• Grow cluster export value at 11% annually; total export value of >$350 M by 2015 • Grow volume 5% • >80% of exports cut and washed in Afghanistan and sold direct to end-markets by 2015 • Develop new products • Increase productivity and raise wages • Increase local wool use from 33% to 65%	• Brand identity: product's aesthetics, quality of inputs, and value • Size matters more in the US; weave and price more in Germany • Afghanistan is well positioned with hand-knotted, naturally dyed carpets, such as *Chob Rung* carpets • Contemporary design market is an untapped opportunity	• Afghanistan should pursue a differentiation-based strategy • This will require concerted focus on developing a quality product (design, inputs, value) and fostering reliable, high-trust relations with buyers • A strong brand will be required to support this differentiation; labor issues will likely be important	• Afghanistan will likely pursue two production models: an Integrated Production Facility (IPF) and a Distributed Production Network (DPN) • Total NPV of 10 year cluster cash flow $84.8 M; required investment of $83.8 M • Public financing will be required to support market access, design diversification, and maintenance of cluster leadership institutions
Institutional Process	• Form and engage private-public cluster leadership group, the Afghanistan Carpet Committee • Agree on a working schedule with Carpet Committee	• Identify core cluster members of groups as well as subject matter experts • Build sense of shared vision within cluster • Initiate issue-specific working groups	• Form a research plan based on initial hypotheses • Leverage *OTF Insight* to conduct international carpet market research	• Use cometitor findings to stimulate discussion around priority areas within cluster group • Involve all subject matter experts in clarifying potential issues	• Engage Afghanistan Carpet Committee in process of strategy vetting, buy-in and implementation • Lead a campaign to inform all stakeholders of strategy implication

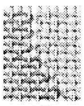
Situation Analysis

Product Information: Handmade Carpets

- Made by knotting colored woolen (or silk) thread onto a wool or cotton backing by hand according to a specified design. The woolen threads are shorn to reveal the carpet's pattern. Kilims are made by tightly weaving horizontal yarns of different colors to develop a pattern (referred to as 'flat weaves').

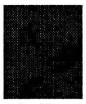


Carpet knots

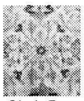


A kilim weave

- Factory production historically occurred in royal courts, and characterizes Iranian, Indian and Chinese production. Village production occurs throughout Central Asia (and Nepal), originally by women of nomadic tribes who used to use them for tent floor and wall coverings.



Traditional Afghan design



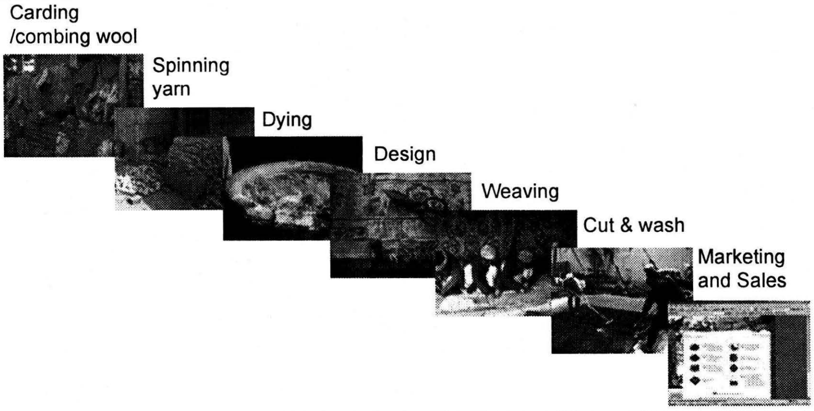
Chob Rung design

- Afghan designs:
  - *Traditional carpets*. Developed mainly in Northern Afghanistan by Turkmen tribes, depicting geometric designs that are often repeated, usually on a dark red or burgundy base. Both chemical and natural dyes are used.
  - Chob Rung *carpets*. Developed over the past decade mainly in Afghan refugee camps in Pakistan, depicting 'Indo-Persian' floral designs in pastel colors. Predominantly woven with natural dyes, they have dominated Afghan and Pakistani exports in recent years.

Note on Kilims: The focus of the strategy is on knotted carpets. Kilims account for 5% of the value of Afghan floor covering exports.

Situation Analysis

Product Information: Production Process



TRANSPORTATION

KNOWLEDGE AND INNOVATION

FINANCING

SUPPORTING INSTITUTIONS

Agenda

Introduction to the OTF Group & the Afghanistan Competitiveness Project

Step 1: Situation Analysis

- Product Introduction
- **International Carpet Market**
- Afghanistan's Carpet Cluster

Step 2: Establishing Goals

Step 3: Understanding Buyer Needs

Step 4: Articulating Market Positioning

Step 5: Developing Action Guidelines

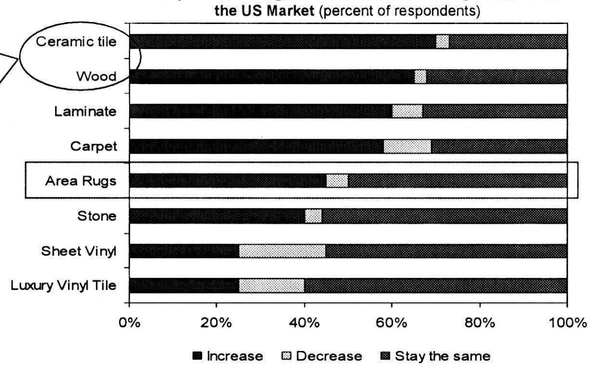
Annexes

Situation Analysis
International Carpet Market: Trends for Area Rugs

Over 50% of floor covering businesses believe that the market for area rugs will remain the same, but over 40% think that it will grow.

Continued growth in hardwood flooring is a positive trend for area rug sales, as the two complement each other. Floor covering outlets are therefore becoming increasingly important sales channels for area rugs.

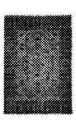
Perception of Change in Future Floor Covering Business in the US Market (percent of respondents)



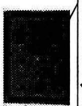
Source: Derived from National Floor Trends (NFT) Market Trends Study, 2002

Situation Analysis
International Carpet Market: Top Suppliers

Despite historically distinct styles (as pictured below), designs have always migrated easily across the region. Design mobility has further increased, with little distinguishing the production of different countries. Exporting most of its carpets through Pakistan, Afghanistan is a large player in the international market.

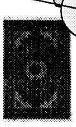


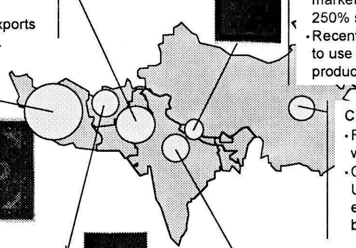
Pakistan: $246 M; 8%
- Approximately 60% of production previously undertaken by Afghan refugees, much of which has repatriated.
- Large portion of Pakistan's exports now produced in Afghanistan.



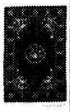
Nepal: $100 M; 21%
- Industry developed by Tibetan refugees in the 1950s.
- Has been enjoying strong growth in the US market over past 10 years, increasing over 250% since 1995.
- Recent decline attributed to market reaction to use of child labor and poor quality production.

Iran: $391 M; 4%
- US and Germany account for almost half of all exports.
- Decline in prices since peak in 1970s due to over-supply and decline in quality. e.g. Kashans that sold for $20,000 in 1980 fetch only $5,000 today

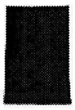




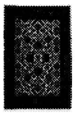
China: $121 M; -12%
- Reputation for good quality, well priced carpets.
- China is dependant on the US market for 70% of its exports, though sales have been stagnant since 1995.



Afghanistan: $149 M; 10%
- 95% of production exported to Pakistan where it is finished and re-exported as Pakistani.



India: $148 M; -9%
- US market accounts for >50% of exports.
- Along with China, India benefited from the US embargo on Iranian carpets, but has been losing market-share to Iran since 2000.



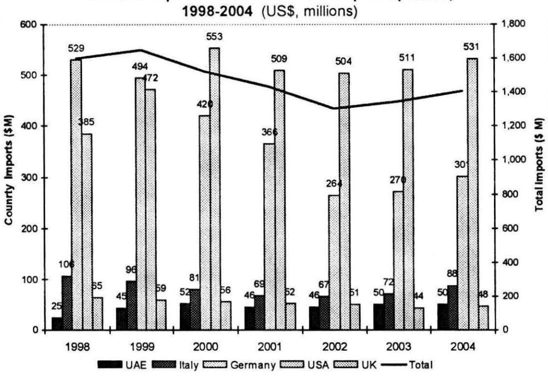
Source: Trade Map 2004 data; percentages show 2003-04 growth. Note: Data discrepancy exists between reported export values and import values. Exports form Iran may be between $300-500 M; India from $150-300. Data for Afghanistan's exports for 2004 from the Afghan Carpet Exporters Guild.

Situation Analysis
International Carpet Market: Top Buyers

The US and Germany are by far the largest buyers, with the US passing Germany in 2000. Shrinking between 1999-2002, the carpet market is rebounding towards its peak in 1999.

- The largest carpet market in 1998, Germany has rapidly declined, falling to half its 1998 level in 2002. The market has turned around since, growing at 7% between 2002-04; however, Germany is no longer likely to be as dominant a buyer as it once was.
- The US market has been the only market to maintain a positive growth rate, averaging 6% between 1998-2004 (driven mainly by high growth pre-2001). However, like other countries, the US market also took a downturn, though not as dramatically. The market picked up to grow at 3% between 2002-2004.

Value of Imports: Global Total and Top-5 Importers, 1998-2004 (US$, millions)



The handmade carpet market is rebounding with the global economy. While still an important market, Germany has lost its place of prominence to the US.

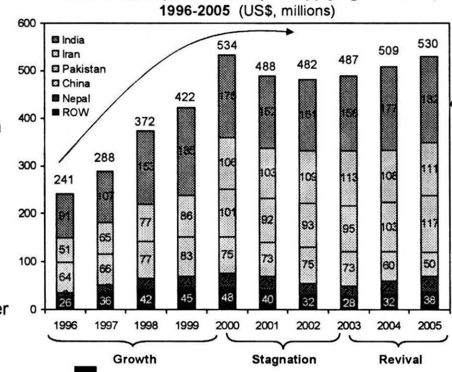
Source: USAID Trade Map 2004.

Situation Analysis
International Carpet Market: The US Market

India has dominated US carpet imports for the past 10 years, doubling its sales. China's performance lacked luster, and has since 2000 lost market share to Iran. Though still a comparatively small player, Nepal experienced the most impressive growth.

- After years of double digit growth to a peak in 2000, US imports stagnated with the to the post-dotcom recession.
- However, the market is showing signs of strong recovery, approaching its 2000 peak in 2005. 2006 looks to be a strong year, with total first quarter imports 15% higher than the same period in 2005.
- Unlike India and China, Pakistan was not as adversely affected by Iran's re-entry to the US. This implies that its exports to the US – both traditional Afghan and *Chob Rung* carpets – cater to a different niche from pure Persian and Indo/Sino-Persian carpets. It has also grown well in 2004-05.

Value of US Imports from Top 5 Supplying Countries, 1996-2005 (US$, millions)



Growth, 2004-05	
IND	3%
IRN	3%
PAK	13%
CHN	-17%
NPL	13%
ALL	4%

Clearly an attractive market, the US is also very competitive. Afghanistan should avoid entering segments that Iran, India and China serve, where it is unlikely to be able to compete on price.

Source: US International Trade Commission

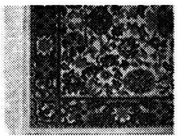
Situation Analysis
International Carpet Market: Avoiding the 'Movement to the Middle'

"We're getting competition that we didn't get before from machine mades." - US Importer

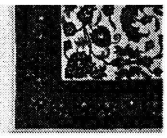
- Major manufacturers and distributors are increasingly turning towards becoming 'one-stop shops', stocking both tradition/oriental and modern designs, as well as machine-made and handmade carpets.
- As machine weaving technologies improve, there is decreasing differentiation in the market between mid-range hand-knotted and good quality machine-made carpets:

*"A major trend in product construction has been the melding of handmade and machine-made sensibilities. In the major middle-market price points of $600 to $1,500 for 6' x 9' rugs, **the method of production is now less important than the way the product is styled and colored** ... Price points for handknotted, hand-tufted and power-loomed products regularly intersect."*

- National Floor Trends Magazine, March 2001



Example of machine-made oriental carpet



Example of handmade oriental carpet

While avoiding direct competition with China, India and Iran, Afghanistan will have to also differentiate its products from machine made carpets, against which it cannot compete on cost or certain elements of quality.

Situation Analysis
International Carpet Market: Changing Trends

Styles and colors are also changing more rapidly. While niches for traditional carpets are affected less by this, the opportunities for growth and volume may lie in serving 'trendy' – but more volatile – markets.

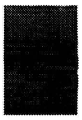
- The market for high quality, traditional Afghan carpets is more stable. However, it has been marred by a limited range of designs and colors, as well as poor quality (such as the use of non-fast chemical dyes and unevenness of carpet and borders).

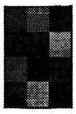
A carpet producer from Aq Cha who deals only in traditional carpets has seen his sales to Germany drop from 6000m² per month to under 2000m².

- *Chob Rung* designs – also referred to tea washed/stained – have done well over the past 10 years, but may be nearing the end of their cycle. Kabul-based producers of *Chob Rung* carpets surveyed by OTF reported an average decline in sales of 25% over the past few years.

"Thee years ago the tea stained look was hot. Today it's dead. Instead of murky tones, today's colors are clear and defined." – GM of Oriental Weavers, USA[1]

- There may be good growth opportunities around 'soft contemporary' designs, such as Nepali/Tibetan carpets (which experienced over 250% import growth into the US between 1995 and 2004).





Examples of 'soft contemporary' carpets

Afghanistan will have to build its capacity to forecast and respond to rapidly changing trends in design and colors.

Source: OTF research; 1. National Floor Trends Magazine, April 2002.

Situation Analysis
International Carpet Market: Summary

- The hand-knotted carpet market is **highly competitive** with the top 5 buying countries accounting for over 70% of total global demand.
- After years of solid growth, the **US market – the largest – leveled out over the past few years**, contributing to greater competition particularly among Iran, India and China. However, it looks to be rebounding healthily.
- Efficient factory production in Iran, India and China allows them to cost-effectively manufacture handmade carpets of high quality (particularly in the case of India and China). **Afghanistan will have to target different niches** from these countries, as it unlikely to be able to compete with them on cost.
- High competition in the handmade sector and new competition from good quality machine-made carpets are leading to a **downward pressure on prices and decreasing value** for carpet producing countries.
- Despite this, **Afghan imports to the US have increased many-fold** over the past year, while Pakistani imports – much of which are produced in Afghanistan – have held steady. However, this is based on the *Chob Rung* line of carpets that may soon face declining popularity.
- Frequent changes in decorating trends require **accurate market knowledge** and responsive production systems, which Afghan producers currently lack.

Agenda

Introduction to the OTF Group & the Afghanistan Competitiveness Project

Step 1: Situation Analysis

- Product Introduction: Handmade Carpets
- International Carpet Market
- **Afghanistan's Carpet Cluster**

Step 2: Establishing Goals

Step 3: Understanding Buyer Needs

Step 4: Articulating Market Positioning

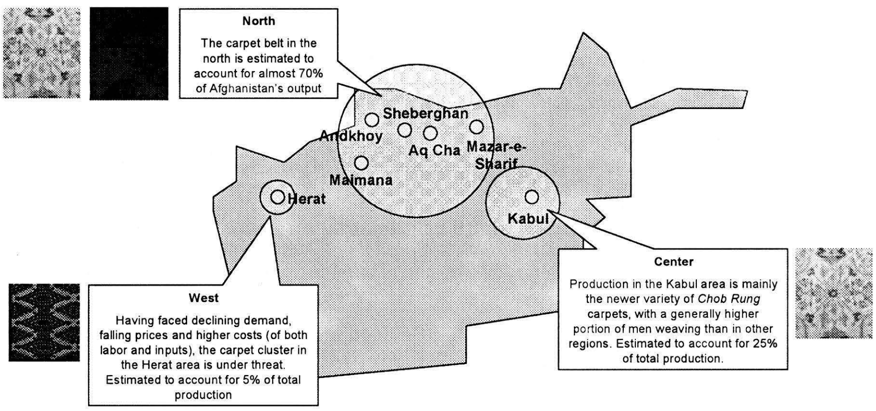
Step 5: Developing Action Guidelines

Annexes

Situation Analysis

Afghanistan's Carpet Industry: Afghan Carpet Cluster Locations

The majority of Afghan production is located in the north, where a combination of traditional and newer Chob Rung *carpets are woven. Kabul is a relatively new center of production, focusing on* Chob Rung *carpets. Traditional carpet production in Herat may be on the verge of collapse.*

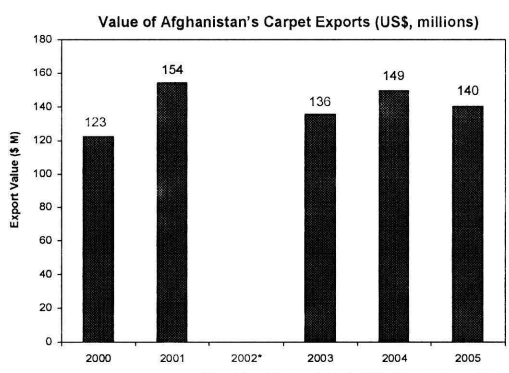


Source: All production estimates by Afghan Carpet Exporters Guild, Mazar office.

