Ministry of Commerce and Industry

Implementing the SME Strategy

Action Plan for Developing Afghanistan's Cashmere Sector

February 2011 - January 2013

Contents

Acronyms

AISA	Afghanistan Investment Support Agency
ACCI	Afghanistan Chamber of Commerce and Industry
EPAA	Export Promotion Agency of Afghanistan
MAIL	Ministry of Agriculture Irrigation and Livestock
MOCI	Ministry of Commerce and Industry

Introduction and Bound

The Government of Afghanistan's SME Strategy was finalised in December 2009[1]. The Strategy aims to encourage pro-poor growth by creating jobs in rural areas which have largely missed out on the booming economy which has long characterised Afghanistan's major cities.

The Strategy analysed SME sectors and, using the following criteria, identified those which should be given priority for assistance:

- Domestic private firms have already entered them spontaneously;
- The sector is labour-intensive and has a strong rural presence;
- The sector's current growth rate either in Afghanistan or globally is high;
- The barriers to entry are low;
- Necessary raw materials are easily accessible in Afghanistan;
- Many of the skills needed to be competitive in the industry already exist;
- The technology requirements are either moderate or Afghanistan has the ability to introduce the technology quickly and cost-effectively;
- Afghanistan has the ability to compete across multiple parts of value chain;
- Afghanistan has the potential to move up the value chain;
- They produce tradable goods and services that have been produced for about 20 years in similar dynamically growing countries – particularly neighbouring ones; and
- Afghanistan is likely to have a competitive advantage

OBJECTIVES OF THE SME STRATEGY

Drive the economic prosperity of Afghanistan

- SMEs with under 300 employees make up 80-90% of Afghan businesses
- SMEs generate over 50% of GDP and employ ~75% of labour force
- Nations such as Pakistan or Singapore have shown that SME development is critical for job creation and poverty reduction

Pursue SME growth, job creation, formalisation

- Because of high unemployment rate (~40% and growing) job-creation and growth critical
- Policies must also reduce costs and increase the benefits of formalisation
- Increased formalisation will help the SME sector grow and increase government revenues, which in turn should promote further growth

Create ~1M jobs & ~$3B dollars of GDP by 2016

- The targets are ambitious but attainable and needed for rapidly growing population

Increase the role of women in SMEs

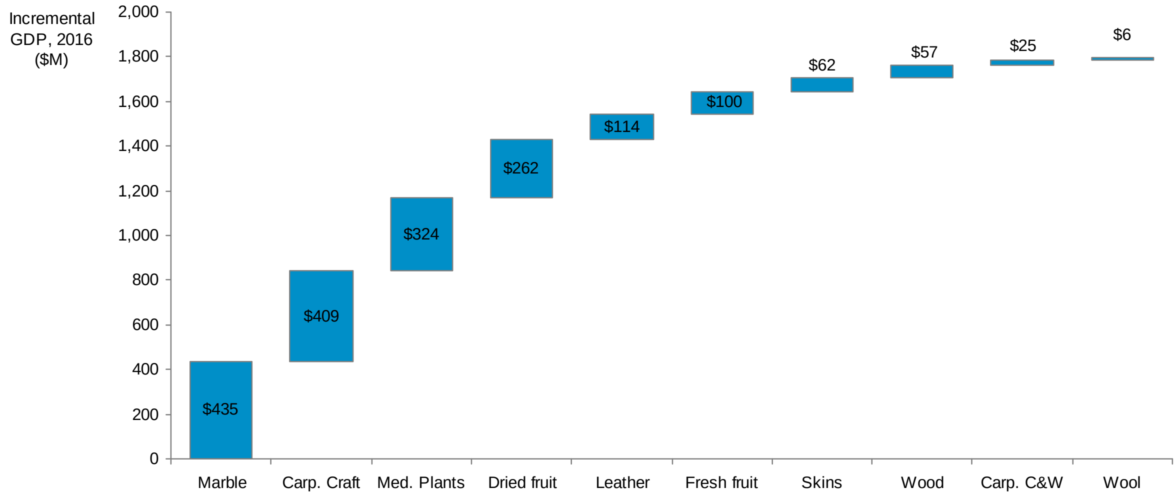
- Women already play a major role in Afghan industries, such as agriculture and carpets and embroidery, but receive limited benefits.
- Policy thus must prioritise female-intensive sectors (such as carpets and embroidery) and improve the benefits women receive

