

Pre-Feasibility Study

LEATHER GOODS MANUFACTURING UNIT (Wallets)



Small and Medium Enterprise Development Authority Government of Pakistan

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November, 2001

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Document No.	PREF-14
Revision	1
Prepared by	SMEDA-Punjab
Approved by	GM Punjab
Issue Date	Nov 20, 2001
Issued by	Library Officer

1 INTRODUCTION

1.1 Project Brief

This proposed project presents details about the investment opportunity in the area of leather goods manufacturing. The product being focused is leather wallet. However the unit is also capable of manufacturing leather key rings, credit card holders, ladies bill folders and other small articles of leather without any addition of machinery.

1.2 Opportunity Rationale

In 1999, Leather goods had a global market of \$ 5.7 billion. Entrepreneurs in Pakistan are well positioned to capture this market because of a large raw material base available locally. Quality hides & skins are available in the country and the tanning industry is well equipped to manufacture high quality finished leather. Different types of leather products include garments, footwear and gloves. The performance of Pakistani exporters in the exports of finished leather, leather garments and leather gloves has been satisfactory. But leather goods and footwear are the two areas in which there is a large room for increasing exports. Leather goods international market is second only to leather footwear in term of dollar value. Over the last few years, the demand for these products in the foreign market has been on a rise.

Tanners and Leather Manufacturers are realizing the need to move towards value addition by producing better quality products, and innovation in fashion trends, in order to introduce them to the high market. Government has provided various incentives and restructured tariff base for boosting exports. Moreover Government provides an export rebate of 5.61% on leather goods exports.

Besides this, the usage of leather goods in the local market has also increased that also makes it attractive area for investment. This pre-feasibility study has been developed for leather goods exports.

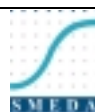
1.3 Viable Economic Size and Proposed Capacity

This feasibility is based on a unit with 4 Stitching Machines with a capacity of manufacturing 145 wallets per day. This unit will not have assembly line operations as in modern leather goods manufacturing units and will be labor intensive.

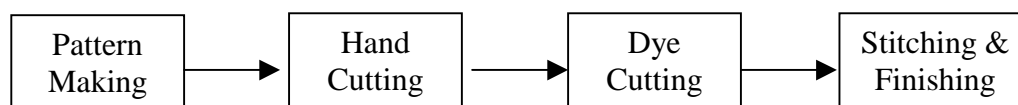
1.4 Project Cost¹

Rs 0.51 million

¹ includes working capital Rs 273,294



1.5 Process Flow Chart



2 CURRENT INDUSTRY STRUCTURE

According to Leather Directory 1994, there were more than 125 leather goods manufacturing units in Pakistan manufacturing all kinds of consumer as well as industrial goods. Total manufacturing capacity was 5.905 million pieces per annum. These units are mostly concentrated in two cities Karachi and Sialkot. Largest cluster was in Karachi that comprised of 86 units and accounted for 71% of the total units and 66 percent of total labor employed. In Sialkot, there were 28 units that accounted for 23%. Remaining 6% was distributed between Islamabad, Lahore and Gujrat.

3 MARKETING

3.1 Total Market Size and Growth

Primary target of this unit will be the export market. In the year 1999 total, world import market of leather goods was \$11,907 million, of which 91% of the leather goods market was constituted by consumer goods² and only 9% by the industrial goods.