Situation Analysis

Afghanistan's Carpet Industry: Afghan Carpet Cluster Size

Despite global market shrinkage from 2000 onwards, the Afghan carpet sector maintained a 2% average growth rate between 2000-05. Data for 2004 show 95% of Afghan carpets being sold through Pakistan, sold for an average of $92 per m².



*No reliable data is available for 2002, following the ousting of the Taliban in October 2001.

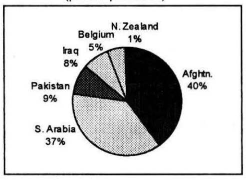
Source: Export quantity data from Afghan Carpet Exporters Guild; price data from Afghan Chambers of Commerce and Industry. No reliable export data was collected for 2002 as a result of instability following the ousting of the Taliban in October 2001. Average yearly estimates are used for the last 3 months of 2001 and the first 3 months of 2002.

Situation Analysis
Afghanistan's Carpet Industry: Carpet Inputs

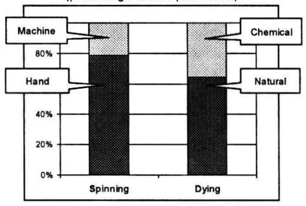
Afghan wool is considered to be very good for carpet production. However, not enough is known about the local wool market to determine whether there is sufficient supply to meet demand.

- Wool from Ghazni is considered among the best for carpet weaving, regarded as a key competitive differentiator of Afghan carpets (described by one exporter as "soft-hard wool").
- However, it is in short supply after recent sheep flock decimation. Access tends to be dominated by large-scale producers who have agents located in wool producing areas.
- Carpets made from machine-spun Belgian wool command price premiums, while carpets made from machine-spun Pakistani and Iranian wool are regarded to be lower quality due to wool impurities.
- Access to good quality spun wool is the number one business barrier reported by producers in Herat, most of whom are small-scale producers.[2]

Source of Wool for Kabul-based Producers
(per m^2 produced)[1]



Wool Processing of Kabul-based Producers
(percentage of total production)[1]



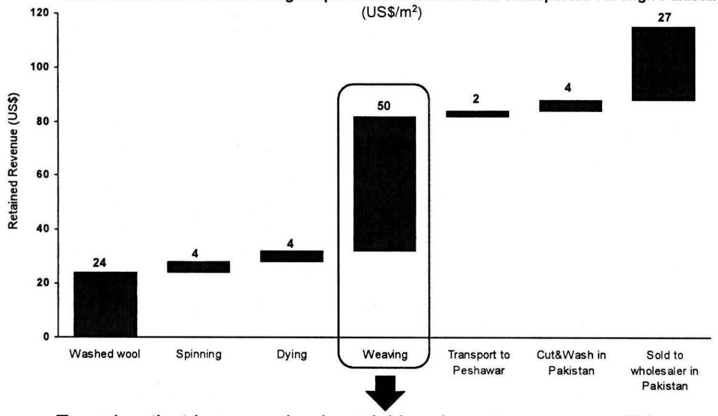
There is a need to improve access to good quality hand- and machine-spun Afghan wool which can serve as a key differentiator of Afghan carpets.

Source: OTF Group interviews. 1. OTF Survey conducted in December 2004-January 2005 (33 respondents, all from Kabul area); hereafter referred to as "OTF Group survey." 2. Cluster meeting in Herat with 120 carpet cluster members.

Situation Analysis
Afghanistan's Carpet Industry: Production – Carpet Value Chain

Weavers get a raw deal. A weaver can weave up to 1 m^2 per month, earning a maximum of \$50 monthly. A mid-size trader, trading about 800 m^2 per month, can earn over \$20,000 monthly. While women do most of the weaving, they do virtually none of the trade.

Value Distribution of *Chob Rung* Carpet Cut and Washed and Transported Through Pakistan
(US\$/m^2)



Ensuring that increased value trickles down to weavers will be an important challenge for the carpet cluster.

Source: OTF Group research

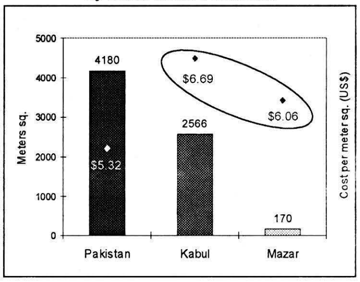
Situation Analysis

Afghanistan's Carpet Industry: Partial Repatriation from Pakistan

Since 2001, over 60% of carpet weavers have returned to Afghanistan from Pakistan, however over 90%[1] of Afghan carpets are sent un-finished to Pakistan for cutting and washing and shipping.

- Pakistan enjoys a number of advantages for cutting and washing:
  - *Access to chemicals.* All chemicals are imported from Pakistan.[2]
  - *Access to expertise.* Good supply of skilled cutting and washing labor. Wages in Pakistan are reportedly $40 per month as compared to between $100-140 per month in Afghanistan.
  - *Climate.* Warmer weather in Pakistan allows for year-round sun-drying of washed carpets. Cut and wash facilities in Mazar and Kabul have to dry carpets indoors with heaters or close for at least 2 months in winter.[3]
- Producers are willing to incur higher cut and wash costs in Afghanistan so as to export directly from Afghanistan.

Total Volume and Cost of Cutting & Washing by Kabul-based Producers



Higher cut and wash prices in Afghanistan are due to: 1. cost of transporting washing chemicals from Pakistan; 2. labor costs that are two-times those in Pakistan; 3. lower competition than in Pakistan.

So long as carpets continue to be cut and washed in Pakistan, they will be exported as Pakistani products. This precludes the development of an Afghan brand.

Source: OTF Group survey and interviews. 1. Based on data form ACEG.. 2. This is less important for traditional carpets which can be washed in soap and water. 3. This barrier can be addressed by use of a large spin dryer, currently made in Iran.

Situation Analysis

Afghanistan's Carpet Industry: Transportation

Afghanistan enjoys a strong land-based carpet transportation sector that is reliable but costly. Linkages to foreign markets – direct from Kabul and through Pakistan – remain weak, and have to compete with subsidies offered by the Government of Pakistan.

- Time and cost

Route	*Approx. distance*	*Cost*	*Time*
Northern Afghanistan to Peshawar	700 kms	$2/m^2$	2 weeks
Western Afghanistan to Peshawar	1,100 kms	$2/m^2$	2 weeks
Peshawar to Germany (via Karachi, Pakistan)	>5000 kms	$1/m^2$	3-4 weeks
Herat to Germany (via Bandarabas, Iran)	>5000 kms	$1.30/m^2$	4-5 weeks

Time and costs include transportation within Pakistan (>1,500 kms) and all port/clearance fees. With a transportation subsidy by the GoP, the cost is actually **reduced to almost zero**.

- Ease
  - Rent extraction and red tape in Kabul make direct transportation by air difficult. In comparison, transportation and clearance systems in Pakistan are reported to be quick and easy.[1]
  - The GoP subsidizes transportation of carpets from Pakistan. In addition, transit rules from Afghanistan, through Karachi, to foreign destinations remain ambiguous. These factors encourage final finishing in Pakistan, and exporting Afghan carpets as Pakistani made.[2]

Direct air links and transit transportation via Pakistan need to be improved. But producers will have to be convinced of the business benefits of direct shipment from Afghanistan before they give up the transport subsidy offered by the GoP.

Source: OTF Group producer interviews. 1. Some partnerships are 'paper' partnerships, whereby the Pakistani citizen charges a 2% commission, leaving with exporter with a 2.5% export credit. 3. Transit rules through Iran are comparatively straight forward.

Situation Analysis
Afghanistan's Carpet Industry: The Branding Challenge

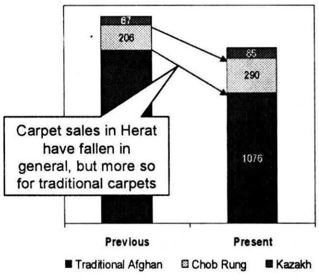
Developing a strong Afghan brand of carpets will require managing the manner in which many Afghan carpets are sold via Pakistan as Pakistani products.

- Traditional Afghan production is more unique, and easy to differentiate from other countries' production. However, the market for it is limited.

"You won't sell them hand over fist, but you sell them regularly, annually and constantly."
- US carpet importer with reference to traditional Afghan carpets

- Much Afghan carpet production has been sustained by *Chob Rung* carpets. Based on new designs and initiated in Pakistan, there is little about these carpets that is uniquely Afghan. They have been exported as Pakistani since their launch.

Carpet Sales in the Herat Region (m^2 produced per month; survey of 40 respondents)[1]



The Afghan brand will have to target both the traditional market as well larger and lucrative – but competitive – markets such as the *Chob Rung* segment.

Source: OTF Group producer interviews. 1. OTF Group Herat carpet survey, conducted April 2005, 40 respondents. It was not possible to get precise data on previous years, just general percent changes "over the past couple of years."

Situation Analysis
Afghanistan's Carpet Industry: Knowledge and Innovation

There is very little knowledge in Afghanistan of the carpet market's needs and carpet consumer trends. Afghan producers are market followers, vulnerable to shifts in trends with limited ability to effectively respond.

- Most producers work on a consignment basis (over 90% of producers surveyed in Kabul) fulfilling orders that specify size, pattern and colors required. They have limited understanding as to why such sizes, patterns and colors are required.

- Producers that do not produce by consignment, reproduce either traditional designs or copy more recent designs that are considered popular (such as varieties of the *Chob Rung*).

- Producers in the North and the West reported declining sales. Kabul-based producers of *Chob Rung* carpets surveyed by OTF reported an average decline in sales of 25% over the past few years. None understand why the decline has occurred and what to do in response.

"We know nothing about the market. It is like doing business blind."
- Creator of the "Khal Mahamadi" carpet

"You've got to keep changing: new designs every year for the trade shows."
– US Carpet Importer (and ex-producer)

Building market linkages and investing in design innovation will be key to reducing the vulnerability of Afghanistan to carpet market swings.

Source: OTF Group interviews and OTF Group Kabul survey (based on responses from 10 producers, not complete set of 33 respondents).

Situation Analysis

Afghanistan's Carpet Industry: Financial and Other Institutions

Financial Institutions

- The majority of Afghan carpets are produced on consignment (as opposed to woven without a pre-arranged buyer). It is usual for 50% of the payment for the order to be paid up-front, which most small-to-mid sized producers require as working capital.
- Much of this working capital comes from Pakistani traders, who buy the majority of Afghan carpets and re-sell them in European and US markets.

"Pakistani merchants as traders are the main traders in Pakistan. It is without any doubt."
- Afghan Carpet Producer and Exporter

- Therefore, through working capital financing, Pakistan plays an integral role in the Afghan carpet production chain (much as it does through cutting and washing and transportation to the end market).

Other Institutions

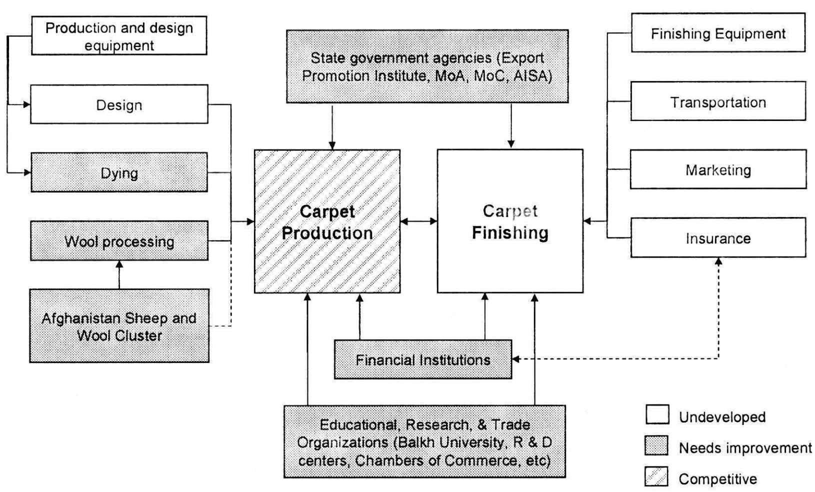
- Three carpet-specific associations exist: one quasi-governmental with national reach; two regionally-specific private associations (Kabul and Aq Cha). All three are struggling to define their mission, develop membership services, and develop a sustainable business model.

Unless Afghan carpet producers are given improved access to working capital, the Afghan carpet trade will continue to be dominated by Pakistani traders who provide advance payments.

Situation Analysis

Afghanistan's Carpet Industry : Summary – Cluster Mapping

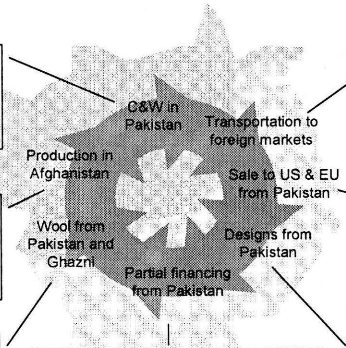
A variety of businesses and organizations form part of the Afghan carpet cluster. Most require improvement, while many remain wholly undeveloped.



Situation Analysis

Afghanistan's Carpet Industry: Summary – Pakistan's Role Revisited

Building the Afghan carpet cluster depends on capturing more of the value in production and trade that is currently occurring in Pakistan. In an insecure investment climate, the importance of mobility increases. Some elements of the value chain are more mobile than others.



Mobility: High
Simple C&W facility but requires transportation of chemicals. Climate offers some restraints.

Mobility: Medium
Reliable global transportation links are difficult to develop, but alternatives exist.

Mobility: High
Majority has moved form Pakistan over only 3 year period

Mobility: Low
Business networks are mobile, but take time to develop.

Mobility: High
Wool production is increasing and imports can fill current gaps

Mobility: Medium
Access to financing can be developed in the near term, but a trusted banking system will take longer.

Mobility: Medium
Market demand linkages take time to be develop, though they can be accelerated through aggressive research.

Situation Analysis

Afghanistan's Carpet Industry: Summary

- Estimated at over **$140 M**, the carpet cluster is Afghanistan largest official export.
- Renowned for good quality wool, Afghanistan needs to focus on **building the wool sector** as the foundation for its carpets exports. However, attention needs to be paid to ensuring access to good quality wool for small and mid-sized producers.
- Very limited value accrues to carpet weavers. While general sector growth should lead to improved livelihoods for weavers, special attention will have to be paid to **ensure that increased profits trickle down** through market-based solutions.
- Cutting and washing is undertaken almost wholly in Pakistan. Building a strong Afghan brand will **require that carpets are cut and washed in Afghanistan** and not finished in Pakistan.
- **Transportation remains difficult**. Unless transit regulations through Pakistan are clarified, there will be little incentive for producers to change current systems which include both final finishing and transportation through Pakistan.
- Developing a **strong brand** that differentiates Afghan carpets in a competitive global market will be important. The degree to which this should be built around natural products and processes and fair trade issues will have to be determined though market analysis.
- The carpet market, like all interiors markets, is constantly changing. **Understanding trends, responding to them, and even leading them**, will be key to Afghanistan's success.
- Many carpet producers tap Pakistani traders as a source of working capital. Unless **other sources of capital** are available, trade will continue to be conducted through Pakistan, with Afghan carpets exported as Pakistani.

