

Executive Summary

CHF International is pleased to present our analysis of the handicrafts sector in Palestine, developed in partnership with PalTrade, PFI and the Portland Trust. This assessment focuses on:

- (1) Identifying opportunities for growth and employment within Palestine's handicrafts sector, particularly for women and the poor
- (2) Confirming obstacles for meeting those opportunities, including the demand for business services in the sector
- (3) Determining the feasibility of a sustainable business model for creating and managing a separate crafts services entity, known as Palcrafts (concept originally proposed in summer 2007)
- (4) Recommending strategies for addressing the demand for services within the sector on a sustainable basis

In order to address these goals a value chain analysis is used to reveal constraints that are likely to impact handicraft producers and businesses, while at the same time presenting clear opportunities for economic growth, donor intervention, and private sector investment. This approach includes validating interviews, impact assessment, and financial analysis.

Our conclusions show that major opportunities in the handicrafts industry lie in the embroidery value chain. In addition to high growth potential, the development of a formalized embroidery sector can reach tens of thousands of women who are currently producing items in their homes, significantly increasing incomes through supplemental household earnings. Although embroidery sells well in the local tourist market, it has not evolved into a competitive export because of the high cost of production, lack of market access, and low capacity for filling large volume orders. If these issues can be addressed, there is the potential to dramatically increase the demand and export potential for Palestinian embroidery.

Moreover, the concept of creating a separate PalCrafts entity that addresses the needs of the entire industry is not sustainable as a private-sector business. These results are based on market research focused on the formal businesses and support organizations such as women's associations, non-profits and trade unions. This analysis reveals that craft sector businesses and many support organizations already have well developed access to markets, new product designs, fair trade certification, sales support, costing and pricing, quality control and packaging services. Thus, a for-profit marketing and design service such as PalCrafts does not address unmet market demands of businesses and would not be a market-driven enterprise.

Additionally, PalTrade and PFI are currently offering many of the proposed PalCrafts services, which are subsidized to producers through donor funding. This means that design and marketing services as proposed through PalCrafts would be competing at a disadvantage with the two umbrella organizations. A more practical approach would be to expand the donor funded model to address several critical unmet needs. For example, two major constraints faced by the craft sector are access to affordable transportation and a declining local tourist market in several cities. Interventions targeting these constraints have the potential for high impact and some level of sustainability. Additionally, providing design and marketing capacity building to the existing artisan support organizations would be a high-impact intervention with minimal input. However, these interventions are not strong candidates for profitability or private sector investment as proposed in the PalCrafts concept.

1.1 Introduction to Palestinian Handicrafts Industry

There are a variety of well developed traditional handicrafts in Palestine. Several of these, such as olivewood and ceramics, have evolved into high quality competitive exports, which also generate strong sales in the local tourist market. Other sub-sectors, such as pottery and mother of pearl products, sell in domestic and regional markets with Palestinians and Israelis as primary consumers. These products all require substantial capital investments for machinery and raw materials. As a result, formal businesses dominate the market with a combination of assembly line production techniques, hand-finishing and professional marketing. Production is done in hundreds of manufacturing facilities that typically employ between 15 – 50 workers each. Additionally, businesses are highly evolved in terms of production techniques. For example, the olivewood producers are using automated laser cutting tools in production. There also exists a solid understanding of markets with a growing focus on exports and access to importers throughout the US and Europe.

Although embroidery is one of the most well know Palestinian handmade product, it is distinctive from the olivewood or ceramic sub-sectors described above because it is primarily produced informally by female artisans who generally work from their homes. This work is facilitated by a variety of NGOs and women’s associations who provide access to raw materials and markets through local craft fairs and retail outlets in hotel gift shops, as well as online retail. Although embroidery sells well in the local tourist market, it has not evolved into a competitive export because of the high cost of production, lack of market access, and low capacity for filling large volume orders. If these issues can be addressed, there is the potential to dramatically increase the demand and export potential for Palestinian embroidery.