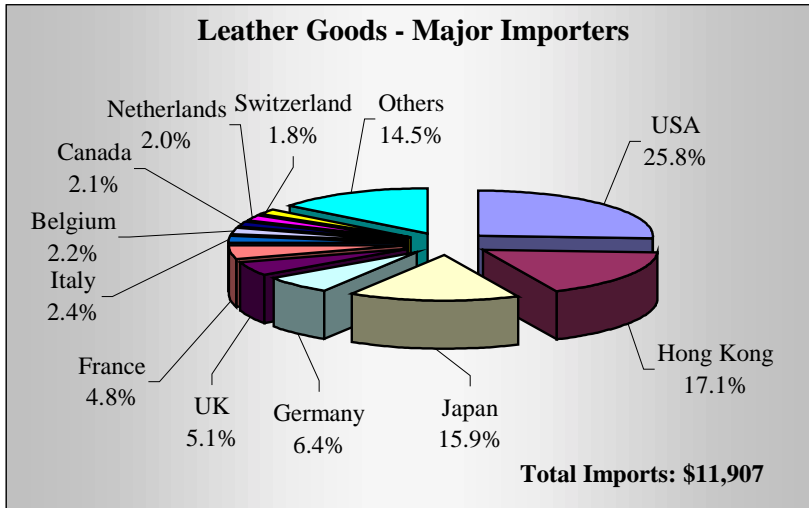
The size of the local market for leather goods is very small with an estimated consumption of roughly 600,000 articles per year. However, this market can offer attractive dividends catering to high-income consumers and formal corporate sector. In order to cater to this market segment, marketing expenses will considerably rise. This pre-feasibility report does not take into account this local market.

Table 3-1:-Major Geographic Markets

Export	\$ Million
USA	3,077
Hong Kong	2,038
Japan	1,897
Germany	761
UK	602
France	570
Italy	280

²leather consumer goods include items like belts, bandoleers, handbags, camera cases, trunks, suitcases, vanity cases, executive cases, briefcase and wallets, while leather industrial goods include items like industrial belts, saddlery & harness etc.

Figure 3.1: - Major Importers of Leather Goods

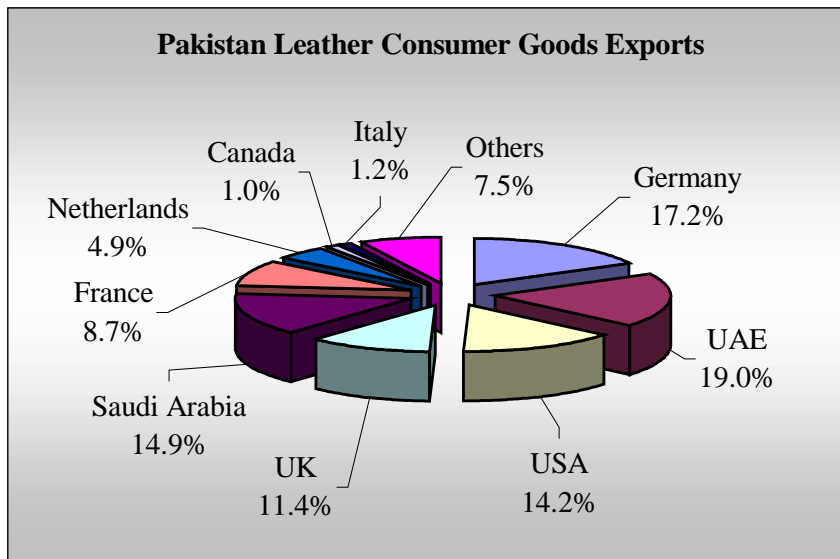


3.2 Pakistan’s Exports

Leather goods constitute a very insignificant portion of the total exports of leather and leather products. In the global imports of leather and leather product, leather goods held share of 22%, whereas Pakistan’s exports of leather goods accounted for only 1.5% of the total leather sector exports.

Total exports of Pakistan’s leather consumer goods for the year 1999-2000 was Rs.118.6 million, 36% of which constituted to the export of purses and wallets.

Figure 3.2: - Pakistan’s Leather Consumer Goods Trading Partners



3.3 Target Customers

Target customers in the export market include large retail chain stores and corporate clients.