Agenda

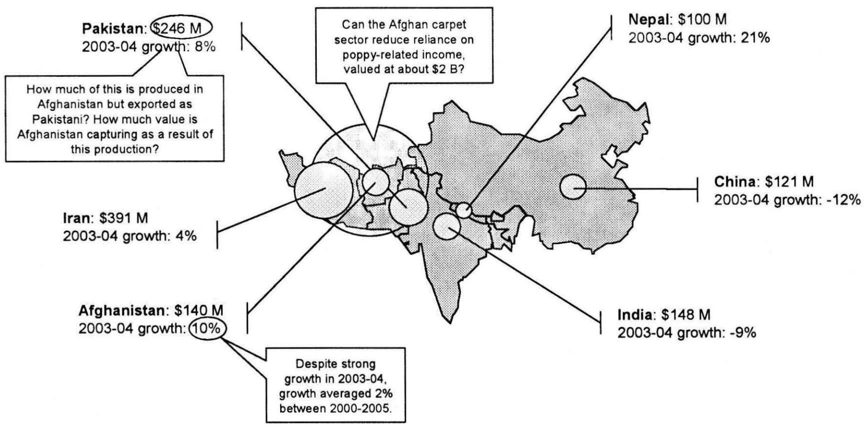
Establishing Goals
The OTF Group 5-Step Process for the Carpet Cluster

	Step 1	Step 2	Step 3	Step 4	Step 5
	Situation Analysis	Carpet Cluster Goals	Understand Carpet Buyers' Needs	Articulate Afghan Carpet Market Positioning	Develop Action Guidelines
Analytical Agenda	• Export value estimated at >$140 M • Market: Increasingly competitive with top 5 buyers accounting for 70% of demand; prices moving downward • Domestic bottlenecks: Cutting and washing, access to finance, transportation, market knowledge and linkage • Differentiation: Important to build strong brand based on quality products	• Grow cluster export value at 11% annually; total export value of >$350 M by 2015 • Grow volume 5% • >80% of exports cut and washed in Afghanistan and sold direct to end-markets by 2015 • Develop new products • Increase productivity and raise wages • Increase local wool use from 33% to 65%	• Brand identity: product's aesthetics, quality of inputs, and value • Size matters more in the US; weave and price more in Germany • Afghanistan is well positioned with hand-knotted, naturally dyed carpets, such as *Chob Rung* carpets • Contemporary design market is an untapped opportunity	• Afghanistan should pursue a differentiation-based strategy • This will require concerted focus on developing a quality product (design, inputs, value) and fostering reliable, high-trust relations with buyers • A strong brand will be required to support this differentiation; labor issues will likely be important	• Afghanistan will likely pursue two production models: an Integrated Production Facility (IPF) and a Distributed Production Network (DPN) • Total NPV of 10 year cluster cash flow $84.8 M; required investment of $83.8 M • Public financing will be required to support market access, design diversification, and maintenance of cluster leadership institutions
Institutional Process	• Form and engage private-public cluster leadership group, the Afghanistan Carpet Committee • Agree on a working schedule with Carpet Committee	• Identify core cluster members of groups as well as subject matter experts • Build sense of shared vision within cluster • Initiate issue-specific working groups	• Form a research plan based on initial hypotheses • Leverage *OTF Insight* to conduct international carpet market research	• Use cometitor findings to stimulate discussion around priority areas within cluster group • Involve all subject matter experts in clarifying potential issues	• Engage Afghanistan Carpet Committee in process of strategy vetting, buy-in and implementation • Lead a campaign to inform all stakeholders of strategy implication

Establishing Goals

Cluster Goals: Background on Competitor Clusters

Can the Afghan carpet cluster grow as large as its key regional competitors? How long will this take? Will the carpet cluster ever grow large enough to offer viable income generation opportunities to reduce reliance on opium cultivation and processing?



Source: USAID Trade Map 2004 data; percentages show 2003-04 growth. Note: Data discrepancy exists between reported export values and import values. Exports form Iran may be between $300-500 M; India from $150-300. Data for Afghanistan's exports from the Afghan Carpet Exporters Guild.

Establishing Goals

Introduction: What is a Realistic Cluster Growth Rate?

A number of different data points can aggregated to develop likely carpet cluster growth targets.

National level GDP growth

- GDP per capita target: Afghanistan is targeting reaching a GDP per capita level of $500 (excluding poppy and opium) by 2015. At current population growth rates, the economy will have to grow at 7.6% per year to achieve this goal.[1]
- Projected growth levels: After high growth in the years proceeding the ousting of the Taliban, the Afghan economy is expected to grow in the near-term at about 9% per year.[2]

Market opportunities

- Between 2000-04 Afghan carpet exports grew by 5% per year despite global market shrinking of 2% over the same period.
- Despite recent decline, the carpet market is picking up again:
  - Germany, while not likely to be as large again as it once was, grew 7% per annum between 2002-04.
  - The US grew 3% in the same period.
- Imports from Pakistan – for which the US accounts for 40% of sales – grew over 5% from 2002-04 and 13% between 2004-05. First quarter data for 2006 indicate 13% growth over first quarter 2005 sales.
- Therefore, both Afghan and Pakistan production has proven to be resilient to recent market decline, faring better than their key competitors, and are rebounding well above average levels.

With the rebound of the global carpet market, the Afghan carpet cluster should be able to better projected national growth levels of 9%.

1. Derived from WDI Online and Afghanistan Ministry of Commerce Reports 2. IMF Mission Concluding Statement, March 2006. Carpet data from Trade Map and USITC. Data form Pakistan used as proxy for Afghanistan, as over 95% of Afghan carpets are exported through Pakistan.

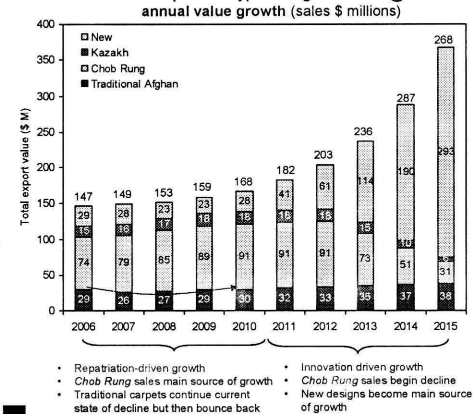
Establishing Goals
Cluster Goals: Develop New Products

Much near-term growth in the carpet sector can come from Chob Rung *production. But in time the popularity of this carpet may decrease and new designs will have to be developed to drive continued growth.*

New Product Assumptions	
Annual production increase	10%
Average traditional carpet 10 yr growth (including initial downturn)	3%
Chob Rung and Kazakh 10 yr growth	-9%

- Resuscitating sales of traditional Afghan carpets will focus primarily on quality issues. It is expected that this market has growth potential, but that this may be limited to about 3-5% annually (equal to sector growth levels).
- New designs will have to replace the *Chob Rung* and Kazakh segments. These may be variations of these carpets or completely different altogether.

Potential product type change scenario @ 11% annual value growth (sales $ millions)



Focusing on understanding market trends and developing market-based designs is key to enabling the sector to grow over the next 10 years.

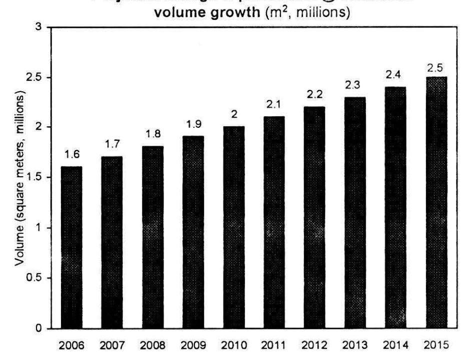
AA: OTF Group Information; 2005 39

Establishing Goals
Cluster Goals: Repatriate Production

Increased production to drive volume growth (projected at 5% annually) will initially be fueled by repatriation of weavers from Pakistan.

- Initial production growth will be driven by the return of weavers to Afghanistan from Pakistan.
- However, after a few years, other sources of growth will have to be found. The main sources of growth are likely to be:
  - *Productivity improvements*: Scope for productivity increases exists but are likely to be limited due to carpets being a labor intensive, handmade product.
  - *Population increase*: Projected population growth of almost 4% will provide the labor required to increase production.
  - *Rising wages*: However, wages for carpet weavers will have to rise if labor is to be attracted to the sector, particularly as the range of alternative income earning opportunities available in Afghanistan increases.

Projected change in production @ 5% annual volume growth (m^2, millions)



After the initial benefit of repatriation of production, continued volume growth will require wage increases to attract labor to the sector.

AA: OTF Group Information; 2005 40

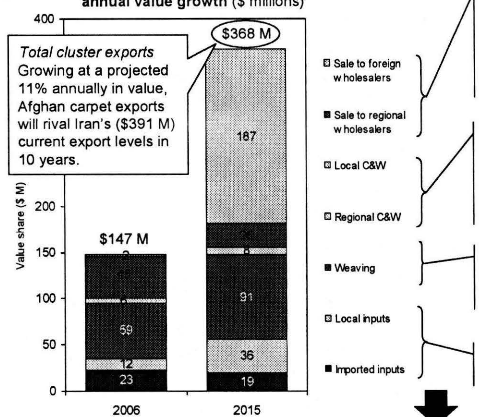
Sources: WDI Online; www.dailytimes.com.pk; OTF research

Establishing Goals

Cluster Goals: Capture More Value

Carpet cluster growth should involve a mix of over-all growth in volume, a transfer of value from other countries to Afghanistan, and – most importantly – an increase in value gained through trading directly with end-market customers.

Projected change in value distribution @ 11% annual value growth ($ millions)



Sales and trading
- Currently little value is captured in trade due to low-margin sales to traders in the region.
- In 10 years, the vast majority of trade will be to end-market buyers, at margins that are 1.5-2 times current levels. This represents a huge value jump from $2 M to $187 M.

Cut and wash
- C&W contributes little direct value, though it is a strategically important process.
- Currently only about 5% is done in-country.[1]
- The growth assumption is based on keeping pace with direct sales end-market/foreign buyers.

Weaving
- Based on a 5% annual increase in volume.
- This is driven by a combination of repatriation from Pakistan, population growth and improved productivity

Inputs
- Currently 33% of wool used is from Afghanistan.[1]
- 10 year goal of 35/65 volume share between imported and local wool.

Increased value capture in Afghanistan will mainly occur though increasing sales to buyers in end markets.

1. OTF estimates.

41

Establishing Goals

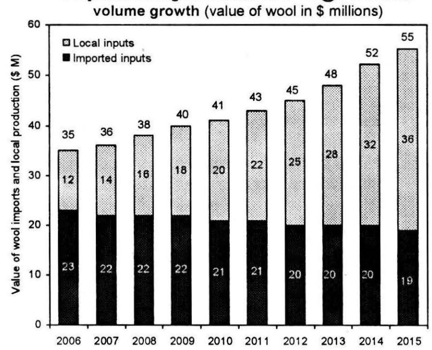
Cluster Goals: Capture More Value – Input Value

Using imported wool for about two-thirds of current production[1] leads to limited value capture for Afghanistan. As local sheep populations recover, Afghanistan can triple the value it captures through the use of more locally produced wool.

Inputs Assumptions	
Current: Locally supplied spun wool	1/3 of total
Goal 2015: Locally supplied spun wool	65% of total

- Increasing local wool inputs to 65% of the sector's requirement will require growth in local production of 12% annually.
- This requires local sheep flocks to grow between 16%.
- Sheep flock growth of 16% annually can be achieved through a lambing rate of 50% and a death rate of 14%.[2]

Projected change in source of wool @ 5% annual volume growth (value of wool in $ millions)



Focusing on rebuilding sheep flock numbers is key to Afghanistan capturing more value through increased local wool usage and reduced imports.

Source: OTF estimate. 1. Wool that is machine-spun in Afghanistan is usually imported, however, this is counted as being part of local inputs. 2. Assumption that only one-half of born lambs are ewes that grow to maturity and begin producing wool.

AA: OTF Group Information: 2005

42

Establishing Goals

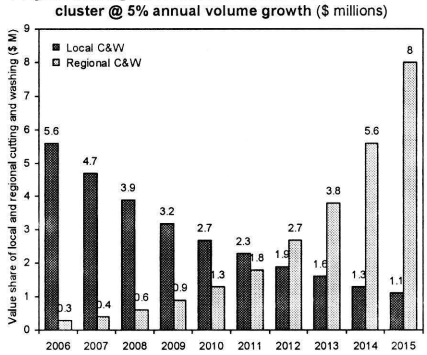
Cluster Goals: Capture More Value – Cutting and Washing

Cutting and washing contributes a limited amount to total sector value. However, increased local cutting and washing is key to increasing Afghanistan's participation in high-value trading with wholesalers in end markets.

Cut and Wash Assumptions	
Current: Production C&W-ed locally	5%
Goal 2015: Projected production C&W-ed locally	88%

- *Business models*: Two models of cut and wash businesses are likely to exist in Afghanistan.
  - Cutting and washing as part of a larger integrated carpet production facility.
  - Cutting and washing as a stand alone business that provides cut and wash services to producers for a fee.
- *Environmental protection measures*: The chemicals currently used for carpet washing are highly toxic. The development and enforcement of strict environmental guidelines should go hand-in-hand with the development of a local cut and wash sector in Afghanistan.

Projected change in location and value of the cut and wash cluster @ 5% annual volume growth ($ millions)



Massive growth in the local cut and wash sector should be accompanied with techniques and technologies that reduce adverse environmental impact.

Source: OTF research

Establishing Goals

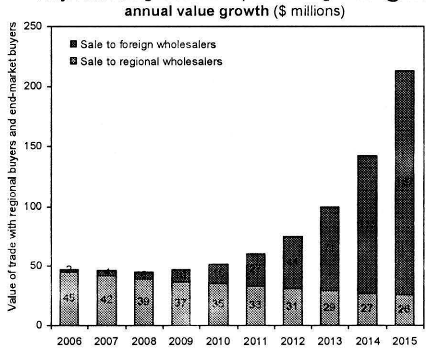
Cluster Goals: Capture More Value – End-market Sales

Forward integration into direct sales with wholesalers in end markets will be the major source of value growth for the Afghan carpet sector, mainly due to much higher sales margins.

Sales and Trading Assumptions	
Current: Volume sold to end-market buyers	5%
Goal 2015: Volume sold to end-market buyers	88%
Sales margins to end-market buyers compared to regional buyers	1.5-2 times

- Despite production volume growth of 5% annually, total cluster export value will grow by 11%. 6% extra growth is due to increased value capture through direct sales to end markets.
- However, this will require aggressive development and maintenance of end-market buyer contacts.
- Furthermore, it can be expected that increased end-market competition will lead to a downward pressure on prices.

Projected change in value capture through trade @ 11% annual value growth ($ millions)



Increasing end-market sales will require developing contacts with end-market buyers. Few Afghan producers currently have such contacts.

AA; OTF Group information; 2005

Establishing Goals
Cluster Goals: Summary

- Opportunities for growth are good, with the global carpet market making a rebound after a period of decline that began in 1999/2000.
- **Changes to the current mix of products** will be required as tastes shift and new carpet styles emerge. This will require a sophisticated design cluster that can develop new types of carpets to replace the current dominance of *Chob Rung* production.
- A combination of repatriation of weavers from Pakistan with increases in productivity and population growth can fuel **volume growth of 5% annually**. However, wages will have rise if the carpet sector is to successfully compete against other industries for labor.
- Increased use of local wool will lead to greater value capture for Afghanistan. Increasing current local input levels from about one-third to almost two-thirds of total production will require **growing sheep flock sizes by 16% annually**.
- The growth of the **cut and wash sector** will add limited increased value but is **vital to increasing sales to end-market customers**.
- Moving towards greater direct **trade with end markets** – where margins are higher – will be a key **driver behind sector-wide revenue growth of 11% annually**.

Establishing Goals
Cluster Goals: Summary

Goals	*Targets*
General	• Grow cluster export value at 11% annually. • Increase export value from $147 M in 2006 to $368 M by 2015.
Develop new products	• Revive exports of traditional Afghan carpets. • Develop new products to replace currently popular *Chob Rung* designs.
Repatriate production	• Maintain average volume growth of 5% annually. • Focus on increasing productivity and wages.
Capture more value: Wool	• Increase local wool content from 33% to 65%. • Invest in upgrading domestic wool sector and pasture.
Capture more value: Cut and wash	• Grow local cut and wash sector. • Develop more environmentally friendly washing practices.
Capture more value: End-market sales	• Increase end-market sales from 5% of total sales to 88% by 2015.