The industries that emerged from this process as being highly attractive include:

- Processing wool (including cashmere), carpet weaving, cutting, washing and trading
- Marble quarrying, cutting, polishing
- Gem stones mining, cutting & polishing and jewellery
- Livestock skins and leather
- Construction
- Wood, timber and carpentry
- Agri-processing

[1] This was done with the assistance of ASMED and USAID

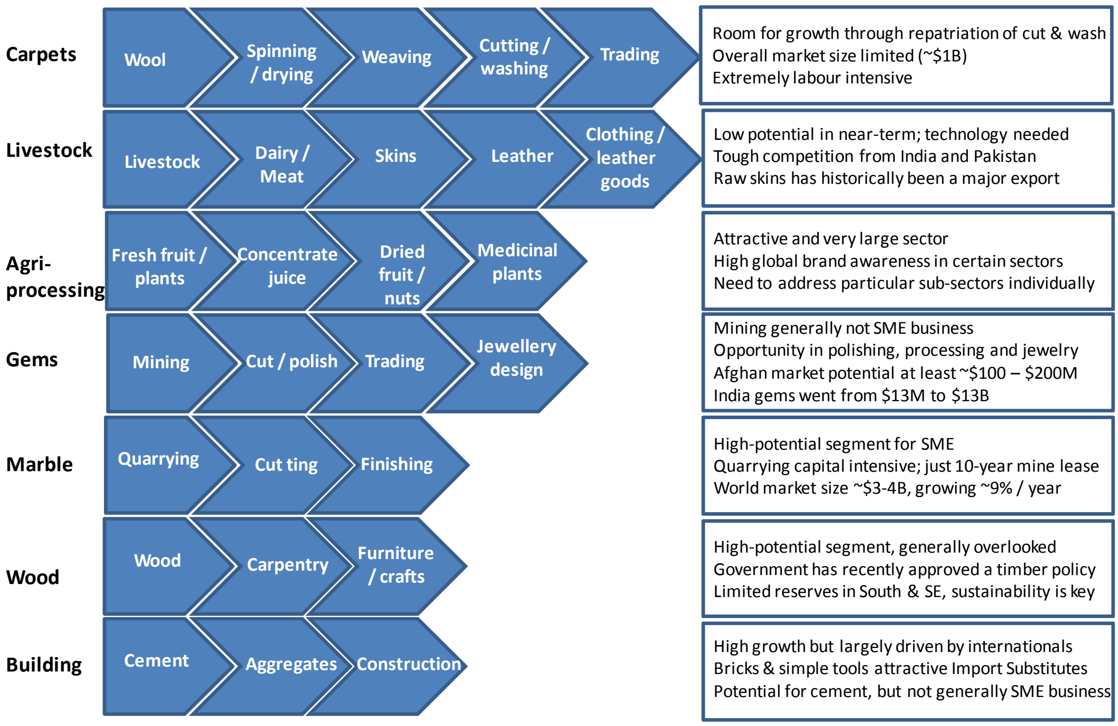
Figure 1: Potential incremental GDP by sector in Afghanistan (2016)[2]



	Marble	Carp. Craft	Med. Plants	Dried fruit	Leather	Fresh fruit	Skins	Wood	Carp. C&W	Wool
09-16 CAGR - status quo	0%	20%	20%	20%	0%	20%	20%	0%	5%	20%
09-16 CAGR - target	70%	30%	50%	25%	50%	30%	30%	25%	60%	25%
Job potential (K)	15	200	150	100	20	50	20	15	6	2

Afghanistan is already internationally competitive in some parts of these sectors and it is likely to be able to successfully move up the value chain.[3]

Figure 2: Value chain opportunities across key sectors



Souce: ASMED's SME Strategy

[2] MOCI, SME Policy, 2009. Figures based on sector reports, interviews, &ASMED assumptions
[3] 'Value chain' refers to the linked set of activities within a supply chain that actively add value to the end product.