1.2 Sub-sector selection

There are many opportunities that exist within the Palestinian handicraft industry, but the complexity and wide range of constraints mean that the scope of business development and donor intervention must be highly focused to reduce costs, risk and maximize impact. In support of this objective a ranking exercise was conducted to determine which sub-sector has the most potential in terms of growth, employment, impact, youth and gender issues. Embroidery stands out as a clear winner with high rankings in all the selection criteria. In addition to high growth potential, the development of a formalized embroidery sector can reach tens of thousands of women who are currently producing items in their homes, significantly increasing incomes through supplemental household earnings.

Table A. Sector Selection Matrix

Selection Criteria:	Olivewood:	Embroidery	Mother of Pearl	Ceramics	Pottery
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“Many buyers and consumers seek unique products made in countries other than China. While the market for purely indigenous designs is limited, ‘global style’—products that combine ethnic elements with contemporary designs—is a growing category and represents an opportunity for handicraft producers”.

“Buyers are increasingly interested in items that are unusual in design and materials, such as a novel treatment; a distinctive embellishment, such as hand beading or embroidery; a combination of materials (for example, wood and metal, or metal and stone); or a layering of colors, patterns, and textures”.

“As the luxury market segment grows, consumers have shown a willingness to pay more for unique products”.

-USAID Global Market Assessment for Handicrafts

Growth Potential	Medium	High (immediate); Medium (long-term)	Medium (immediate); Low (long-term)	Medium	Low (immediate); Medium (long-term)
Employment	High	High	Low	Low-Medium	Low
Impact	High	High	Low	Medium	Low
Youth	High	High	Low	High	High
Gender/ Women	Low	High	Low	Medium	Low

2 Market Analysis

2.1 Market Assessment

Palestinian handicrafts have proven to be competitively well positioned in the local tourist market and mid-market exports to the US and EU. The success and sophistication of olivewood and ceramic producers underscores the market demand for traditional Palestinian products. Although examples of large-scale handmade embroidery production do not exist in Palestine, some extrapolation of market potential can be done based on the success of olivewood and ceramics businesses as well as general trends in global handicraft markets. On average, olivewood and ceramics businesses are able to achieve revenue of \$300,000 - \$500,000, despite a crowded playing field, dramatic constraints imposed by Israeli occupation, and low barriers to entry. The most successful olivewood exporter averages roughly \$2-4 million dollars in sales per year. Producers in the olivewood and ceramics industry also report growth in the export segment of their business, which comprises from 50-70% of their sales. Currently, the olivewood and ceramics companies are tapping into only a small fraction of the global handicraft export market, which is estimated to be in the billions of dollars.

The embroidery-driven baby clothing market also has significant export growth potential. In the US, the retail value for the infant, toddler and preschool clothing market segment now approaches \$17 billion -- and could hit \$20 billion by 2010, this according to the *U.S. Market for Infant, Toddler and Preschool Clothing* report produced by Packaged Facts, Inc.

A decline in tourism in the Palestinian Territories over the past ten years coupled with market access constraints from Israeli occupation, have resulted in a contraction of the local tourism handicraft market. However, there is strong potential growth in the export market supported by trends in the US handmade products sector.

A recent study entitled *Global Market Assessment for Handicrafts* conducted by the United States Agency for International Development (USAID) found that "There is a growing market for home accessory products, particularly in the high-end segment. It is expected to grow not only in Western markets but in all regions as middle-class populations expand rapidly, particularly in China and India. This trend suggests that there are numerous and expanding opportunities for artisans in developing countries to create products for these markets." Additionally, the report states that "Home accessory sales for the specialty and lifestyle market were estimated at \$7.4 billion in 2004 and were projected to grow at the rate of 5 percent to \$7.8 billion in 2005. Buyers in this category look for unique products that are not available at mass retailers; thus, they are often interested in sourcing from developing countries and new suppliers. Some continue to purchase products from U.S. producers, but market experts estimate that as many as half of the products in this channel are imported directly from developing countries." The market for handicrafts continues to grow and expand into different niche markets that demand diversity in handmade products. Authorities estimate that the luxury niche market in the US will grow at a rate of 15% a year and will become a \$1 trillion market by 2010.