Agenda

- Introduction to the OTF Group & the Afghanistan Competitiveness Project
- Step 1: Situation Analysis
- Step 2: Establishing Goals
- **Step 3: Understanding Buyer Needs**
- Step 4: Articulating Market Positioning
- Step 5: Developing Action Guidelines
- Annexes

Understanding Buyer Needs
The OTF Group 5-Step Process for the Carpet Cluster

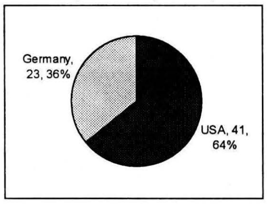
	Step 1 Situation Analysis	Step 2 Carpet Cluster Goals	Step 3 Understand Carpet Buyers' Needs	Step 4 Articulate Afghan Carpet Market Positioning	Step 5 Develop Action Guidelines
Analytical Agenda	• Export value estimated at >$140 M • Market: Increasingly competitive with top 5 buyers accounting for 70% of demand; prices moving downward • Domestic bottlenecks: Cutting and washing, access to finance, transportation, market knowledge and linkage • Differentiation: Important to build strong brand based on quality products	• Grow cluster export value at 11% annually; total export value of >$350 M by 2015 • Grow volume 5% • >80% of exports cut and washed in Afghanistan and sold direct to end-markets by 2015 • Develop new products • Increase productivity and raise wages • Increase local wool use from 33% to 65%	• Brand identity: product's aesthetics, quality of inputs, and value • Size matters more in the US; weave and price more in Germany • Afghanistan is well positioned with hand-knotted, naturally dyed carpets, such as *Chob Rung* carpets • Contemporary design market is an untapped opportunity	• Afghanistan should pursue a differentiation-based strategy • This will require concerted focus on developing a quality product (design, inputs, value) and fostering reliable, high-trust relations with buyers • A strong brand will be required to support this differentiation; labor issues will likely be important	• Afghanistan will likely pursue two production models: an Integrated Production Facility (IPF) and a Distributed Production Network (DPN) • Total NPV of 10 year cluster cash flow $84.8 M; required investment of $83.8 M • Public financing will be required to support market access, design diversification, and maintenance of cluster leadership institutions
Institutional Process	• Form and engage private-public cluster leadership group, the Afghanistan Carpet Committee • Agree on a working schedule with Carpet Committee	• Identify core cluster members of groups as well as subject matter experts • Build sense of shared vision within cluster • Initiate issue-specific working groups	• Form a research plan based on initial hypotheses • Leverage *OTF Insight* to conduct international carpet market research	• Use competitor findings to stimulate discussion around priority areas within cluster group • Involve all subject matter experts in clarifying potential issues	• Engage Afghanistan Carpet Committee in process of strategy vetting, buy-in and implementation • Lead a campaign to inform all stakeholders of strategy implication

Understanding Buyer Needs
Survey Objectives

Through better understanding the global carpet market, Afghan producers will be able to find and meet the demands of profitable, high-growth segments, and differentiate themselves from their competitors.

- Survey objectives:
  - Assess product attributes that are most important to carpet buyers, in terms of size, design, color, etc.
  - Clarify buyers' operational priorities.
  - Develop understanding of sourcing channels.
  - Compare Afghanistan as a supplier of carpets to other competitor countries.
- Target group:
  - Carpet wholesalers in the USA and Germany, the two largest handmade carpet markets.
  - Businesses for whom handmade carpets make up >75% of their sales.

Geographic location of respondents (Total 64)



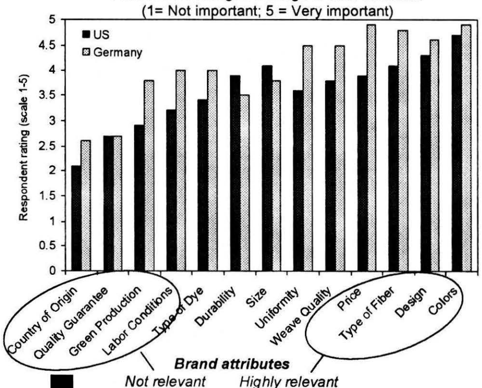
Drawing 64 respondents from a population of 260, there is a 90% chance that the measured value will be within +/- 8.94% of the value and a 95% chance that the measured value on question will be within +/- 10.66% of the value.

Understanding Buyer Needs
Product Attributes: Overview

Color, design, type of fiber, and price are the most important product attributes in both the USA and Germany. Carpet size matters more in the US while price and quality of weave matter more in Germany. Country of origin, quality guarantees, environmental and labor issues matter the least.

- Despite commonality in many areas (highlighted in diagram), there are some important differences between the US and German markets:
  - Size is the 3rd most important attribute in the US, but 9th in Germany.
  - Quality of weave ranks 5th in Germany, but 9th in the US.
  - Durability ranks 6th in Germany, but 9th in the US.
- It is common in the US for identical carpets to be produced in many different sizes, referred to as 'programmed carpets.' They are therefore sold not as unique products, but as standardized interiors items.
- Germany's emphasis on weave and uniformity, as opposed to size, indicates that oriental carpets are still purchased as original artisanal products, valued for the quality of the workmanship. However, this is changing: *"Carpets are becoming more of a fashion good and are not regarded as a traditional good anymore." – Wholesaler, Germany*

Most important product attributes
Ranked according to average of both countries
(1= Not important; 5 = Very important)



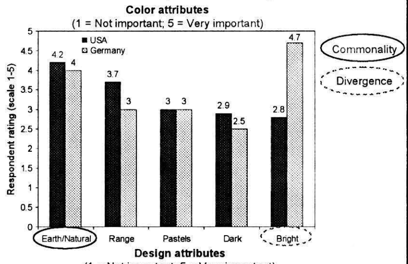
The product's aesthetics, quality of inputs, and value should form the foundations of a national carpet brand.

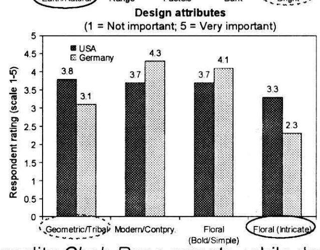
Understanding Buyer Needs
Product Attributes: Color and Design

Earth or natural tones are popular in both the US and Germany, as are contemporary designs and simple floral patterns. Both markets rate intricate floral carpets low, while differing considerably in their rating of bright colors.

US market
- Respondents rate earth/natural tones highly.
- Bright colors come in last.
- Tribal designs and both contemporary and simple florals are highly rated, while intricate floral designs do badly.
- Product implications:
  - Khazakhs and *Chobis* in natural dyes would do well.
  - There is an untapped opportunity in earthy contemporary designs, such as Gabbehs.
  - Intricate Kashmiri-type carpets are unlikely to be big.

German market
- Respondents rate earth/natural tones highly, like the US.
- But in contrast to the US, bright colors are by far the most popular.
- Both contemporary and simple florals are highly rated, while intricate floral designs do badly. Tribal designs come somewhere in the middle.
- Product implications:
  - *Chobis* in natural dyes would do well.
  - There is an untapped opportunity in contemporary carpets, in both bright colors and earth tones.



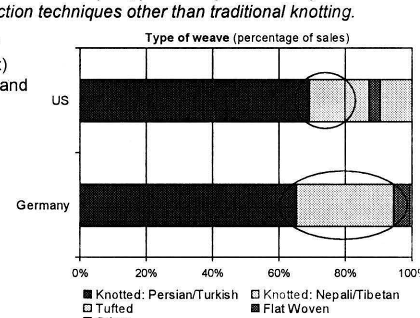


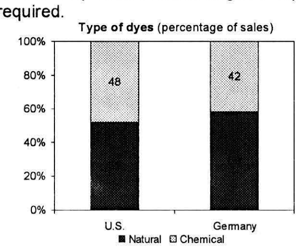
Afghanistan needs to maintain its production of good quality *Chob Rung* carpets, while developing capacity to enter the contemporary design segment through increased market learning.

Understanding Buyer Needs
Product Attributes: Type of Dyes and Weave

Demand for traditionally knotted, naturally dyed, carpets continues to be strong. However, there is a substantial market for Nepali/Tibetan knotted – often modern – carpets, particularly in Germany. Serving this niche will require learning different production techniques other than traditional knotting.

- OTF industry interviews in the USA and competitor research in India (the largest supplier to US market) indicate that the Nepali/Tibetan knotting technique and tufted carpets are fast growing segments.[1]
- This is linked to the popularity of contemporary carpets, for which intricacy of design that can be achieved by traditional knotting techniques is not required.





"The Afghan knotting style and industry is in a rut, staying comfortably within the same old groove. [Producers] are not prepared and willing to change these old habits and structures in order to apply more contemporary production techniques." – Wholesaler, Germany

The hand-knotted, naturally dyed carpet segment is being well served by Afghanistan. However, learning new production techniques will allow some producers to access good but comparatively new opportunities in the contemporary market segment.

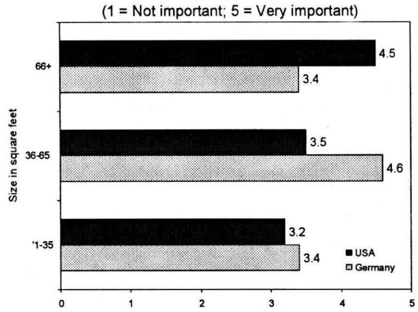
1. For example, a number of producers in India began tufted carpets around 2000, having exclusively produced knotted carpets. Tufted carpets now account for almost 50% of output for many

AA: OTF Group Information; 2005 52

Understanding Buyer Needs
Product Attributes: Size and Country of Origin

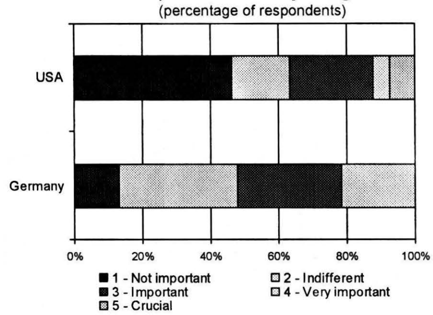
American consumers buy larger carpets. Buyers in both markets consider the country of origin to be of little consequence, though more so in the US.

Preferred sizes
(1 = Not important; 5 = Very important)



Customer quote: "In America size is important - European sizes do not work here (European 6'7" x 10' versus US 6' x 9 or 8' x 10' or ')."

Importance of country of origin
(percentage of respondents)



Increased use of vertical looms will improve Afghanistan's ability to produce the larger carpets demanded in the US. Surveyed wholesalers state that the carpet being woven in Afghanistan will lead to little tangible benefit.

Understanding Buyer Needs
Product Trends: "Customer Quotes"

Traditional carpets are losing market share to the contemporary segment. However, this is a difficult and high risk segment to serve. The demand for earth tones and natural dyes – a key element of Afghan production – remains strong.

"Changes are multiple:
- One trend is for vegetal dyed rugs, which the Afghans are very aware of and make now in beautiful designs.
- Another trend is toward tufted rugs, especially for the mass market, where the surface of the rug is difficult to distinguish from a fine hand-knotted rug.
- Another trend is toward modern designs with very simple patterns.
- And there always is the traditional rug buyer who will value the quality of the rug above everything else, though this is a diminishing market." – Wholesaler, USA

"More demand for modern, contemporary and simple designs. Earth and natural colors are becoming more popular." – Wholesaler, Germany

"More contemporary, vegetable dye and hand-spun wool." – Wholesaler/Retailer, USA

"More emphasis on contemporary designs and colors geared toward fashion [is required]. Red/blue are losing ground." – Wholesaler/Retailer, USA

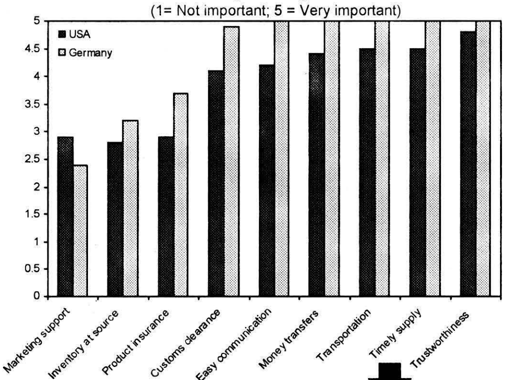
"There is always a steady market for classic designs and colors, which are well-made. The 'color du jour' market is very risky, as colors go out of fashion fast, ... become un-sellable, and get dumped onto the market at very low prices." – Wholesaler/Retailer, USA

The market is polarizing: "1. Very low end will be larger; 2. Very high end will be larger." – Wholesaler, USA

Understanding Buyer Needs
Operations: Buyer Requirements

Supplier reliability and ease of transaction are what matter most to buyers. Suppliers need not concern themselves with elements such as marketing, inventory or insurance management.

Operational priorities
Ranked according to average of both countries
(1= Not important; 5 = Very important)



What matters to buyers
"Customer Quotes"

"Reliability of producer is very important – [a] long-term trustworthy relationship is key." – Wholesaler/Retailer, Germany

"Quality of materials, honesty and reliability of supplier." – Retailer, USA

"The trustworthiness of the supplier and his understanding of the US market in terms of colors and designs." – Wholesaler, USA

"Good quality and design; reliability of the producer; adequate realization of [a] given order." – Wholesaler, Germany

"Protection of a contractor's designs [is important]. If I develop a design, I don't want it pirated ... which is common amongst Afghan weavers." – Wholesaler/Retailer, USA

There is no substitute for being an honest, reliable producer. However, much is also dependent on the enabling environment, in terms of transportation, banking and communication facilities.

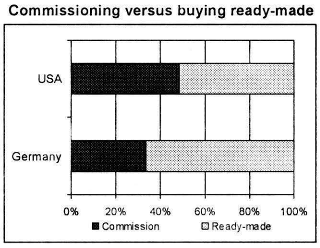
AA: OTF Group Information; 2005 55

Understanding Buyer Needs
Operations: Sourcing Channels

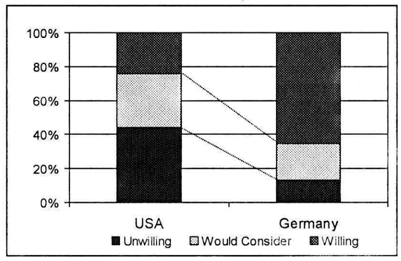
Almost half of US buyers commission their carpets. However, Americans are also less willing to travel to Afghanistan to source carpets than German buyers.

- About 70% of respondents source their carpets direct from producers, with the balance buying from wholesalers in the supplier country.
- Trade magazines and on-line sources are rated among the most common source of new carpet supplier contacts. Trade shows do not feature highly.

Commissioning versus buying ready-made



Willingness to travel to Afghanistan to source carpets



- *There is considerable reluctance by American buyers to even entertain the idea of sourcing carpets directly from Afghanistan.*
- *In contrast, over 60% of buyers from Germany say that they are willing to travel to Afghanistan to buy carpets.*

Reluctance of American buyers to travel to Afghanistan is problematic – particularly because they commission almost half of their carpets. Building their comfort with visiting Afghanistan will be key to capturing their business.

AA: OTF Group Information; 2005 56

Understanding Buyer Needs
Operations: "Customer Quotes"

The ability to produce high quality, 'programmed' carpets is key to succeeding internationally. This entails 'listening' to customers, developing highly customized products, and ensuring consistency of weave and supply.

"Never mind changing the carpets, just get the weavers to do what I order! Get them to ask questions until they understand what's required." – Wholesaler/Retailer, USA

"[We require] manufacturers [who are] open to/following our exact specifications for color, design, size, quality of materials and method of manufacturing." – Wholesaler, USA

"Production should be based on custom orders. [Producers] need to adjust production towards individuality to meet market demands." – Wholesaler, Germany

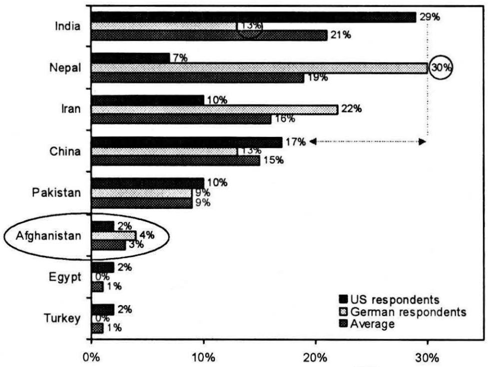
"Systematize production - produce 4-5 designs, 10-12 colors, and 20-25 sizes. Fill a container every 4 weeks and ship it out." – Wholesaler, Germany

"Proper finishing of the woven carpet [is key]. Half [the producers] won't spend that extra 5-10% [required]: dust, wash, shear, knot the fringes, and block the rug so it lies flat." – Wholesaler/Retailer, USA

Understanding Buyer Needs
Buyer Perceptions of Suppliers

India and Nepal enjoy strong reputations among buyers, with Iran coming in third. However, there are substantial differences in perception between markets.

Which country comes closest to being your ideal carpet supplier? (Percent of total respondents in each market)



Nepal is rated very highly in Germany, but comes in 5th out of 8 in the US.

There is a substantial gap between India's reputation and the second strongest, China, in the US.

Afghanistan rates very low. This may in part be accounted for by limited buyer familiarity with Afghanistan (due to limited exports in comparison to other major producers).[1]

Afghanistan rates poorly as a supplier. The challenge lies in addressing this, while an opportunity exits in that Afghanistan is still a little known exporter.

1. OTF discussion with buyers in the USA revealed limited knowledge of Afghan carpet production, other than traditional varieties from pre-conflict era.