Currently, there is untapped potential in the value chains of Afghan products, with Pakistan and other regional neighbours benefiting from much of the more profitable activity further up the value chain (manufacturing, packaging, trading, marketing, etc.).

Principles

Given an adequate enabling environment and a stable security situation, the private sector would, left to its own devices, eventually create a vibrant, high-value cashmere industry. However, in a post conflict country, such as Afghanistan, it is highly likely that the sector will not take advantage of opportunities to move up the value chain in a timely fashion in areas where at lower levels it is successful. This is due to a weak, risk averse private sector, with limited access to capital, not much recent exposure to innovation and the possibilities opened up by technology, a suspicion of the outside world and low capacity in some critical areas.

The challenge faced by the government and the donor community is how they can expedite rather than retard the expansion of the cashmere sector. In light of this, interventions will only take place in line with the following principles:

FOUR KEY ROLES FOR GOVERNMENT IN SME DEVELOPMENT

- ***Policy maker*** **– Develop a national and regional SME policy which will identify priority sectors for SME development and address the major needs of each of those sectors, especially in financing, capacity building, and infrastructure**
- ***Facilitator*** **– Remove obstacles, bureaucracy and market inefficiencies that inhibit SME growth**
- ***Regulator*** **– Ensure that the competitive environment for SME growth remains strong, and that the many forces that influence their growth (government, SMEs, trading partners, etc.) contribute to that environment**
- ***Coordinator*** **– Help align organisations (donors, NGOs, associations, etc.) that are already working to promote SMEs**

1. Donors and government must not crowd out private sector involvement and investment

Apparent opportunities need to be examined critically to see if there is a plausible answer to why the private sector is unable or unwilling to exploit these opportunities. If there is no sensible answer - and no plausible theory about how the government is able to assist the private sector to exploit these opportunities - then the government should not intervene. In light of this, this Action Plan calls for further investigation in a number of areas to see whether this rationale exists or whether the government is better advised to partner with the private sector, or step aside.

2. Due consideration must be given to incentives and service delivery channels

Even where there is a plausible answer as to why the private sector is unable or unwilling to exploit opportunities in a timely manner, before acting, consideration should be given to seeing whether

USING THE PRIVATE SECTOR TO IMPROVE PRODUCTIVITY IN FISH FARMING

In Bangladesh, the government traditionally sought to improve the productivity of fish farming through extension services under which public servants provided advice to farmers. Unfortunately extension service officers had few incentives for good performance and a dysfunctional working culture prevailed.

An analysis of the private sector and the incentives faced by it showed that private input suppliers (such as nurseries) had a commercial incentive to provide useful advice to farmers as a means of improving their performance and of differentiating what they did from their competitors. They were provided with information on improving client productivity which they pushed out with spectacular results.

government can act to change the incentives faced by the private sector enabling it to deliver the required goods or services. There should not be a presumption that Government is the answer; often adjusting the incentives faced by the private sector, or utilising their expertise and existing service delivery channels will deliver a more cost-effective solution.

3. Due consideration must be given to public-private partnerships

Even where changed incentives will not deliver a solution, because bringing private sector experience and skills to bear on a problem being faced by an industry or sector is often critical to the development of effective solutions, a private public partnership may be a better course of action than government provision or intervention. As a result, due consideration will be given to this as a possible option.

4. Government must plan appropriately for its exit from the stage

As the capacity of the private sector increases, government will face a further challenge: knowing when to step aside. It may be that by underwriting investment in a move up the value chain, the Government is able to reduce the uncertainty associated with that investment, enabling the private sector to confidently invest in similar projects. At this point, government should cease its direct involvement and seek to play a supporting role.

5. Government must maintain its enabling environment role

Creating an enabling environment is the key role of government. Other areas where government action may be warranted include:

- Transfer of skills and knowledge;
- Reducing uncertainty, and consequent risk;
- Capturing externalities; and
- Provision of public goods.