Customers in the US are changing their buying behavior in a number of ways; for one, they are demanding more luxury products: “Today’s luxury market is less about ostentation and materialism and more about a search for meaning and emotional fulfillment,” according to Pam Danziger, an expert on the new luxury market. LOHAS is an acronym that stands for Lifestyles of Health and Sustainability and describes a \$227 billion US marketplace for goods and services that appeal to consumers who value health, the environment, social justice, personal development and sustainable living. These consumers are often referred to as “cultural creatives,” “conscious consumers” or “LOHAS Consumers,” and represent a sizable group in the United States: 32.3% of adults, or 68 million consumers. This growing population in the US — up roughly 10% from 2006 to 2007 — has significant concerns about human rights, fair trade, the environment, sustainable practices and spiritual and personal development. Moreover, as consumers, they want to integrate their values with the products and services they buy and use.

With this growing consumer trend, demand for high-value handmade products from emerging markets is increasing. The largest online retailer, eBay Inc., has recently launched a socially responsible marketplace called Worldofgood.com, an eBay Marketplace, which is targeting over 19 million shoppers around the world through advocacy campaigns and significant marketing investment. Through market research, eBay has projected a very high growth rate of socially conscience consumers over the next 5-10 years and through the development of Worldofgood.com, eBay will be tapping into this growing market share.

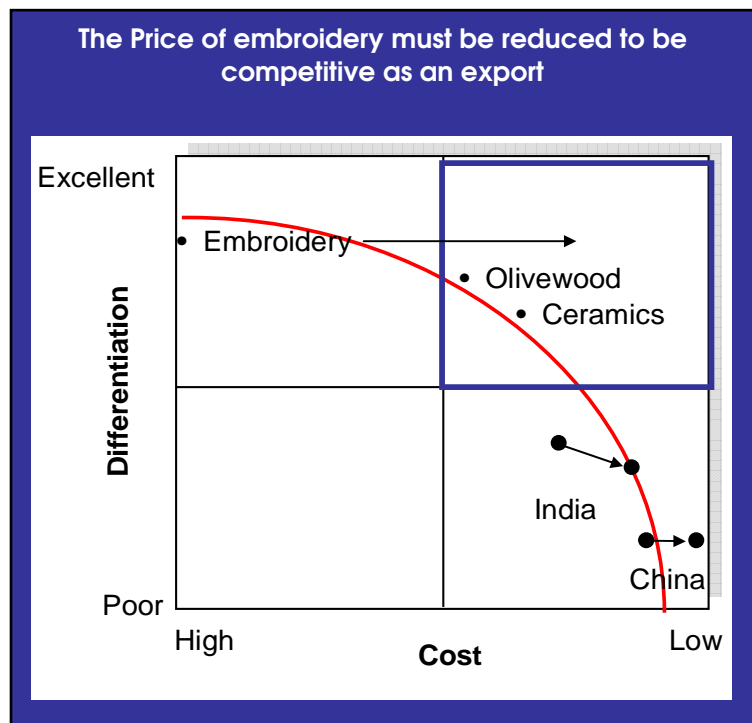
2.2 Market Positioning

There are numerous Palestinian businesses that have successfully entered international markets. This is especially true in olivewood and ceramics where products reflect both traditional Palestinian designs and efficient production. Market research conducted by several organizations including CHF, PFI, PaTrade and Portland Trust have identified embroidery as having strong market potential in terms of quality and design. However, the reliance on inefficient production makes high-volume export difficult and prices too high to be competitive with comparable products from China and India. This issue can be addressed by designing products which use embroidery as an embellishment to add value to base textiles. Textile companies can mass produce a base product that is then embellished by hand by small scale producers. This model has already proven effective in the ceramics and olivewood industries. Moreover, simplifying traditional embroidery designs can further increase efficiency without having a significant impact on quality. This market positioning concept is shown graphically below in Figure 1, where the upper right quadrant represents the target market positioning for Palestinian embroidery.

The Global Market Assessment for Handicrafts adds further support to the concept of formalizing the embroidery industry. The assessment explains that there are 4 key strategies that should be pursued by handicraft producers:

1. Focus on markets and channels in which there is less direct competition with high-volume, low cost producers of “industrial” handicrafts, for example, the independent retailer market by way of wholesale importers. Rather than competing directly with China, identify and sell to market niches such as high-end home accessories and the importers whose smaller orders are declined by large craft factories.