Understanding Buyer Needs
Summary: General

- The product's **aesthetics, quality of inputs, and value** should form the foundations of a national carpet brand. According to wholesalers, focusing on 'unique Afghan attributes' is unlikely to have much traction.
- The data suggests that Afghanistan is well positioned with its production of hand-knotted, naturally dyed carpets. It should **maintain and continue to improve its production of high quality *Chob Rung* carpets**. However, traditional Afghan designs will have to be reinvigorated with more contemporary colors if sales are to rebound.
- The **contemporary design market is an untapped opportunity** for many Afghan producers, based on findings in our Situation Analysis. However, entering it will require extensive learning and technical support to producers for both design and production.
- The ability to faithfully produce high quality, 'programmed' carpets is becoming an increasingly important differentiator of carpet-producing countries. This entails **'listening' to customers, developing highly customized products**, and ensuring consistency of weave and supply.
- **Supplier reliability and ease of transaction are what matter most to buyers**. Afghanistan rates poorly as a supplier. The challenge lies in addressing this, while an opportunity exits in that Afghanistan is still a little known exporter.

Understanding Buyer Needs
Summary: Buyers in the USA

Product attributes

- Size matters. Increased use of vertical looms will improve Afghanistan's ability to produce larger carpets demanded in the US.
- Respondents rate earth/natural tones highly.
- Bright colors come in last.
- Tribal designs and both contemporary and simple florals are highly rated, while intricate floral designs do badly.

Market dynamics

- The US is getting polarized. Inexpensive tufted carpets are dominating the low- to mid-range segment. This is pushing hand-knotted carpets into the upper end of the market, where quality and not cost will be the key market differentiator.
- India, with a firm orientation towards programmed carpets, enjoys a reputation of being the 'ideal' supplier.
- Attracting buyers from the USA to Afghanistan will be very difficult, but is important in light of the high percentage of carpets that are commissioned. Participation at trade shows and arranging buyer-seller meetings as interim sales channels and confidence-building measures.

Understanding Buyer Needs
Summary: Buyers in Germany

Product attributes

- Respondents rate earth/natural tones highly, like the US.
- But in contrast to the US, bright colors are by far the most popular.
- Both contemporary and simple florals are highly rated, while intricate floral designs do badly. Tribal designs come somewhere in the middle.
- Price is important

Market dynamics

- Germans continue to buy carpets as unique artisanal products, but this is changing. Open question: Will quality of weave decline in importance and size grow, as is the case in the US?
- As a key supplier of contemporary carpets, Nepal enjoys a good reputation in Germany.
- Buyers from Germany are surprisingly willing to travel to Afghanistan. Concerted efforts to facilitate this will help to not only generate sales but also build Afghanistan's reputation as carpet buyer destination.

Agenda

Market Positioning

The OTF Group 5-Step Process for the Carpet Cluster

	Step 1	Step 2	Step 3	Step 4	Step 5
	Situation Analysis	**Carpet Cluster Goals**	**Understand Carpet Buyers' Needs**	**Articulate Afghan Carpet Market Positioning**	**Develop Action Guidelines**
Analytical Agenda	• Export value estimated at >$140 M • Market: Increasingly competitive with top 5 buyers accounting for 70% of demand; prices moving downward • Domestic bottlenecks: Cutting and washing, access to finance, transportation, market knowledge and linkage • Differentiation: Important to build strong brand based on quality products	• Grow cluster export value at 11% annually; total export value of >$350 M by 2015 • Grow volume 5% • >80% of exports cut and washed in Afghanistan and sold direct to end-markets by 2015 • Develop new products • Increase productivity and raise wages • Increase local wool use from 33% to 65%	• Brand identity: product's aesthetics, quality of inputs, and value • Size matters more in the US; weave and price more in Germany • Afghanistan is well positioned with hand-knotted, naturally dyed carpets, such as *Chob Rung* carpets • Contemporary design market is an untapped opportunity	• Afghanistan should pursue a differentiation-based strategy • This will require concerted focus on developing a quality product (design, inputs, value) and fostering reliable, high-trust relations with buyers • A strong brand will be required to support this differentiation; labor issues will likely be important	• Afghanistan will likely pursue two production models: an Integrated Production Facility (IPF) and a Distributed Production Network (DPN) • Total NPV of 10 year cluster cash flow $84.8 M; required investment of $83.8 M • Public financing will be required to support market access, design diversification, and maintenance of cluster leadership institutions
Institutional Process	• Form and engage private-public cluster leadership group, the Afghanistan Carpet Committee • Agree on a working schedule with Carpet Committee	• Identify core cluster members of groups as well as subject matter experts • Build sense of shared vision within cluster • Initiate issue-specific working groups	• Form a research plan based on initial hypotheses • Leverage *OTF Insight* to conduct international carpet market research	• Use competitor findings to stimulate discussion around priority areas within cluster group • Involve all subject matter experts in clarifying potential issues	• Engage Afghanistan Carpet Committee in process of strategy vetting, buy-in and implementation • Lead a campaign to inform all stakeholders of strategy implication

Market Positioning

Overview: Summary of World's Top Carpet Suppliers

Supply of handmade carpets is highly concentrated with the top 5 producers accounting for over 70% of the market. Competition between them is high.

	Iran: $391 M	Pakistan: $246 M	India: $148 M
Current state	• Considered the 'home' of handmade oriental carpets. • Iran's exports have revived since the US embargo was lifted in 2000. • Quality has declined as a result of: – Loss of design talent after the revolution – Erosion of competitiveness of traditional industries; result of dominance of the oil economy ("Dutch disease") • Carpets often sold direct to retail, as individual pieces.	• Approx. 60% of production was done by Afghans. • *Chob Rung* carpets drive most production, more of which are being produced in Afghanistan. • Major concern is that industry is migrating back to Afghanistan.	• Rated as 'ideal supplier' in US market, according to OTF survey. • Focuses on supplying variety of products and customized production. • Shifted to serving contemporary market over the past 5 years, coinciding with the re-entry of Iran to the US market. • Serving the contemporary market has led to the introduction of new production techniques.
Potential future direction	• Iran is resting on its laurels - ranking 3rd as an 'ideal supplier' of carpets, according to OTF wholesaler survey. • It has a reputation as a supply-driven producer, reluctant to incorporate market-driven designs. • *"They are way backwards, using pinks and blues and reds. They haven't changed to meet today's needs."* *– US carpet wholesaler*	• *Chob Rung* production keeps the market buoyant. • Pakistan maintains most direct contacts with buyers, and therefore all-important market linkages/information.	• Flexible industry, highly attuned to market shifts, increasing focus on 'programmed', customized carpets. • Increasingly catering to mid-to-low margin, high volume segment. • Some forward integration on direct-to-retail supply. • Increased production of *Chob Rung* carpets in response to recent demand.

Source: Data from Trade Map 2004; percentages show 2003-04 growth. Note: Data discrepancy exists between reported export values and import values. Exports form Iran may be between $300-500 M; India from $150-300. Data for Afghanistan's exports for 2004 from the Afghan Carpet Exporters Guild.

Market Positioning
Overview: Summary of Top 5 Suppliers and Afghanistan

	China: $121 M	Nepal: $100 M	Afghanistan: $149 M
Current state	• Strong reputation for price-quality value. • Predominant focus on tufted carpets. • Rising wages pushing China out of knotted carpet market.	• Relative new-comer to the industry, beginning in the 1950s with the influx of Tibetan refugees. • Nepali/Tibetan knotting techniques and designs well suited to contemporary market. • Fastest growing exporter to the US. • Enjoys strong reputation as 'ideal supplier' of carpets in Germany, according to OTF survey.	• Demand for traditional Afghan carpets has been falling over the past few years. • Most current production growth is from *Chob Rung* products – developed over the past 7-10 years in Pakistan. • Local consumption of handmade carpets has all but disappeared, weakening the industry's demand linkage.
Potential future direction	• Increasingly high quality machine-made carpets. • Wage increases will soon move China out of the hand-made and, potentially, tufted segments. • China is already becoming an importer of hand-made carpets.	• Continuing supply to contemporary segment. • Increased competition from India may push Nepal into the higher margin segment of the market.	• Reduction of trade through Pakistan, with more producers forming direct links with end-market buyers. • Cluster highly vulnerable to shifts in market trends. • *Chob Rung* keeps the market buoyant; no changes in current production planned.

There is considerable change occurring, with competition in the contemporary segment increasing, in particular among India and Nepal. China's potential gradual exit will likely be replaced by India, which is focusing on serving all product segments.

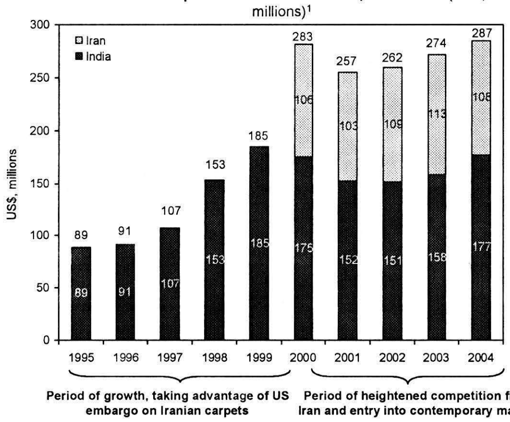
Source: *Ibid.*

Agenda

Market Positioning
Indian Carpet Cluster: Indian Exports to the USA

Filling the gap left by the US embargo on Iranian carpets, India has dominated the US carpet market for the past 10 years, doubling its sales over that period. However, it has lost market share to Iran which re-entered the US market in 2000.

Value of US Imports from India and Iran, 1995-2004 (US$, millions)[1]



Value of Carpet Exports from India in 2003 (US$, millions)[2]

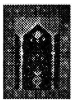
Importing country	% of sales
USA	56
Germany	17
UK	5
Canada	3
France	2
ROW	17

The US is India's most important market, accounting for over half of all exports

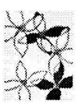
Source: 1. US International Trade Commission. 2. **Trade Map, Note: Data discrepancy exists, depending on data source. Indian exports reported at $91 M by Trade Map, while US imports from India reported at $158 M by USITC,**

Market Positioning
Indian Carpet Cluster: Carpet Production Centers

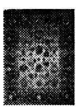
Different cities have different areas of specialization. Bhadoi is the main carpet producing center, producing the widest range of carpets, with the largest production facilities.



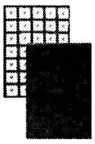
Kashmir
"For your exquisite silk carpets." [1]
- Intricate silk carpets.
- Little made-to-order production (due to long turn-around time).
- Supply constraints reported.



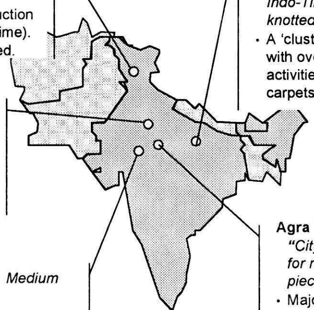
Panipat*
"For your contemporary fashion oriented tufted."
- Almost exclusively tufted carpets, both traditional and contemporary designs.



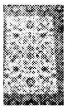
Jaipur*
"City of innovative styles. Medium and high qualities."
- Hand-knotted carpets.
- Approximately 10-15% are from high-twist, hand-spun wool, using what is referred to as 'Ghazni wool'.



Bhadoi*
"Great … for your cheaper yet fashion oriented hand-tufted, Indo-Tibetan and great hand-knotted of low & high qualities."
- A 'cluster' in the truest sense, with over 80% of the town's activities somehow related to carpets.[1]



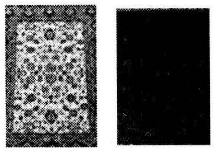
Agra
"City of natural vegetable dyes for recreation of your antique pieces"
- Majority of production is hand-knotted.
- Considered to produce lower knot count products.



* Research and site visits conducted by OTF in this production center (and surrounding area); June 2005. 1. Estimate by cluster members. 1. Quotations from web site of the Carpet Export Promotion Council, *www.indiancarpets.com*. 2. Some producers claimed to use actual Ghazni wool; others said it was unlikely to be from Ghazni.

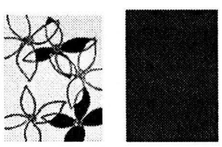
Market Positioning
Indian Carpet Cluster: Product Overview

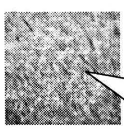
The market for hand-knotted traditional carpets has declined in recent years. Production has increasingly shifted to contemporary styles, coupled with high volume, low cost production.



Traditional carpets

- Individual producers reported declining total sales over the past 3-5 years, migrating out of traditional carpets into contemporary designs.
- Much remaining traditional production is for low knot counts.
- Therefore more people are producing tufted traditional carpets (see section below on weaving).





The popular 'shaggy' carpet' requires use of the Nepali knotting technique

Contemporary carpets

- High growth product. Despite lower margins, producers interviewed by OTF claimed that profits were up due to higher volume.
- Short product cycles of one year, requiring high levels of design and weaving innovation.
- Simple patterns mean that they can be produced using tufting or Nepali knotting techniques. Comparatively faster production allows for sale at lower price points.

Source: OTF producer interviews, India, June 2005.

Market Positioning
Indian Carpet Cluster: Inputs

Dying methods that are common in Afghanistan were phased out in India more than 20 years ago. Natural dyes are seldom used, though the same 'look' is achieved with chemical dyes.

Dying

- The vast majority of the industry uses chemical dyes. Natural dyes are used in Agra.
- Producers interviewed by OTF say that customers are not willing to pay price premiums for naturally dyed carpets, which sell at approximately 30% more.[1]

Wool prices

- Prices in India for low quality wool are better than in Afghanistan – where similarly priced wool may not be pure – but higher for higher quality wool .

India		Afghanistan	
N. Zealand	$5-6	N. Zealand	$4.50
Hand-spun 'Ghazni'	$5.40	Hand-spun Ghazni	$4.00
Local (good quality)	$3	Pakistani (poor quality)	$2.20-3
Local (poor quality)	$1.20	Iranian (poor quality/non-pure)	$1.50

Dying technique used in Afghanistan

Dying technique used in India

Automated wool cleaning

Automated wool dying

Dying techniques vary, however, for many producers they remain quite simple. Producers claim that adaptations on the method used in Afghanistan lead to more even wool coloring.

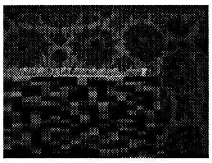
Although access to wool is often cited as a major issue in Afghanistan, the Afghan cluster is not poorly positioned with regard to its access to competitively priced inputs.

Source: OTF research. 1. Though natural dyes are not used, a natural dye effect is achieved in India. The degree to which producers in Afghanistan also use 100% natural dyes is not totally clear. Some have admitted to using chemical dyes, due to the high cost of natural dying (both input costs and the process).

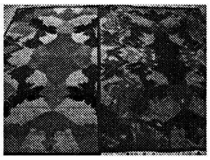
Market Positioning
Indian Carpet Cluster: Design – Overview

Indian producers are constantly changing designs and patterns to keep pace with changing consumer trends. Design is often the responsibility of full-time designers or the business owners themselves.

- Few producers interviewed produced carpets according to a very specific order or requirement. Design is interactive: customers set general guidelines, expect recommendations and ideas back from producers, and then agree on a final design and price.
- Some producers met by OTF have up to 5 full-time, professional designers on staff. Otherwise design is often the responsibility of the owner of the business.
- Large producers generate one new design every day, sending samples to buyers to test their interest.
- On average, only 1 out of 10 new designs initiated by producers end up going through to production.
- Production is being increasingly standardized, however, variety remains substantial. One producer produces 10-15 'qualities' (carpets made of similar inputs and of the same price), with 50-100 varieties for each.



Same color palette; different designs



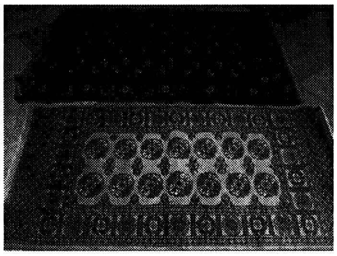
Design adaptations recommended to customer
L: Recommendation, R: Original

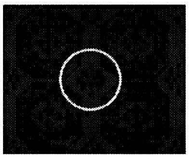
Source: OTF research.

Market Positioning
Indian Carpet Cluster: Design – Transforming Tradition

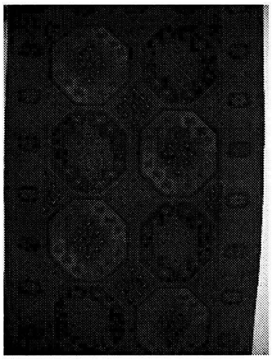
India does not restrict itself to traditionally Indian designs, but is quick to adopt and adapt designs from different parts of the world, creating interesting and potentially saleable products in the process.