4 RAW MATERIAL

The basic raw material required for manufacturing of wallets is as follows:

Table 4.1: - List of Raw Material³

Description	Price/unit	Availability local or imported
Buffalo Calf Leather	Rs 60/Sq ft	Local
Silk Lining	Rs 2-3 per wallet	Local
Metal Corners	Rs 0.75 per corner	Imported but also available locally
Zip (if specified)	Rs 3/ Zip	Imported/Local

5 MAN POWER REQUIREMENTS

5.1 Types of Skills Required

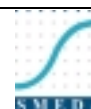
Due to versatility of the type of skills, the skilled labor (Karigar) is difficult to get. Expertise is required in the following areas:

- Pattern making,
- Cutting
- Stitching
- Skiving

Table 5-1: -Human Resource Requirement

Positions	Required	Salary/ Month	Salary/Annum
CEO (owner)	1	25,000	300,000
Stitcher	4	5,000	240,000
Skiving machine operator	1	2,000	24,000
Helper	5	2,000	120,000
Salesman	1	4,000	48,000
Total	12		732,000

³ The raw material specification will vary with different wallets for different markets.



6 MACHINERY DETAILS

Table 6.1: - Machinery List

Sr. No	Type	Brand Name	No.	Cost per Machine	Total Cost ⁴
1	Stitching Machine	Singer-431	4	40,000	160,000
2	Skiving	Korean	1	30,000	30,000
3	Creasing tools				10,000
4	Cylinder ⁵ bed	Singer		45,000	
Total Machinery Cost					200,000

The prices quoted above are those of the imported machinery, but these machines are also available in the local make.

6.1 Other Options Available for Machinery

Singer 431 is the most successful stitching machine for manufacturing leather goods. Other Machines available are Singer-591 and machines by Mitsubishi.

7 LAND & BUILDING

7.1 Total Land Required (Area)

For leather goods manufacturing unit with production of about 145 wallets per day, approximately 1120 sq. ft. area is required

7.2 Building Covered Area Requirement

Description	Required area (sq. ft)
Factory area	1000
Management building	120
Total area required (in sq. ft)	1120

Land & Building Construction Cost	Rate (Rs./ sq. ft.)	Construction cost
Approximate Land cost (Rs.)	Rs. 500,000/4,500 sq. ft	124,444
Factory area	350	350,000
Management building	600	72,000
Total Building construction cost		422,000
Total Cost Land & Building)*	(Approx.)	Rs. 546,444

⁴ These costs may vary from the most recent.

⁵ Only if manufacturing of ladies bags is planned.

*If Constructed

7.3 Recommended Mode

Renting a small house or building is a recommended option.

Table: 7-3 Rent Cost

Rent cost	Monthly rent (Rs.)	Annual rent (Rs.)
Building rent cost	6,000	72,000

7.4 Suitable Locations

Karachi is the most suitable location for establishing a unit of leather goods manufacturing, followed by Sialkot & Lahore. Availability of skilled labor and commercial splitting⁶ facility are important while selecting a location.

7.5 Infrastructure Requirements

- Electricity
- Telephone
- Fax

8 PROJECT ECONOMICS

8.1 Project Costs

Table: 8-1 Project Cost/Capital Requirements

Projects Costs (Rs.)	Total Cost
Plant & Machinery	200,000
Machinery Installation	10,000
Furniture & Fixtures	5,000
Miscellaneous (salaries)	25,000
Total Capital Costs (Rs.)	240,000
Raw material inventory	194,119
Up front for building rental	72,000
Up front insurance payment	7,175
Total Working Capital (Rs.)	273,294
Total Investment in the Project (Rs.)	513,294

⁶ A single German splitting machine cost Rs 350,000 so commercial splitting is recommended.

Table 8—1 Financing Plan

Financing		
Equity	40%	203,517
Debt	60%	307,976

Table 8—3 Project's Returns

Internal Rate of Return	41.29%
Net Present Value (NPV)	Rs 1,119,458
Payback Period (Years)	1.15

9 REGULATIONS

9.1 Special Incentive for the Sector by the Govt.

Being an export based unit the government provides 5.61% export rebate (F.O.B.) on exports of leather goods.

10 KEY SUCCESS FACTORS

Availability of skilled labor force and continuous flow of export orders are the key success factors for this business. This requires aggressive marketing efforts.

Another important factor that now plays a very important role is the packaging of the product. For export marketing of leather goods, packaging is of special significance because of both legal requirements in the importing countries and the necessity to get the products to the markets in good condition.