Objectives of the Cashmere Action Plan

In addition to the general objectives for the SME Strategy set out above, the objectives of the Cashmere Action Plan are to:

1. Move the industry up the value chain through repatriating key parts of the value chain from neighbouring countries;
2. Increase processing of raw cashmere fibers;
3. Enable producers to earn higher prices for raw fibres;
4. Create a significant number of sustainable jobs;
5. Reduce the cost of high quality inputs for the regional/national carpet/textiles sector;
6. Create the conditions in which there may be an opportunity for the private sector to move further up the value chain into weaving of yarn.

Afghanistan's Action Plan for its Cashmere Sector has been developed jointly by the ministries that have a role in developing this sector. It was finalised after extensive consultation with stakeholders including donors, the private sector and industry associations.

The intention behind this document is to improve clarity, accountability and coordination between stakeholders by setting out a comprehensive plan of support for this sector including specific actions and associated deadlines.

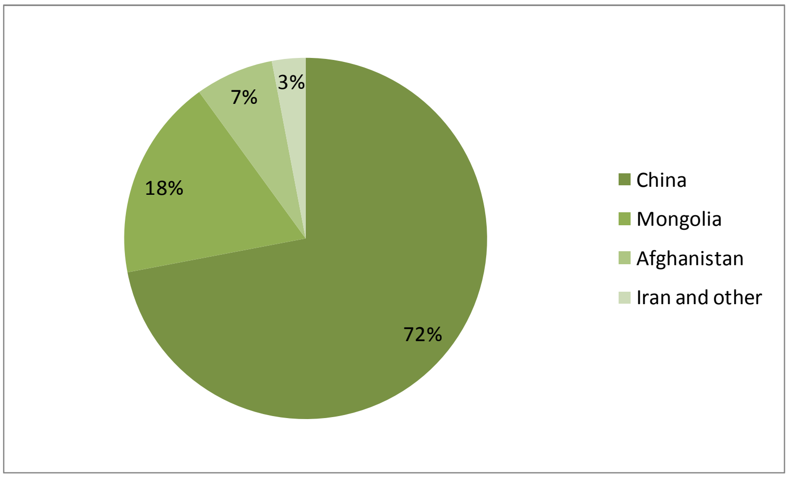
Progress against it will be assessed quarterly and while the Action Plan lasts for two years, it will be reviewed periodically to ensure that it remains relevant and includes emerging issues and the government's proposed response to them. This sector Action Plan will then be formally revised in January 2013.

Background to Cashmere

Cashmere is the fine soft-haired undercoat of the cashmere goat which can be harvested during moulting in the Spring or from carcases during winter, to manufacture garments.

The two main producers of raw cashmere are China and Mongolia. Afghanistan produces 6% of the global supply of cashmere, amounting to 1000 metric tonnes annually and $18 million in value.

Figure 4: Global production of raw cashmere[4]



Production

In 2007 cashmere from only 30% of Afghan cashmere-producing goats was being harvested, with the remaining 70% of Afghan goat farmers unaware of the value of cashmere or the channels for trading the product. USAID's ASAP (Accelerating Sustainable Agriculture Programme) has made significant efforts to raise awareness of the opportunities for selling cashmere goat hair, reaching over 170,000 goat herders over 2008-9.

However, with a goat population of 7.3 million[5], there is still potential for Afghanistan to increase the volume of cashmere it produces by focusing on improving harvesting techniques and establishing clear market linkages for producers.

Quality

There is a range of quality attributes that will determine the price of raw cashmere including diameter, fibre length, colour, curvature (crimp) and purity. The finer and lighter coloured cashmere

[4] Cashmere Value Chain Analysis, Afghanistan, Frauke de Weijer, ASAP, USAID, 2007
[5] FAO Livestock census, 2003

found in China and, to a certain extent, in Mongolia commands a higher price premium, as the table below indicates:

Figure 5: Prices for Mongolian cashmere by quality, USD[6]

DIAMETER	**Superior**	**Grade I**	**Grade II**	**Grade III**
COLOUR	13.0-15.5 micron	15.51-16.8 micron	16.81-17.6 micron	17.61-19.0 micron
White	34	31	29	22
Light Grey	34	31	29	22
Grey	33	31	28	21
Brown	33	30	28	21

On average Afghan cashmere is darker with a diameter of 16-17 microns which means it is of a lower quality and cheaper than that of Mongolia and China.