The top carpet is an older carpet – a classic Turkmen-Afghan carpet in traditional colors. Below is a new Turkmen-Afghan design, woven in India, with the use of more contemporary colors.[1]





A traditionally Afghan motif (above), often used as a secondary 'gul' on Suleman designs, is incorporated into a flat-weave kilim in more contemporary colors (right).



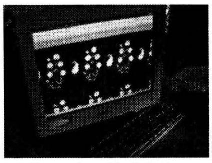
If Afghanistan is to capitalize on its rich carpet tradition, it will require greater design flexibility and adaptation to meet the fast-changing needs of modern carpet buyers.

1. Quotation by US carpet wholesaler/retailer: "[Afghanistan requires] more emphasis on contemporary designs and colors geared toward fashion. Red and blue are losing ground."

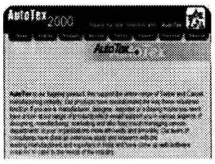
Market Positioning
Indian Carpet Cluster: Design – Producer Quotes

Indian producers strongly emphasize the importance of design capabilities, and the ability to constantly change with shifting market trends.

- "India is totally different [from Afghanistan]. We plan designs: size, colors, patterns."
  – Carpet exporter, Varanassi
- "You have to keep changing, or you cannot exist in the industry."
  – Carpet producer, Badhoi
- "The creative thing is a must."
  – Carpet producer, Badhoi
- The Americans want changes ... always changes."
  – Carpet producer, Jaipur



Computer-aided design (CAD) technologies are commonly used, along with traditional hand-drawn 'cartoons'



India is far ahead of Afghanistan on design. Afghanistan will have to begin by increasing its direct contacts with end-market buyers – to improve the flow of market information.

Source: OTF research.

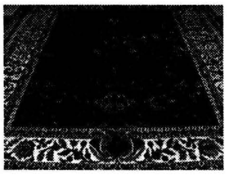
Market Positioning
Indian Carpet Cluster: Weaving – Tufting

Tufting is becoming a popular production technique. It allows for a variety of patterns and is suitable for mid-range traditional carpets and fast-changing contemporary designs.

- Cheap to produce, tufted carpets sell wholesale for between \$16-\$24 per m^2 for a low to mid-range carpet.
- A high-end tufted rug that wholesales for \$38/m^2 would sell for the equivalent of \$130/m^2 if it were knotted (see picture, bottom right).
- Unlike knotted carpets, quality is not measured by the number of knots, but by the weight of the inputs used per m^2.[1]
- Technology limits design intricacy, however, this is less of an issue for bold/simple contemporary designs. Also, producers are becoming better able to produce relatively intricate traditional designs through tufting.
- Tufted carpets have a limited life of about 5-7 years. However, this is not an issue with contemporary designs which have are changed more regularly, or if the carpet is about one third the cost of a traditional carpet.
- China is considered India's the main competitor in this product segment.

  "The big threat is that in America people don't even know about handmade. It is all design."

  - Carpet producer/wholesaler, Badhoi



Traditional tufted carpet with artificial silk. Sells wholesale for \$38/m^2. The equivalent knotted carpet sells for \$130/m^2.

Aside from being appropriate for the contemporary segment, tufting is also beginning to dominate the mid-to-low traditional segment, increasingly replacing knotting.

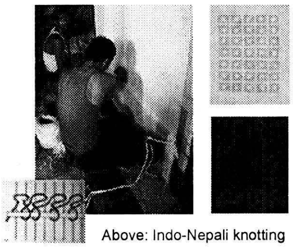
Source: OTF research. 1. 2 kgs of tufted carpets is equivalent to 100 knots per sq. inch (or 40 knots per 10 cms), which usually requires between 3-4 kgs of wool.

Market Positioning
Indian Carpet Cluster: Weaving – Nepali Knotting and Handloom Weaving

Indo-Nepali knotting and handloom weaving limit design intricacy. However, they are appropriate for contemporary designs, and last longer than tufted carpets.

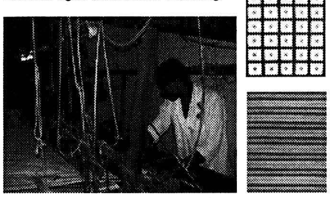
- Cheap to produce due to the high speed knotting technique. They last longer than tufted carpets, and do not require acrylic backing to hold knots in place.
- Loops and cut-loops, created by wrapping pile around metal rods, allow for variety of textures and effects.
- Designs intricacy is even more limited than with tufted carpets. Though this is less of a concern with contemporary designs.
- Rapid production allows for handloomed carpets to wholesale for between $7-14 /m^2.

"Indo-Nepali is the future."
- Producer of traditional knotted carpets, Jaipur



Above: Indo-Nepali knotting

Bottom/right: Handloom weaving



Learning alternative knotting techniques is key to being competitive in the contemporary hand-made carpet segment.

Source: OTF research.

Market Positioning
Indian Carpet Cluster: Weaving – Traditional Hand-knotting

The hand-knotted segment is struggling in India. Workers are shifting to the tufting industry – or other industries altogether – where wages are higher.

- Producers of traditional knotted carpets interviewed by OTF are migrating out of the segment, or at least reducing their product dependence on knotted carpets (if they are able to).
- There is increased interest in 'Chobis' – India's equivalent to Afghanistan's *Chob Rung* carpets, made with high-twist, hand-spun wool. Though seldom naturally dyed, they are given 5 washes to produce an antique/natural look.
- Example of recent changes in the traditional knotted segment:
  - IDEAL Carpets, producing since 1975.
  - 2000 began tufted carpets; tufted now 50% of output (in value).

Tufted 50%		Knotted 50%	
Modern 40%	Traditional 60%	Indian 70%	'Chobi' 30%

Indian hand-knotted carpet producers are beginning to aggressively targeting a key Afghan product line - the *Chobi*.

Producer quotes

- *"The overall picture is not so promising." – Knotted carpet producer, Jaipur*
- *"Just we are surviving because we don't have options to do anything else." – Knotted carpet producer, Jaipur*

Wholesale carpet prices per m^2

Quality	Indian knotted	'Chobi'
Medium	$62	$86
Med-high	$83	$97
High	$102	N/A

- *"Afghani-look is more popular: high twist and more tufted wool." – Knotted carpet producer, Jaipur*

Source: OTF research.

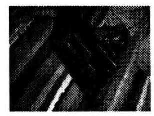
Market Positioning
Indian Carpet Cluster: Cutting and Washing

Carpet cutting and washing is similar to Afghan methods. However, technological innovations have been introduced – some simple, others more substantial. Prices are generally lower, approximately one-third of what is paid in Pakistan and/or Afghanistan.


Afghanistan


India

- Cutting machinery is similar to what is commonly used in Afghanistan.
- The introduction of a flat plate helps to maintain a more even shearing.



- Cooler weather in some carpet producing areas in India requires the use of carpet drying machinery.
- Similar technologies are particularly appropriate for Afghanistan's main production centers in the north.

Left: Drying machine

Below: Drying chamber

Afghanistan will have to introduce new technologies – like those used in India – as it develops its local cut and wash sector.

Source: OTF research.

Market Positioning
Indian Carpet Cluster: Branding

India is positioning itself as the carpet producer able to provide the market's complete range of products, producing customized carpets to meet any buyer's needs.

- India is positioning itself as the single-source carpet buyer destination, covering the full range of handmade carpet products. It is also increasingly positioning itself as a high volume, low cost supplier.

  "You have it all here in India. Source your carpets in India." – Carpet Export Promotion Council, www.indiancarpets.com

- It is unlikely that the Afghan carpet sector can position itself similarly, as it does not offer the same degree of variety and scale.
- The use of child labor became an industry-wide concern in 1995. However, according to Care & Fair, India, children account for no more than 1.5% of carpet industry-related labor.
- Other than the use of child labor, labor issues in general are increasing concerns. Environmental standards are also gradually receiving greater attention by producers.

Producer quotes

- *"The child labor issue is very much important." – Carpet producer/wholesaler, Bhadoi*
- *"They are very much concerned with child labor. If they even see a child on your looms they will cancel all your order." – Carpet producer, Bhadoi*
- *Environmental issues are a "very serious issue for LDCs. The key fight will be starting now." – Carpet producer/wholesaler, Bhadoi*

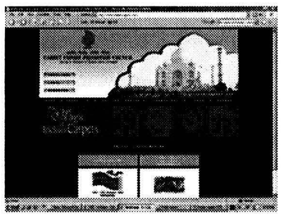
Afghanistan will have to develop a more focused brand identity than India. Addressing labor issues in some measure will have to form a part of this.

Source: OTF research.

Market Positioning
Indian Carpet Cluster: Institutional Support

There are a number of institutions that support the carpet cluster. Most of their activities involve trade promotion and research and development.

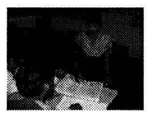
Above: Carpet fair
Below: Child-free label



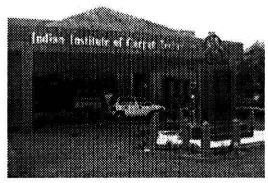
- Government organization that represents carpet exporters.
- Main activity entails arranging international carpet fairs (rotating through different production centers in India).
- Manages child-free production 'Kaleen' label.

INDIAN INSTITUTE OF CARPET TECHNOLOGY (IICT)

- Public organization that provides knowledge and innovation services to the carpet sector.
- Offers 4-year degree on carpet design and production, among other training.
- Fee-based technical and consulting services offered to producers.



Above: Carpet design class at IICT



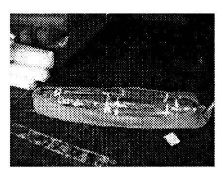
Afghanistan's carpet cluster will require institutional support at a level at least equal to India. This will require substantial public financing.

Source: OTF research.

Market Positioning
Indian Carpet Cluster: Company Profile

Oriental Weavers, located in Panipat, sells the majority of their carpets direct to retailers. This heightens compliance pressure with workplace codes of conduct, enforced by their customers.

- Beginning as wool processor, Oriental Weavers now produces only tufted and handloomed carpets, with a capacity of 60,000 square feet a month.
- 75% of their output is sold to retailers. Many retailers conduct unannounced site visits to ensure compliance with a number of supplier requirements. These include:
  - No child labor
  - Good lighting
  - Fire safety measures
  - Access to first aid in workplace
  - Availability of worker healthcare and housing.
- Drivers behind Oriental's success:
  - Ensuring reliable production and maintaining high quality
  - Staying on top of trends
  - Maintaining good buyer relations.
- Next main push: aggressive marketing



Carpet ready for shipping direct to US retailer. Includes retailer's shop-floor labeling, printed by Oriental in India

Producer quotes

- *How to succeed in the carpet market: "After luck and God, it is honesty, sincerity and relations with buyers."*
- *"Domotex and all does make a difference."*

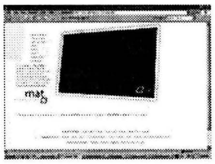
Source: OTF research.

Market Positioning
Indian Carpet Cluster: Company Profile

MA Trading are focusing their strategy on selling direct to retailers. A major component on which the success of the strategy rests is developing a strong brand that will help to differentiate their products.

- MA Trading have been in the carpet business for 3 generations. Migrating out of traditional designs 12 years ago, they concentrated on Gabbehs, particularly from 1995-98. They now focus exclusively on the contemporary market.
- Their main thrust is to sell direct to retailers. The main focus for direct-to-retail sales is the US, which is currently only 10% of their market (the remainder being Europe).
- In time they plan to do the same in Europe, their main market, converting their wholesalers into their distributors.
- Building their own brand is a key part of this strategy. It will be one of the main means by which they differentiate themselves from other Indian producers. They are aggressively building their brand identity, exhibiting at 10-15 carpet fairs per year.

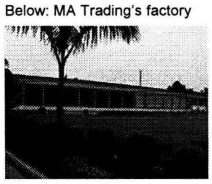
  "The wholesalers are just selling their brand. They are not producing anything themselves."
- MA has 5 in-house designers, and over 500 of their own designs. They are focusing on a standardized catalogue, doing less custom carpets for particular clients.
- They see their main threat coming from machine-made carpets. Machine-made quality is improving, and producers are able to produce lower quantity runs of a particular design than previously, offering more flexibility.



mat THE BASICS

Above: MA Trading's web site and brand

Below: MA Trading's factory



Source: OTF research.

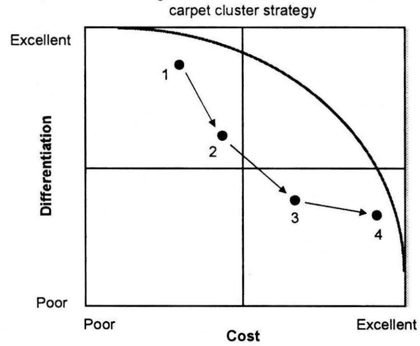
Market Positioning
Indian Carpet Cluster: Strategic Shifts

All businesses must make a simple choice about how to compete in the market: compete on producing goods and services more cost-effectively than their competitors, or compete based on providing a unique product or service to which their customers attach a higher value (and so are willing to pay higher than average prices).[1]

- It is possible to roughly plot where a business – and by extension a cluster – lies with regard to its strategic choices.
- The Indian carpet cluster has been moving increasingly towards a cost-focused strategy, as opposed to a differentiation-based strategy.

1. 16th century. Production of highly exclusive carpets in Mugal courts. New designs introduced, blending Persian and Indian artistic traditions.
2. 19th century. Factory production for European markets. Mainly English-owned.
3. 1980/90s. Production for global markets. New knotting techniques introduced.
4. Late 90s, early 2000s. High growth in the contemporary segment, with increased focus on tufted carpets.

India's gradual transition to a cost-based carpet cluster strategy



The red line depicts the 'productivity frontier.' Competitive firms are positioned close to this frontier, doing an excellent job at either cost-effective production or product differentiation, or a very good job at a mix of both.

Source: OTF research; **"Oriental Carpets : A Complete Guide,"** Murray L. Eiland, Murray Eiland III, 1998.

Market Positioning
Indian Carpet Cluster: Summary

The Indian carpet cluster is active and aggressive, acutely aware of the high level of competition in the global carpet market. Its strategic position is increasingly shifting towards high volume, low costs production, of a wide variety of carpets.

- The Indian carpet sector is sophisticated. Discussions with producers focused on market trends, product design, marketing and branding, and forward integration.
- Producers are acutely aware of competition in the carpet market – which is very high – and aggressively develop responses to market shifts.
- Focus is increasingly moving to high volume, low cost production:
  - Many producers are moving out of hand-knotted carpets into hand-tufted carpets and the Nepali weaving method.
  - Knotted carpets are generally mid-range/quality.
- Contemporary designs account for much recent growth, while the traditional segment has been largely flat.
- Because contemporary designs do not have a long life, people are not willing to pay a lot for them. This further pushes towards the use of quick and cheap production technologies.

Agenda

Introduction to the OTF Group & the Afghanistan Competitiveness Project

Step 1: Situation Analysis

Step 2: Establishing Goals

Step 3: Understanding Buyer Needs

Step 4: Articulating Market Positioning

- Overview
- Indian Carpet Cluster
- **Contrasting China and Nepal**
- Afghanistan's Potential Trajectory

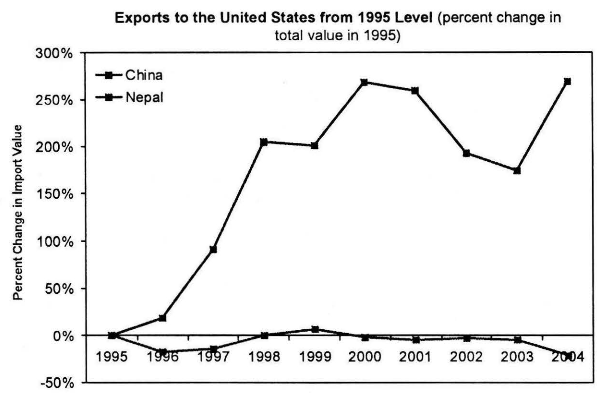
Step 5: Developing Action Guidelines

Annexes

Market Positioning

Contrasting China and Nepal: Overview

Both China and Nepal have been experiencing declining sales globally over the past few years. However, their sales to the US have differed substantially: Nepal's sales have exploded while China's have been shrinking.



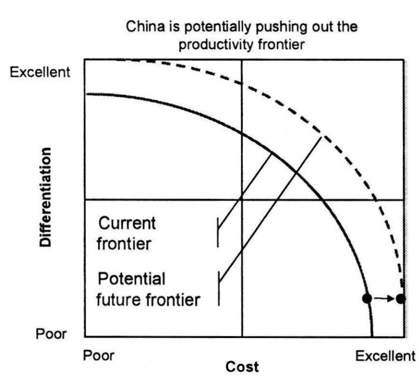
Source: US International Trade Commission

Market Positioning

Contrasting China and Nepal: China

With rising wages, China is moving out of the hand-knotted carpet business. The majority of its production is in the tufted segment, where it is India's main competitor.