11 THREATS FOR THE BUSINESS

- Difficult or non-availability of imported accessories
- Failure to procure raw material
- The skilled labor for this industry is difficult to find
- The level of technology being used is very low. This not only reduces the production capacity of the smaller manufacturers, but also affects the quality of their products, thereby affecting their competitive edge in the international markets

12 FINANCIAL ANALYSIS

12.1 Projected Income Statement

PROJECTED INCOME STATEMENT					
	Year 1	Year 2	Year 3	Year 4	Year 5
Sales	3,516,975	4,145,006	4,863,474	5,684,185	6,252,604
Other incomes (Rebate)	197,302	232,535	272,841	318,883	350,771
Cost of goods sold					
Raw Material	2,135,306	2,522,331	2,966,261	3,474,696	3,830,853
Payroll (Production Staff)	384,000	403,200	423,360	444,528	466,754
Machine Maintenance	70,340	84,558	99,215	115,957	127,553
Direct Electricity	46,068	50,675	55,743	61,317	67,449
Total	2,635,714	3,060,764	3,544,578	4,096,499	4,492,609
Gross Profit	1,078,563	1,316,777	1,591,737	1,906,569	2,110,766
Operating Expenses					
Payroll (Admin)	300,000	315,000	330,750	347,288	364,652
Payroll (Marketing and Sales)	48,000	50,400	52,920	55,566	58,344
Fixed electricity	47,415	52,156	57,372	63,109	69,420
Insurance Expense	7,175	6,458	5,740	5,023	4,305
Administrative Overheads	35,170	41,657	49,124	57,703	63,795
Amortization (Pre-operational Expenses)	3,500	3,500	3,500	3,500	3,500
Depreciation	20,500	20,500	20,500	20,500	20,500
Total	461,759	489,671	519,905	552,688	584,516
Operating Profit	616,804	827,106	1,071,831	1,353,881	1,526,250
Non-operating Expenses					
Financial Charges on Long-term Loan	6,243	4,495	2,433	-	-
Financial Charges on Running Finance	49,193	128,824	150,466	175,170	203,359
Land Lease	-	-	-	-	-
Building Rentel	72,000	79,200	87,120	95,832	105,415
Total	127,436	212,519	240,019	271,002	308,774
Profit Before Tax	489,368	614,587	831,813	1,082,879	1,217,476
Tax	70,340	82,900	97,269	254,008	301,117
Profit After Tax	419,029	531,687	734,543	828,872	916,359
Retained Earnings beginning of year	-	419,029	950,716	1,685,259	2,514,130
Retained Earnings end of year	419,029	950,716	1,685,259	2,514,130	3,430,490

12.2 Projected Cash Flow Statement

PROJECTED CASH FLOW STATEMENT						
	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Operating activities						
Net profit		419,029	531,687	734,543	828,872	916,359
Amortization (Pre-operational Expenses)		3,500	3,500	3,500	3,500	3,500
Depreciation		20,500	20,500	20,500	20,500	20,500
Accounts receivable		(479,588)	(85,641)	(97,973)	(111,915)	(77,512)
Equipment Spare Parts Inventory	0	(5,862)	(1,185)	(1,221)	(1,395)	(966)
Up-Front Insurance payment	(7,175)	718	718	718	718	718
Stocks-RM	(194,119)	0	(35,184)	(40,357)	(46,221)	(32,378)
Accounts payable	0	49,536	8,981	10,299	11,795	8,262
Cash provided by operations	(201,294)	7,833	443,376	630,008	705,852	838,483
Financing activities						
Long term debt principal repayment		(9,708)	(11,456)	(13,518)	0	0
Add: buliding rent expense		72,000	79,200	87,120	95,832	105,415
Building rent payment	(72,000)	(79,200)	(87,120)	(95,832)	(105,415)	(115,957)
Addition to long term debt	34,683					
Addition to running finance	273,294	442,395	120,231	137,247	156,602	112,418
Issuance of share	205,317					
Cash provided by/ (used for) financing activities	441,294	425,487	100,855	115,017	147,019	101,876
Total	240,000	433,320	544,231	745,025	852,872	940,359
Investing activities						
Capital expenditure	(240,000)					
Cash (used provided by invetsing activities)	(240,000)					
Net Cash	0	433,320	544,231	745,025	852,872	940,359
Cash balance brought forward	0	0	433,320	977,551	1,722,576	2,575,448
Cash carried forward	0	433,320	977,551	1,722,576	2,575,448	3,515,807