To compound this, the majority of Afghan traders mix the higher quality bahari[7] cashmere with the lower quality *skin*[8] cashmere to create an average product at an average price. This limits the end use of the cashmere and leads to limited differentiation of quality in the product being exported.

Processing

The raw or greasy cashmere hair collected from the goat needs to undergo a number of processes to transform it into high end garments. These processes can be summarised as follows:

1. Harvesting (either by combing or by shearing & de-hairing)
2. Scouring
3. Machine de-hairing
4. Spinning
5. Weaving or knitting
6. Manufacturing and finishing

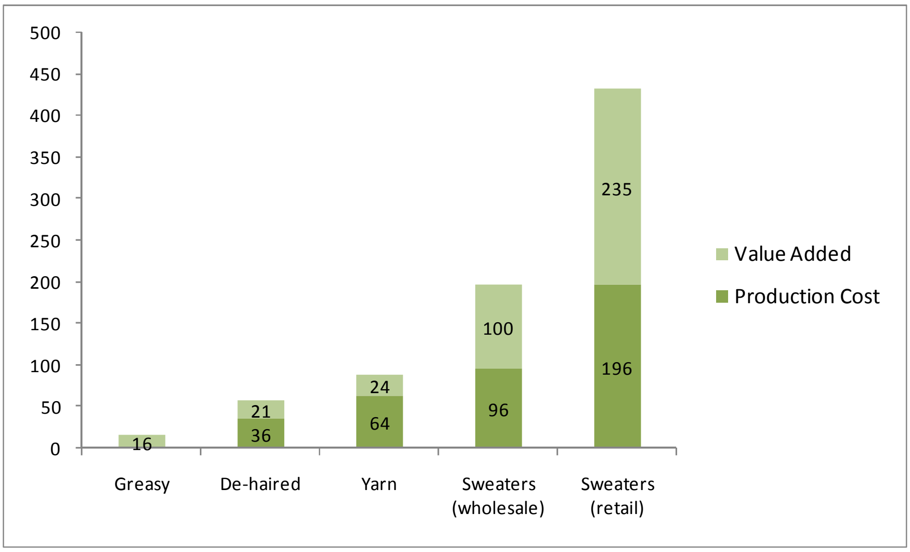
An overview of the value chain is provided below:

Figure 6: Value addition, US$ by kg of greasy cashmere

[6] LeCraw, 2005, quoted in Cashmere Value Chain Analysis, Afghanistan, Frauke de Weijer, ASAP, USAID, 2007

[7] *Bahari* cashmere is obtained through combing or shearing live animals during spring; this hair is clean, with no chemicals applied. The bahari is therefore of a higher quality.

[8] *Skin* cashmere: Obtained from dead skins during winter, this hair is unclean, brittle and has chemicals applied. The skin is therefore of a lower quality.



The first stage will be undertaken by farmers in Afghanistan. There are two means through which a farmer can harvest goat hair:

Combing: This is a cleaner method that delivers a higher yield and a longer fibre length. However combing is considered more difficult technically by goat herders, and takes more time for inexperienced combers. Moreover, it is a less flexible method as it requires the livestock to be sufficiently near the home to be combed.

Shearing and de-hairing by hand: The cashmere is not as clean when sheared and there is a high likelihood of cutting the hair, thereby reducing fibre length. However, shearing is a more flexible approach (the goats can be sheared quickly and the women can de-hair whenever is convenient), and exporters currently express a preference for shearing.

Subsequent phases of processing are typically undertaken outside of Afghanistan – in China, Iran or Europe. In recent years China has outlined an aggressive strategy for controlling the value add chain for cashmere, and European companies maintain control of marketing and branding in the retail arena. This makes it difficult for Afghanistan to access the value at these stages of the value chain. However, with expertise from Foreign Direct Investment, opportunities exist for Afghanistan to make inroads in machine de-hairing and scouring; spinning and some basic manufacturing.

Trading

As mentioned above, Afghan traders mix bahari and *skin*[9] cashmere, with the consequence that Afghanistan has no price differentiation for varying quality of cashmere, with traders and exporters paying a 'one size fits all' price for all types of Afghan cashmere. This practice means that Afghanistan misses out on market opportunities at both the high quality and low quality level.