- China has a reputation for producing high quality, well priced, handmade carpets.
  "What you order is what you get."
  – US importer in reference to Chinese carpets
- However, rising wages are forcing China to transition out of the hand-knotted carpet segment where it cannot remain competitive.
- The majority of its production is in the tufted carpet segment, where it is India's main competitor.
- China is also beginning to produce good quality machine-made carpets, competing in the mid-market segment.
- By introducing low-cost, good quality machine-made products that compete directly with handmade carpets, China could potentially be pushing out the productivity frontier, making it harder for handmade carpet producers to compete on cost alone.



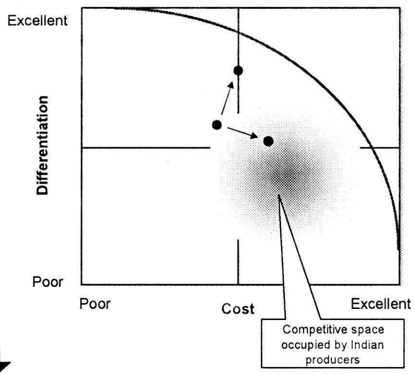
As in many sectors, low cost production in China is increasing competitive pressures across the industry. Carpets is no exception.

Market Positioning
Contrasting China and Nepal: Nepal

After a turbulent past few years, the Nepali carpet cluster is at a cross-roads: some producers are focusing on quality in an effort to differentiate themselves from Indian production, while others are continuing a low-cost strategy. Nepal's general brand is helped some exclusive producers – often foreign owned – that have established production there.

- Despite strong growth in exports to the US, the Nepali carpet cluster experienced substantial decline since 1998, leading to the closure of up to 50% of its carpet businesses.
- This was a result of:
  - increased competition in the same segment from India
  - economic decline in Germany, Nepal's main market.
- The industry is rebounding, showing higher export value growth than quantity growth, reflecting a greater focus on quality.
- However, contemporary tufted carpets from China are emerging as a new, and potentially large, threat.
- A number of key carpet designers/producers from the US have established production in Nepal, building the general brand of Nepali carpets. They include Odergaard and Tufenkian.

Nepal has a choice to either differentiate itself from India or to compete directly on cost



Nepal has a choice: focus on quality or compete head-to-head with India on cost. It is unclear which path the majority of the cluster will chose.

Source: www.nepalreserach.org; OTF interviews with producers.

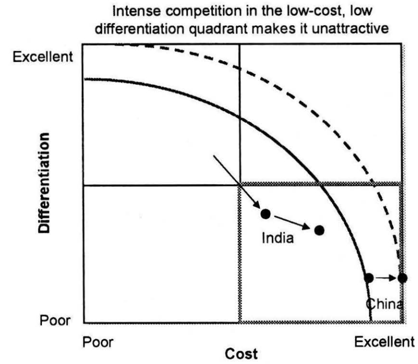
Agenda

Market Positioning

Afghanistan's Potential Trajectory: Avoiding the Mid-Range Market

India is moving to the middle of the market, competing on a mix of design innovation and cost-effectiveness. Afghanistan is unlikely to be able to compete against India in these two areas in the near term.

- The Indian carpet cluster is a dynamic and innovative competitor – many years ahead of Afghanistan.
- Afghanistan is not likely to be able to match India in the mid-range of the market in terms of volume, variety and cost.
- Competition is also further increasing with the introduction of good machine-made carpets from China, which may be pushing out the productivity frontier.
- The weak business environment in Afghanistan is less supportive of efficient production than many other countries, therefore cannot support a low cost strategy.[1]
- This forces the strategic choice that the Afghan carpet cluster can make, precluding businesses from pursuing a low-cost strategy as the base of their competitive advantage.
- This is not altogether a bad thing. Strategies that focus on low cost production can lead to a downward pressure on wages. This is particularly problematic for labor intensive industries, such as carpets.



Afghanistan cannot succeed in the near term with a cost-focused strategy. This requires it focus on differentiation as the basis of its competitive position.

For example, according to the World Bank, Pakistan has ten times more road coverage than Afghanistan, and India has 30 times that number.

Market Positioning

Afghanistan's Potential Trajectory: Focusing on Differentiation

Focusing on the higher end of the market plays to Afghanistan's natural strengths in terms of good quality inputs and a tradition of carpet weaving. However, particular attention to quality will be required, as well as increased investment in building design capacity.

- Pursuing a differentiation-based strategy will require extensive education among all producers of customer needs.
- This will require a focus on both the product and business interaction with buyers:
  - *Product.* Dedication to the product's aesthetics (design and color combinations), quality of inputs and buyers' perception of value for money.
  - *Business interaction.* Developing a reputation for honesty and reliability.
- This will require substantial institutional capacity, in terms of:
  - Education about demand
  - Ability to create designs that respond to demand
  - Support services to facilitate buyer interaction.
- A strong brand will be key to supporting Afghanistan's differentiation. This will help separate its *Chob Rung* production from Indian imitations. Addressing labor issues – for which neither India and Nepal were sufficiently prepared in the past – should be an important element of the brand creation.[1]

Will the current system of distributed production at the village/household level be able to support a differentiation-based strategy that is focused on quality and reliability?

1. Labour and environmental issues did not feature prominently as concerns among buyers surveyed by OTF. However, research among producers suggests that these are important issues that need to be addressed. This is likely to be more so in premium segments.

Developing Action Guidelines
Agenda

The OTF Group Five Step Change Process
Overview: The Way Forward for the Carpet Sector

	Step 1	Step 2	Step 3	Step 4	Step 5
	Situation Analysis	Carpet Cluster Goals	Understand Carpet Buyers' Needs	Articulate Afghan Carpet Market Positioning	Develop Action Guidelines
Analytical Agenda	• Export value estimated at >$140 M • Market: Increasingly competitive with top 5 buyers accounting for 70% of demand; prices moving downward • Domestic bottlenecks: Cutting and washing, access to finance, transportation, market knowledge and linkage • Differentiation: Important to build strong brand based on quality products	• Grow cluster export value at 11% annually; total export value of >$350 M by 2015 • Grow volume 5% • >80% of exports cut and washed in Afghanistan and sold direct to end-markets by 2015 • Develop new products • Increase productivity and raise wages • Increase local wool use from 33% to 65%	• Brand identity: product's aesthetics, quality of inputs, and value • Size matters more in the US; weave and price more in Germany • Afghanistan is well positioned with hand-knotted, naturally dyed carpets, such as *Chob Rung* carpets • Contemporary design market is an untapped opportunity	• Afghanistan should pursue a differentiation-based strategy • This will require concerted focus on developing a quality product (design, inputs, value) and fostering reliable, high-trust relations with buyers • A strong brand will be required to support this differentiation; labor issues will likely be important	• Afghanistan will likely pursue two production models: an Integrated Production Facility (IPF) and a Distributed Production Network (DPN) • Total NPV of 10 year cluster cash flow $84.8 M; required investment of $83.8 M • Public financing will be required to support market access, design diversification, and maintenance of cluster leadership institutions
Institutional Process	• Form and engage private-public cluster leadership group, the Afghanistan Carpet Committee • Agree on a working schedule with Carpet Committee	• Identify core cluster members of groups as well as subject matter experts • Build sense of shared vision within cluster • Initiate issue-specific working groups	• Form a research plan based on initial hypotheses • Leverage *OTF Insight* to conduct international carpet market research	• Use competitor findings to stimulate discussion around priority areas within cluster group • Involve all subject matter experts in clarifying potential issues	• Engage Afghanistan Carpet Committee in process of strategy vetting, buy-in and implementation • Lead a campaign to inform all stakeholders of strategy implication

Developing Action Guidelines

Overview: Key Strategic Drivers

The focus of the carpet strategy is to increase volume – through both repatriating production from Pakistan and increasing production in absolute terms – and build the ability of the Afghan carpet cluster to enter in to higher margin trade through selling directly to end-market buyers.

- Building production capacity in Afghanistan will require considerable private financing. Initially, the majority will come from internal resources and form informal channels. As the formal banking sector in Afghanistan matures, more financing is expected to come from commercial sources. The ability to do this will be dependent on a strong supporting cluster of financial intermediaries.
- It is also dependant on selling at higher price points. At interest rates of approximately 15%, carpet businesses cannot afford to borrow from commercial sources. This will require forward integrating to direct-to-end-market sales.
- Increasing access to end market buyers will require time and patience. It will require building a network of potential buyers and then building buyer confidence – one buyer at a time – through meeting *and exceeding* their expectations. This will require market intermediaries who can assist carpet businesses overcome language and technology barriers.
- Direct buyer access will also require sophisticated buyer interaction and dialogue on design. Buyers expect suppliers to not only faithfully reproduce designs that they commission, but also suggest changes to existing designs or new designs altogether. This will require more sophisticated design capacity than currently exists in Afghanistan.
- The investment required to undertake the carpet strategy will have to be assumed by carpet businesses themselves, and is therefore built into the business model on which the financial projections are based. There is a minimal role for public financing envisaged.

Developing Action Guidelines

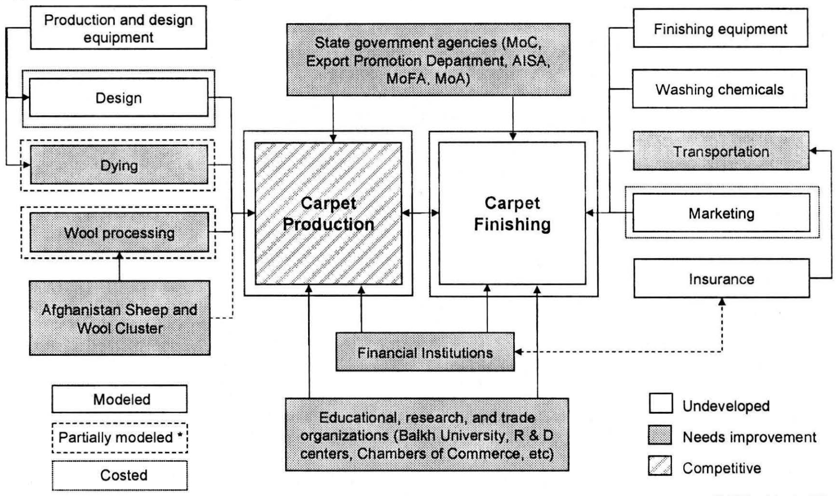
Overview: Support Services

The Afghan carpet cluster can – and should – upgrade its capacity with a limited degree of public support in the form of direct subsidies or freely provided services. The higher profit margins which Afghan carpet producers will enjoy as a result of selling directly to end markets can be reinvested to build their capacity, particularly with regard to design and marketing.

- While most costs can be assumed by the private sector, the costs of certain cluster-wide initiatives are not likely to be borne by private firms, at least not initially. Some will have to be fully subsidized and others partially subsidized, with the subsidy declining in time as their usefulness is demonstrated (with increasing costs borne by private firms).
- Three forms of subsidy are proposed:
  1. Complete/full subsidy, where no private contribution is required for the duration of the activity, such as a cluster-wide marketing and branding campaign.
  2. Full-declining subsidy, where in all costs are covered in year one, but the subsidy is phased out by 10% per year over 10 years, such as the hiring of technically skilled staff to manage trade delegations.
  3. Half-declining subsidy, where in half of the costs are covered in year one, but the subsidy is phased out by 10% per year over 5 years, such as booth rental at trade fairs.
- The majority of the services that are being proposed can be contracted to private firms. It is not necessary that public organizations build their internal capacity to be able to provide them. However, general oversight and coordination will be required. This role should be served by the Afghanistan Carpet Committee.

Developing Action Guidelines
Overview: Identifying Investment Needs

Many of the elements of the carpet cluster can be subsumed into a single carpet production and finishing process. There is a high degree of interest among the Afghan carpet cluster to take such an approach, creating integrated production facilities under one roof.



* Only for hand-spun wool, modeled as integral part of carpet production.

AA: OTF Group Information: 2005 95

Developing Action Guidelines
Overview: Modeling Different Degrees of Centralization

Two models of carpet production are likely to reside side-by-side in Afghanistan: a factory-based model where up to 50% of the weaving is done on site; and a distributed production network where most elements of production are outsourced, from weaving to finishing.

- For the purpose of simplifying the cluster-wide financial model, the two production models – the Integrated Production Facility (IPF) and the Distributed Production Network (DPN) – are treated quite distinctly and with distinct characteristics.
- The cluster model is based on the assumption that all new production capacity is from IPFs. Though this is likely to be the case for the majority of new production, this will not be the case for all. All current production is attributed to the DPN model; which is the case for the overwhelming majority of current production.
- Further simplification occurs with regard to treatment of inputs. The use of hand-spun wool is limited to production by IPFs while machine-spun wool is limited to DPNs. In reality, both models will use a mix of the two, depending on individual producers' carpet product lines.

AA: OTF Group Information: 2005 96

Developing Action Guidelines
Overview: Modeling Different Degrees of Centralization (cont'd)

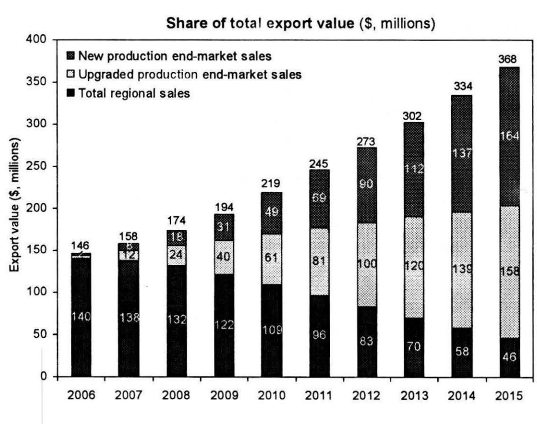
The core assumptions on which the IPF and DPN models are based are summarized below.

	Assumptions for Integrated Production Facility (IPF)	*Assumptions for Distributed Production Network (DPN)*
General	• Improved quality management and design capacity at facility will allow for development of products that command price premiums.	• Decreased ability to closely manage quality as a result of distributed production will likely lead to reduced price premiums. However, considerably less investment is required.
Production volume and growth	• Accounts for all projected volume growth (5% per annum).	• Accounts for all current production. • Gradual migration to increased end-market trade.
Wool spinning and dying	• Hand-spun wool. • All natural dyes.	• Machine-spun wool. • Natural and chemical dyes.
Carpet designing	• Complete in-house design capacity.	• In-house designers focused primarily on end-market production.
Carpet weaving	• 50% conducted at on-site weaving campus. • 50% contracted out to household level. • Wages increase by 1% annually	• All contracted out to household level. • Wages increase by 1% annually.
Cutting, washing and finishing	• In-house at production facility.	• Only for end-market sales. • Building C&W capacity is main DPN investment cost.
Transportation	• Contracted out.	• Contracted out.
Marketing	• Higher competition leads to acquisition cost increase of 20% per annum.	• Marketing costs incurred only for portion of sector that is migrating to end-market trade.
Sales	• Prices are 2x current prices, but fall 1% per annum due to increased competition.	• End-market sales migration at 10% per annum, accounting for all current production by 2015. • End-market prices are 1.5x current prices, but fall 1% per annum (does not apply to legacy production).

AA: OTF Group Information: 2005 97

Developing Action Guidelines
Building Production Capacity: Value Share of End-market Sales

Investment efforts will focus on production for direct to end-market sales. This will come from a combination of new capacity of IPFs and redirecting current DPN capacity towards end-markets. The latter will require investing in a local cut and wash sector, as well as greater spending on design and marketing.



1. NPV discount rate of 20%. Total NPV includes all production; separate DPN NPV is only for cashflow of upgraded capacity. 2. Multiple of current export sale price to regional buyers.

TOTAL	
NPV[1] of cluster cash flow	**$84.8 M**
Total investment	**$83.8 M**
Integrated production facility 5% volume growth	
NPV[1] of IPV cashflow	$31.5 M
Investment	$48.2 M
Price assumption[2]	2 times
Distributed production network 10% volume 'conversion'	
NPV[1] of upgraded DPN cashflow	$45.6 M
Investment	$35.6 M
Price assumption[2]	1.5 times

Note: DPN models require less investment by business owners because looms are housed by weavers. Business owners in effect pass down investment costs (land and buildings) to workers, despite them being less able to bear such costs.