12.3 Projected Balance Sheet

PROJECTED BALANCE SHEET						
	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Current Assets						
Cash	0	433,320	977,551	1,722,576	2,575,448	3,515,807
Equipment Spare Parts Inventory	0	5,862	7,047	8,268	9,663	10,629
Up-Front Insurnace payment	7,175	6,458	5,740	5,023	4,305	3,588
Stocks and Inventory	194,119	194,119	229,303	269,660	315,881	348,259
Receivable	0	479,588	565,228	663,201	775,116	852,628
Pre-paid building rent	72,000	79,200	87,120	95,832	105,415	115,957
Total	273,294	1,198,546	1,871,989	2,764,560	3,785,829	4,846,868
Gross Fixed Assets						
	205,000	205,000	205,000	205,000	205,000	205,000
Less: Accumulated depreciation	0	20,500	41,000	61,500	82,000	102,500
Net Fixed Assets	205,000	184,500	164,000	143,500	123,000	102,500
Intangible Assets						
Pre-operational Expenses	35,000	31,500	28,000	24,500	21,000	17,500
Total	35,000	31,500	28,000	24,500	21,000	17,500
Total Assets	513,294	1,414,546	2,063,989	2,932,560	3,929,829	4,966,868
Current Liabilities						
Running Finance	273,294	715,689	835,920	973,167	1,129,770	1,242,187
Accounts payable	0	49,536	58,517	68,816	80,611	88,873
Total	273,294	765,225	894,437	1,041,983	1,210,381	1,331,061
Long-term liabilities						
Long-term Loan	34,683	24,974	13,518	0	0	0
Total	34,683	24,974	13,518	0	0	0
Equity						
Paid-up Capital	205,317	205,317	205,317	205,317	205,317	205,317
Retained Earnings	0	419,029	950,716	1,685,259	2,514,130	3,430,490
Total	205,317	624,346	1,156,033	1,890,576	2,719,448	3,635,807
Total Liabilities And Equity	513,294	1,414,546	2,063,989	2,932,560	3,929,829	4,966,868



12.4 Key Assumptions

Table 12—1 Machinery Assumptions

Number of Machines Installed	5
Maximum Capacity Utilization (Year 1)	70%
Total Production of the unit per day	145
Total Production of the unit per month	4,060
Total Production of the unit per year	33,495

Table 12—2 Operating Assumptions

Annual Production capacity	47,850
Hours operational per day	8
Days operational per month	28
Days operational per year	330

Table 12—3 Economy-Related Assumptions

Electricity growth rate	10%
Wage growth rate	5%

Table 12—4 Cash Flow Assumptions

Accounts Receivable cycle (in days)	45
Accounts payable cycle (in days)	7
Raw material inventory (in day)	30
Equipment and spare part inventory (in days)	30

Table 12—5 Revenue Assumptions

Production capacity of the unit	47,850
Sale price per unit in year 1 (in Rs.)	105
Sale price growth rate	10%
Maximum capacity utilization	100%
Export sales	100%

Table 12—6 Expense Assumptions

Factory & Administrative overhead (% of Sales)	1%
Machine maintenance (per year)	2% of sales
Machine maintenance growth rate	2%
Pre-paid building Rent (months)	12
Pre-paid insurance (months)	12
Insurance rate (% of net fixed assets)	3.5%
Spare part inventory growth rate	10%
Rent growth rate	10%
Raw material price growth rate	5%
Rebate	5.61% of the f.o.b.value
Turnover Tax	2%

Table 12—7 Financial Assumptions

Project life	10
Debt	60%
Equity	40%
Interest rate on long-term debt	18%
Interest rate on short term debt	18%
Debt tenure	3
Debt payments per year	1
Discount rate (weighted Avg. cost of capital for NPV)	16%