Both ends of the quality spectrum are important. Whilst high quality cashmere will command a better price, the World Bank and the CCMI (Camel Hair and Cashmere Manufacturers Institute) predict fast growth in the middle-lower quality range and for blending and manufacturing into cheaper garments.

[9] *Skin* cashmere: Obtained from dead skins during winter, this hair is unclean, brittle and has chemicals applied. The skin is therefore of a lower quality.

More broadly, the current value of imports for carded / combed cashmere fibres reached a healthy $189,841,385 in 2010[10], according to the UN, with the following countries representing the major global importers of carded / combed cashmere: Italy, Republic of Korea, China, UK and India.

The Scope of the Cashmere Action Plan

Exclusions

A wide variety of factors impede businesses of all types in Afghanistan. While improvements have been made, the environment in which businesses have to operate is often poor: many government processes are overly complicated, bureaucratic and riddled with corruption; reliable supplies of electricity and water are not always available; and industrial land is in short supply. Solving these problems is critical to the success of SMEs and indeed to all businesses in Afghanistan.

For the most part, these issues are being dealt with elsewhere, in the Government of Afghanistan's infrastructure development program, in the Ministry of Commerce and Industry's review of the legal framework for business and in its work to streamline licensing processes. Many of the issues are province specific and will be picked up in the provincial development plans which are the companions to this and the other 6 sector strategies.

There is a broad need to formalise this and other sectors. Once again, this is, for the most part, covered in the Formalisation Strategy being developed by the Ministry of Commerce and Industry (MOCI).

Progress to date

Much work has already been done in the sector across a number of the priority areas, including:

- The launch of Afghan Macau's operations in Herat in March 2006. This Chinese Joint Venture has established a scouring line and installed mechanical de-hairing equipment.
- In 2009, the USAID programme, ASAP, completed an awareness raising exercise for Afghan goat herders, training over 170,000,416 herders and distributing 150,000 combs throughout Afghanistan's 34 provinces.
- In March 2009, the Mazar-i-Sharif International AgFair and Cashmere Exhibition was held to promote Afghanistan's produce, livestock, and cashmere on the world stage.
- In May 2009, the first Cashmere Road Show took place in Panjsher Province, with participation from both U.S. and Afghan government officials
- Emergence of more prominent, higher volume traders such as Sodis Masood Co. Ltd, an Afghan cashmere trading company based in Herat that buys quality cashmere from regional goat herders. In 2009 the company sold 20 metric tons of the product to a European buyer, worth $130,000.

[10] UN, COMTRADE, 2010, 510531 (Fine animal hair, carded/combed, of Kashmir (cashmere) goats)

Action Plan

The Table below describes a number of issues/impediments to growth faced by the textiles industry. For each issue it sets out a policy response, identifies the government agency that is responsible for ensuring that this response occurs and sets a completion date.

The Ministry of Commerce and Industry will be responsible for co-ordinating the implementation of the activities outlined below, and for designing a Monitoring and Evaluation framework to track progress against the activities below.

Issue	No.	Action	Responsible Agency	Completion Date
Increasing production				
Cashmere has traditionally only been harvested from 30% of the goat population	1.	Expand USAID's awareness programmes (including the distribution of combs) to goat farmers across Afghanistan. As before, the incentives of low investment and immediate income options should be stressed. The current baseline is 171,416 herders trained – there is now a need to revisit these herders to re-affirm the messages and to identify any barriers to entry into the cashmere market	**MAIL**	**May 2012**
	2.	Link non-harvesting farmers up with established cashmere traders in Afghanistan	**MAIL (MOCI support)**	**January 2013**
Improved grading and quality control				
No price differentiation between Afghan cashmere of varying quality, and limited knowledge of quality grades Producers do not know how to meet	3.	Government and external agencies/donors to train both producers and exporters on methods of grading raw cashmere. Training in understanding quality and grading could be linked to the second wave of awareness raising programmes mentioned above	**MOCI**	**January 2013**
	4.	Link processing companies with producer organisations that are able to supply what is required	**MOCI (AISA support)**	**January 2013**
	5.	Undertake an assessment of the cashmere characteristics of indigenous breeds in Afghanistan (international buyers often prefer to purchase particular types of	**MAIL (MOCI**	**May 2012**