98

Developing Action Guidelines
Building Production Capacity: Production Investment

Financing for increased manufacturing capacity and upgrading of current production can feasibly come from commercial sources. However, the ability of carpet producers to sustain local interest rates of approximately 15%[1] is dependent on the ability to export directly to end-markets and sell for prices between 1.5 to 2 times of what they currently sell for. At current price points, they cannot afford commercial loans.

New capacity (IPF)		
Plant (including land)	$33.1 M	2006-2015
Equipment	$15.1 M	2006-2015
Marketing and promotion	$2.6 M	2006-2015
Current capacity upgrade for end-market trade (DPN)		
Plant (including land)	$21.7	2006-2015
Equipment	$13.9 M	2006-2015
Marketing and promotion	$4.4 M	2006-2015

1. The financial models on which this section is based were developed using an interest rate of 15%, the average commercial lending rate in Afghanistan.

AA: OTF Group Information: 2005

Developing Action Guidelines
Building Production Capacity: Finance and Land Challenges

Access to land and access to investment capital are two of the largest barriers faced by the Afghan carpet cluster.[1] Both of these have to addressed as top priority issues to meet the required production capacity investment.

Access to finance

- The majority of Afghanistan carpet producers have no experience in raising financing from formal banking channels.
- The ability of the carpet cluster to access financing from the commercial banking sector is therefore dependent on a cluster of effective business intermediaries (or business development service providers).

Access to Land

- None of this investment will be undertaken by businesses unless they are assured secure land title. While the development of industrial parks provides a good mid-term solution, it is not sufficient to meet existing demand.
- Increasing access to government land with secure title appears the only additional alternative while private title is being documented.[2] This will require developing clear and transparent processes to purchase and/or lease land.

1. Access to land and access to finance are ranked the 2nd and 4th most pressing business barriers according to the World Bank's investment Climate Survey. 2. According to estimates by the Emerging Markets Group, documenting existing land title and developing a title management system in Afghanistan may take 10 years.

Developing Action Guidelines
Cultivating Market Linkages

Forward integrating into direct to end-market sales is a major strategic imperative for the Afghan carpet cluster. The ability to do so successfully will depend on easy access to working capital, the ability to grow and maintain a network of buyers, and reliable transportation links.

Working capital

- All new production capacity through IPFs is targeted at direct sales to end markets. It is envisaged that existing DPN capacity will be gradually upgraded – at a rate of 10% of current volume a year – to be able to finish carpets in Afghanistan and sell direct to end-markets.
- This will create substantial demands for working capital, estimated to average $7.6 M a year between 2006 and 2015. Unless these demands are met, Afghan producers will not be able to disengage themselves from regional buyers, who supply working capital through advance payment on orders.

Buyer access and intermediation

- While the security situation in Afghanistan remains precarious, buyers will be reluctant to travel to Afghanistan. Afghan carpet producers will have to instead travel to their buyers. This should include trips to core markets as well as international trade fairs, such as DOMOTEX in Germany and the Atlanta Fair in the US.
- Cultivating and maintain relationship with buyers will be challenging for the Afghan carpet cluster. Few producers speak English and even less are on-line. Ensuring access to people who are conversant in English and computer literate, to serve as market intermediaries is crucial. Such capacity will have to be hired in-house or contracted through business service providers.

Transportation

- As a heavy non-perishable good, transportation by sea is imperative for carpets. The main sea routes available are through Karachi, and partially through Bandar Abbas. Guaranteeing the right of transit of Afghan carpets through Pakistan is therefore critical the to ability to deal directly with end-market buyers.

Developing Action Guidelines
Cultivating Market Linkages: Support Services

The majority of marketing costs are internalized into individual firms' cost structures. These will average $680,000 per year cluster-wide. But, public financing will be required for certain cluster initiatives, such as national branding campaigns and consortia coaching services.

	Total cost / Type of subsidy	Time period[1]
Consortia participation at trade fairs	$615,000	2006-2015
• Management and coaching	Full, declining	2006-2015
• Afghanistan carpet booth	Half, declining	2006-2010
Brand development	$800,000	2006-2015
• Strategy and brand development	Full	2006 & 2011
• Implementation	Full	2006-2015
Afghanistan carpet exhibition	$75,000	2008-2015[2]
• Professional management services	Half, declining	2008-2011
Marketing Total	**$1.5 M**	2006-2015

1. The time period refers to the period over which subsidy payments are required. The activities will run beyond the subsidy period, with the exception of full (non-declining) subsidy activities. 2. Holding a carpet exhibition in Afghanistan should be delayed until buyer comfort with travel to Afghanistan increases.

Developing Action Guidelines

Innovating to Differentiate: Firm Spending and Support Services

Buyers rate color and design as the most important attributes of a carpet. As the Afghan carpet cluster deals directly with end-market buyers, it will have to build its knowledge of fast-changing design trends, and incorporate them into their product development. Currently, much of this is done by regional buyers.

- Buyers expect suppliers to not only faithfully reproduce designs that they commission, but also suggest changes to existing designs and propose new designs altogether.
- This will require considerable investment in market learning and design, such as hiring professional designers who can assess and respond to market trends.
- Stimulating this kind of private investment can be supported through limited public expenditure. Examples may include: design courses and study tours (initially partially subsidized); an annual carpet design contest and award; publishing a directory (or 'yellow pages') of independent carpet designers.

	Total cost / Type of subsidy	Time period
Design innovation support	$200,000	2006-2015
• Design contest	Full	
• Designer directory/yellow pages	Full	
Training	$603,000	2006-2015
• In-country courses	Half, declining	
• External study tours		
– Management and support	Full, declining	
– Participant subsidy	Half, declining	
Design and Training Total	**$803,000**	

Developing Action Guidelines

Managing Public Relations: Support Services

Managing relations with Pakistan will be important as the carpet sector shifts back to Afghanistan and as direct competition intensifies.

- Publicizing investment and partnership opportunities for Pakistani businesses can help to reduce the threat of a competitive backlash.
- Coupled with this, Afghanistan will have to aggressively manage its image with regard to labor issues, in particular as they relate to gender dynamics and the use of child labor.

	Total cost / Type of subsidy	Time period
Competitor Campaign	$90,000	2006-2010
• Strategy development	Full	2006
• Implementation	Full	2006-2010
Customer Campaign	$130,000	2006-2010
• Strategy development	Full	2006
• Implementation	Full	2006-2010
PR Total	**$220,000**	2006-2010

Developing Action Guidelines
Ensuring Sustainability

The rents that accrue to the carpet cluster as a result of higher margin trade with end-markets must not only go to business owners. Wages paid to weavers should also increase. Also, negative environmental externalities should also be reduced by enforcing private investment in safeguards.

Raising wages

- Though gainfully employed, carpet weavers live close to the poverty line. However, as a labor-intensive industry, the carpet cluster is sensitive to wage increases. Wage increase of between 6-10% per year would not be sustainable beyond 2015.
- However, wages will have to increase to not just improve the lot of weavers, but also if carpet producers are to be able to compete with other economic sectors for limited labor.
- However, the ability to support wage increases is dependent on selling at higher profit margins to end-market customers.

Environmental sustainability

- Wool dying and carpet washing both result in the discharge of toxic water. Good practice guidelines developed by the National Environment Protection Agency (NEPA) recommend the development of settling ponds to separate the toxins form the water before it is discharged.
- The investment cost of such environmental upgrades are not substantial, so can be absorbed by the businesses themselves (and built in to the business model on which cluster growth projections are based).
- Incentives of partially off-set some of these costs may help to ensure compliance in the absence of NEPA enforcement capacity.

Developing Action Guidelines
Ensuring Sustainability: Institutional Leadership

The successful implementation of the carpet strategy is dependent on leadership and oversight. There must be continued pressure to address issues of access to finance and land. Furthermore, the public spending required to support carpet businesses needs to be coordinated.

- The Afghanistan Carpet Committee was set-up in mid-2005. A public-private leadership body, chaired by the Ministry of Commerce, the Carpet Committee meets to address and develop solutions to business barriers faced by the carpet cluster.

AFGHANISTAN CARPET COMMITTEE

- The Carpet Committee should continue to play a leadership and coordination role in supporting the implementation of the carpet strategy. As most of the strategy is driven by private investment, the Committee's role will mainly be to highlight investment bottlenecks and monitor progress.
- The Carpet Committee should be responsible for securing financing for cluster support services. Implementation of support activities should be outsourced to specialized service providers. The Committee will nonetheless be required to play a supervisory and coordination role.
- It is envisaged that the Afghanistan Export Promotion Agency will serve as a secretariat for the Carpet Committee.

Developing Action Guidelines
Monitoring Strategic Progress: Indicator Dashboard

Tracking progress on the implementation of the strategy, and assessing the degree to which the strategy is leading to an increase in the quantity and value of carpets produced in Afghanistan, requires the regular collection and analysis of data. This should be coordinated by the Afghanistan Carpet Committee.

	Near-term indicators	*Mid-term indicators*
Production investment	• New production (IPF) – Number of facilities per year – Total capacity (m^2) • Upgraded production (DPN) – Number of facilities per year – Total capacity (m2) • Commercial financing – Number of business plans written – Number of business plans financed – Total commercial financing approved	• Total exports – Value – Quantity
Cultivating market linkages	• Trade fair participation – Total number of participants (first-time and repeat) – Sales made / new contacts generated – Satisfaction rating (average score) • Branding strategy complete (Y/N) • Afghanistan Carpet Exhibition held (Y/N) • Transit agreement with Pakistan agreed (Y/N)	• Total exports – Average price • Direct sales to end-markets – Quantity – % of total exports (m2 and value) – Average price

Developing Action Guidelines
Monitoring Strategic Progress: Indicator Dashboard (cont'd)

	Near-term indicators	*Mid-term indicators*
Innovating to differentiate	• Trade fair participation – Total number of participants (first-time and repeat) – Satisfaction rating (average score) • Afghanistan Carpet Design Contest held (Y/N) • Designer directory updated annually (Y/N)	• Total exports – Average price
Managing public relations	• Labor strategy complete (Y/N) • Competitor strategy complete (Y/N)	
Ensuring sustainability	• Weaver wage increase (%) • Total investment in environmental upgrades – Total annual investment – Capacity of NEPA-complaint facilities (m2)	• Average carpet weaver monthly wage
Institutional Leadership	• Number of general meetings held • Number of workgroup meetings held	• Satisfaction rating (average score)

Agenda

Introduction to the OTF Group & the Afghanistan Competitiveness Project

Step 1: Situation Analysis

Step 2: Establishing Goals

Step 3: Understanding Buyer Needs

Step 4: Articulating Market Positioning

Step 5: Developing Action Guidelines

Annexes

Annex 1
Priority Initiatives: Analyzing the Clusters' Seven Forms of Capital

Addressing the constraints faced by the carpet cluster requires addressing short-comings or a lack of investment across a variety of different types of capital, both physical and social. Understanding the carpet cluster's position across seven key forms of capital can help to guide the choice of near-term initiatives to begin undertaking.

Category	Current State	Desired State	Initiatives
Cultural	• Widespread intrinsic appreciation for carpets. • High levels of entrepreneurship.	• Create stronger appreciation for satisfying market demand.	• Outreach campaign on competitiveness and global carpet trends.
Human	• Strong tradition of carpet weaving to draw from. • Discipline to develop high quality carpets varies. • Though the majority of weavers are women, very few women are involved in other value chain activities. • Future human capital base of the cluster, and the country in general, being eroded by poor labor conditions and child exploitation.	• Wide spread understanding - from weavers to producers - of market need and production changes required to meet it. • Training available to develop new production techniques, from dying to designing to weaving. • Women are involved in all stages of carpet production, particularly in lucrative trading, • Fair labor conditions. Weavers (including children) have access to good healthcare and education opportunities.	• Develop guidelines for carpet quality improvement, that lead to higher incomes for weavers. • Develop program to increase women's ability to trade carpets through increased access to capital and improved market knowledge. • Develop program to improve labor conditions. • Build carpet brand that is focused on labor issues (incl. child labor).
Knowledge	• Virtually no market knowledge, with most production based on age-old designs or imitation of newer patterns. • No institutions exist to develop new designs and techniques.	• Defined ideas about market segments, distribution channels, and how to access them. • Well equipped R&D facilities to lead design innovation and improve production quality.	• Market research on promising target markets such as the US, as well as potential new niche markets. • Initiate innovation generation and new carpet designs.

: Priority Initiatives

Annex 1
Analyzing the Clusters' Seven Forms of Capital (cont'd)

Category	Current State	Desired State	Initiatives
Institutional	• Virtually no institutions that support the cluster. • The Afghan Carpet Exporters Guild is little more than a 'bean counter.' • Very few institutions to provide market linkage and intelligence.	• Voluntary, transparent, market-driven quality control and branding institutions. • Associations that bring together actors throughout the value chain to share information and increase collaboration, particularly supporting producer-market linkage.	• Develop a transparent , independent, institution to monitor product quality. • Increase capacity of Afghan Carpet Exporters Guild to conduct and communicate market research and analysis. • Improve direct producer access to buyers.
Financial	• Only large producers have access to financial capital. • Vacuum is filled by Pakistani traders, who therefore dominate the Afghan carpet trade.	• Access to working capital on terms appropriate to non-formal nature of carpet contracts. • Variety of lending instruments available to suit needs of different size businesses.	• Engage financial institutions with specific ~~business opportunities~~. • Assist donors and the commercial banking sector to design appropriate financing mechanisms (with particular emphasis on women's access).
Manmade	• As a cottage industry, the carpet sector is comparatively less reliant on manmade capital. • Limited water inhibits processing (wool scouring and cutting & washing). • Transportation options are highly limited.	• Improved access to water is combined with promotion of water management techniques. • Multiple, reliable, transportation options available to traders, by air, sea, land.	• Research water management techniques and provide funding to support water management best-practices. • Improve existing transportation links, including direct air transport and transit through Pakistan.
Natural Endowments	• High quality wool available, though supply is limited. • Climate not amenable to washing and drying in main carpet producing areas.	• Steady supply of high quality wool with continual flock enhancement. • Development of techniques to overcome climatic constraints without compromising quality.	• Draft business plans to invest wool processing • Support cut and wash facilities to build capacity and introduce drying technologies.

: Priority Initiatives

AA: OTF Group Information: 2005 111

Annex 1
Priority Initiatives: Summary

- Increasing **access to cut and wash facilities** in Afghanistan will enable Afghan producers to export finished products as Afghan and not Pakistani carpets. Demand for local cutting and washing access is high. Addressing constraints in local cut and wash capacity – investing in upgrading existing businesses' facilities and financing the development of new ones – is an important initiative that the carpet cluster can undertake now.

- Building **contacts with end-market buyers** is vital if Afghanistan is to move in to higher margin trade. This will take time, effort and resources. Participating at international trade fairs is a good potential channel for Afghan carpet producers begin building a network of international buyers and learn about global carpet market trends.

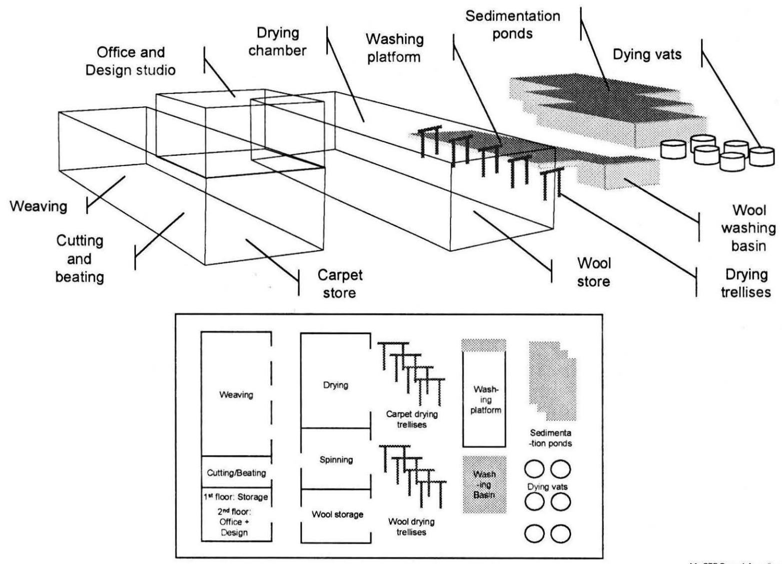
- Conducting in-depth **market research** will provide the necessary understanding of where Afghan carpets are positioned relative to their key competitors, and where they should be positioned in the future. As part of this effort, an initiative to encourage **indigenous new designs** should be launched, focusing on developing designs that are responsive to current market trends.

Note: The ACP supported the implementation of all of the above quick-win initiatives as part of its support efforts for the carpet cluster between April 2005 and June 2006.

112

Annex 2

Sample Integrated Production Facility



AA: OTF Group Information; 2005 113