2. Develop more products that embrace the concept of global style in order to both access the large and growing demand for contemporary design and remain distinctive in the marketplace. Opportunities for handicrafts exist in all market segments, but are most abundant for products that fit



comfortably into people's homes *and* bring an authentic indigenous element into their lives.

3. Look to local and regional markets for opportunities that may have been overlooked and can serve as a springboard to larger and more competitive markets.

4. Constantly upgrade skills and techniques, including detailed handiwork, quality (especially finishes), product development, and customer service to remain competitive, difficult to imitate, and appealing to work with. Investments to reliably deliver modest quantities of unique, high quality goods destined for higher-end retail stores are advised over those intended to improve the ability to compete with low-cost, high-capacity producers.

2.3 Palestinian Handicrafts Overview

There are several key linkages and statistics in the handicrafts industry—specifically the olivewood and ceramics value chains—that have important implications for developing opportunities in the embroidery sub-sector. Currently, olivewood and ceramic businesses produce on average \$500,000 in revenue and operate at a 40% profit margin. These businesses have strong ties to international end markets and work with a range of import-focused retailers including fair trade business such as Ten Thousand Villages, Global Exchange, along with church based groups and mid-market retail shops. Such market linkages are supported by good management practices, internet communication, and market driven designs. Production is primarily done in a factory workshop using assembly line techniques. Although the products are all hand finished, there is a strong integration of automation for producing base products such as wooden forms and ceramic dishes. Sophisticated machinery used in production includes laser cutters, routers, silk screeners, and wood drying kilns. Overall these factors point to a mature industry that is highly evolved in terms of both market access and production. We can infer from these two chains that the Palestinian embroidery can have the same impact in the export market if the products are driven by trends and are linked with the luxury marketplace by sophisticated buyers and wholesalers.

Transportation is a major crosscutting issue for all producers and represents a substantial barrier to both local and export market access. There are several distinct aspects associated with this problem. 1) The cost of shipping products has more than doubled because of the need for 'back-to-back' transport across borders. Consequently it is no longer cost effective to ship small orders of less than one pallet in size. The logistical process of shipping orders into Israel is expensive, time consuming and damaging to products. 2) Shipments are not regular and are subject to delays. 3) Significant bureaucratic constraints prohibit growth in the formal sector. For example the transportation of goods requires two types of forms and VAT numbers that are not always available.

There is a vibrant but unstable **tourism sector** in Palestine that is monopolized by Israel and is highly reliant on the political situation in the region. The unbalanced market diversification defined by strong export market connections and limited access to the tourism market in Jerusalem is a major constraint as tourism steadily rises due to the relative calm in the region.

The informal **producers** do not have capital or resources to access new designs for product development, but large businesses are accessing new designs through understanding of trends and market feedback. Handicraft businesses receive new **designs** from retailers and also through knowledge of end market trends. Unfortunately, many of the benefits of this process are undercut by design stealing by informal producers. The result is commoditization of products and price based competition.

Gender: Formalized businesses are primarily comprised of adult males and teenage male youth who are either children of business owners or need to work to support their families. Workshops incorporate women by sourcing out work that is produced in the homes. There are a small number of women who work in workshops; however the number of women currently being integrated into formalized sub-sectors is minimal.

Access to imported **raw materials** in the West Bank is relatively easy, yet expensive. The current monopoly of the local raw material supply has created a significant bottleneck in the handicrafts sector.

2.4 Constraints and Opportunities Specific to the Embroidery Sub-Sector

The embroidery sub-sector analysis outlines the flow of raw materials, products, and the roles of the participants involved in producing and selling Palestinian handicrafts. The purpose is to provide a reference for understanding both the production and market dynamics including participants, constraints, and opportunities that exist in the industry. The value chain assessment helps to present the opportunities and constraints to the sector as a whole, which are outlined in the following sections.