Issue	**No.**	**Action**	**Responsible Agency**	**Completion Date**
commercial grading requirements, and buyers are unable to gain reliable supplies of graded cashmere,		cashmere, according to colour, length or diameter of fibre, or style).	**support)**	
Exporters mix bahari and skin cashmere	6.	Capacity building for exporters to demonstrate the benefits of keeping bahari and skin separate and targeting different markets: • Bahari (high quality) sent to Europe • Skin (lower quality) sent to China	**ACCI**	**May 2012**
Average quality cashmere from Afghan goat population	7.	Distribution of information on breeding, harvesting and handling techniques, including an awareness of the pros and cons of shearing versus combing.	**MAIL**	**December 2011**
	8.	Feasibility study for the introduction of goat breeds that produce longer, thicker, and whiter fibres for the long-term success of the Afghan cashmere industry	**MAIL**	**December 2011**
Expand processing in Afghanistan				
Limited processing in Afghanistan	9.	Demonstration visits to Macau Cashmere's operations in Herat by cashmere farmers, traders or businessmen who express an interest in expanding their activities in the trade	**MOCI**	**December 2011**
Limited skills in processing and manufacturing	10.	Encourage investment by reducing the risk of investing by international and local investors in processing by identifying suitable government owned facilities which can be leased. A first step for this exercise will be leasing out Government land to experienced investors.	**MOCI**	**December 2011**
	11.	Market study into the demand for cashmere garments for the "fair trade" or artisanal market sector, accompanied by a feasibility study for R&D for the necessary	**MOCI**	**January 2013**

Issue	No.	Action	Responsible Agency	Completion Date
		equipment and techniques to set up a manufacturing facility in Afghanistan.		
Assist exporting[11]				
Low income for exporters and poor market linkages in the international arena - a comparison between the production price and export price of Afghan cashmere reveals that the margins for traders are extremely small.	12.	Profits would increase with a greater differentiation of the quality of cashmere (as tackled above) and support in the building of end market linkages to expand the operational scale of exporters. To encourage this, more direct market linkages with end-buyers will be established by establishing a cashmere association or guild to act as an agent for the industry in interactions with foreign buyers: • The creation of an association or nationally recognised network of cashmere growers and other actors in the value chain would also provide a useful channel through which to co-ordinate many of the activities outlined in this document. • Detailed plans for the creation of such a federation could consider starting at the provincial level and then scaling up.	**MAIL (ACCI support)**	**January 2013**
	13.	Develop a detailed plan for hosting a website on which contact information for buyers and sellers can be posted. The website should be linked to the emerging market information development systems being developed by MAIL. This should be an open site with a wide geographical coverage, including Asian cashmere suppliers and those in Europe, North American and Australia,	**MAIL (ACCI support)**	**May 2012**
Marketing				
Poor marketing of Afghan cashmere	14.	Develop a strategy for expanding into niche markets such as: • "Fair Trade" • Handmade by Afghan women	**MAIL (AISA and MOCI support)**	**December 2011**

[11] For a more detailed outline of activities in this area, the Ministry of Commerce and Industry is developing a Trade Policy to be completed by the end of 2011.

Issue	No.	Action	Responsible Agency	Completion Date
		• Ecological Fibres (no chemical dyes used) Such a strategy should take consideration of involving private sector actors in neighbouring countries and forging partnerships with emerging groups such as Fabindia[12] and Fair Trade forums. Moreover, a marketing strategy should also design training programmes to equip the sector with the skills to enter the niche markets referenced above.		
	15.	Develop a global marketing strategy for Afghan cashmere based on lessons learnt from donor-funded cashmere marketing projects in Mongolia, Ladakh in India, Kyrgyzstan and Tajikistan. This strategy should consider past suggestions including: • Raising awareness about and the reputation of Afghan cashmere in key markets through a cashmere quality communications campaign • Community bulk marketing schemes and pre-season advertisement of prices for quality classes.	**MOCI (with AISA support)**	**January 2013**

[12] The Indian company Fabindia now links over 40,000 craft based rural producers to modern urban markets.