This section will provide an overview of the major constraints in the embroidery sub-sector identified during the value chain analysis. Analyzing these constraints in detail will reveal both challenges to embroidery focused businesses, and specific opportunities for addressing serious issues affecting the market. This constraint analysis is designed to be incorporated into businesses planning and proposals for donor interventions.

2.4.1 Sales and Marketing

In contrast to the formal businesses in other sub-sectors, embroidery producers do not have a well developed understanding of markets or access to retail channels. Much of the embroidery is sold to local Palestinian customers who buy heavily embroidered clothing for weddings and special occasions through custom orders directly to the embroiderer. In order to access tourist and export markets most producers rely on NGOs. Unfortunately, many of these NGOs have a poor understanding of basic business concepts such as pricing, cost of goods sold, and marketing. The second Intifada has also exacerbated the poor performance of embroidery in the local tourist market, which have contracted as much as 40%¹. The tourism sector is slowly rebounding, but due to the high cost of products, embroidery is not well positioned in this market segment.

By linking the embroidery sub-sector into the baby clothing market segment there are significantly more opportunities for growth, compared with traditional embroidery products such as women's dresses and scarves. According to a 2007 report published by Mintel International Group Ltd., market drivers and future trends in the baby clothing market segment predict steady growth, with the infant/toddler segment still claiming the biggest share of the market.

Sales in the \$48.7 billion children's clothing market have been growing steadily since 2002, as parents who may be on a tight budget continue to find money in their discretionary income to spend on children's clothing. Sales have been healthy and continuing upward, growing 37% from 2002-07 in current terms. Current sales activity is expected to remain robust, but deceleration could occur with further economic adjustments such as the current softening of the US housing market and global economic crisis.

As sales for baby clothing increase in the US market, specialty boutique retailers are sprouting up in order to respond to high market demand. There are over 300 high-end boutique children's clothing stores in the New York City vicinity with thousands of stores located throughout North America. With the increase of luxury trends and the boom of the eco-conscience consumer, the market opportunities for a high-end and eco-friendly embroidered baby clothing line are significant.

2.4.2 Production and Design

Informal producers face high production costs related to the level of labor intensity required for most traditionally designed products. This is particularly true with respect to embroidery where a single piece can take several weeks to complete. The number of women utilizing handicrafts as supplemental income has been estimated at over 60,000 (based on a Handicraft Sector Analysis completed by the POWER program in October 2005); however, a recent Economic and Social Commission for Western Asia (ESCWA) study shows that 66% of all Palestinian women work through home-based income generation activities such as crafts and food production – this equates to approximately 670,230 women according to PCBS population statistics. Based on these statistics we assume that at least 30,000

¹ USAID Cluster Competitiveness Assessment 2007

Palestinian women produce embroidery throughout the West Bank and Gaza. The production and distribution of the embroidery is primarily facilitated by a variety of NGOs and women's associations who provide access to raw materials and markets through local craft fairs and retail outlets in hotel gift shops, as well as online retail. The quality of production differs from producer to producer, but the NGOs who are targeting the export/tourist market identifies and sells high-quality products.

2.4.3 Transportation

The cost of shipping products has more than doubled because of the need for 'back-to-back' transport across borders. Consequently it is no longer cost effective to ship small orders of less than one pallet in size. VAT system creates difficulty in shipping to many smaller retail including NGOs and churches that have not filed required paperwork to obtain a number.

2.4.4 Raw Materials

Typically, raw materials are supplied by the NGO or women's association directly to the producer and are calculated into the final price of the embroidered piece when it is sold. High quality thread imported from Europe adds to the high cost of the end product, but since local supply of high quality raw materials is limited, it is necessary to import the inputs into the West Bank.

2.4.5 Gender

Roughly 86% of women in Palestine do not work outside the home, primarily due to social constraints. Working on home-based embroidery production represents a unique opportunity for these women to supplement their income and develop vocational skills.

2.4.6 Income Generation

The excess inventory in the local tourist market results in unpredictable demand. This situation is exacerbated by the fact that producers are often not paid by retailers until their products have been sold. Although some of the highly skilled embroiders are able to sell their products for high prices (in the hundreds of dollars range) these type of products can take months to complete. This results in income as low as \$25 per week.