

Leveraging Technology for accelerating the Growth of Rural SMEs in GPZ Value Chain

Abstract

In late August of 2016, the Legislative Parliament of Nepal approved the Special Economic Zone (SEZ) Bill (2014) which included a landmark law prohibiting workers from holding any form of banda, protests or revolts affecting production. This decision that came after 16 years of waiting has been a huge boost for SEZs. At the moment, only Bhairahawa SEZ is preparing for operation by signing land-lease contracts with selected industries that have applied for space within the SEZ.

Simara SEZ is the SEZ in pipeline after Bhairahawa SEZ, and is supposed to have a separate garment processing zone (GPZ). However, little has been done to develop the backward linkages which can potentially serve the garment industries. Rural farmers, entrepreneurs, and enterprises capable in supplying garment industry with necessary input materials lack appropriate technology to do so efficiently.

Technology Development Fund (TDF), which aims to support industries and entrepreneurs by providing locally developed technology, is one promising avenue . Unfortunately, TDF lies dormant at the moment since its formulation in 2013. This paper examines the opportunity to link TDF with GPZ in order to bring it out of current dormancy.

Scope of the Study

The research topic 'Leveraging technology for accelerating the growth of rural SMEs' requires further explanation in order to specify the research boundaries. After various interactions with related agencies including Ministry of Industry, Special Economic Zones Development Committee and other relevant stakeholders, 'technology' in the research refers to technologies related to garment processing industry. Likewise 'rural SMEs' refers to potential SMEs present in the garment processing value chain around the regions where the SEZs are being build. And specifically the research was conducted considering the development of potential ecosystem around Simara Special Economic Zone (SEZ) which is being built as a Garment Processing Zone (GPZ).

Research Methodology

The study uses qualitative data analysis approach, and has used three major data collection methods listed as follows:

1. Desk research
2. Key informant interviews (formal and informal both)
3. Observation (during interaction programs)

Most of the information was collected using secondary sources like information available in the Internet. These information included policies, bills, and acts of Nepal accessed through websites of ministries and public agencies. Additionally, news contents were also accessed through on-line versions of English dailies in Nepal.

Secondly, interviews and observations were used for collection of primary data. Both semi-structure d as well as unstructured interviews were conducted with key personnels in government agencies, entrepreneurs, and experts of Nepal. Lastly, major chunk of primary data also came from attending interaction programs related to SEZs in Nepal organized by various development partners.

Rationale for Special Economic Zones

In 1978, when China realized it needed Western technology and investment to transform its economy, it opened doors for foreign capital and businesses by establishing four special economic zones (SEZs) (Open Door Policy, 2016). Since then it has grown into an economic giant. And such is the significance of SEZ for any country seeking economic growth. Farole (2011) defines SEZs as *'demarcated geographic areas contained within a country's national boundaries where the rules of business are different from those that prevail in the national territory. These differential rules principally deal with investment conditions, international trade and customs, taxation, and the regulatory environment; whereby the zone is given a business environment that is intended to be more liberal from a policy perspective and more effective from an administrative*

perspective than that of the national territory.' Simply put, SEZ provides a secure and enabling environment where businesses can operate with lesser chance of being affected by the external factors.

Special Economic Zone Development Committee (SEZDC) has been assigned to capture the promise of SEZs in Nepal. SEZDC in Nepal has envisioned to achieve the following through establishment of 14 SEZs around the country:

- attracting FDI
- growing industry verticals
- enhancing business environment

First, SEZDC plans to facilitate and support foreign investors interested in investing both manufacturing and services sectors. Second, the committee also envisages to expand and extend the existing industry verticals by capitalizing on high growth areas. Third, the committee also aims at enhancing business environment by strengthening essential infrastructure and public service delivery. (SEZDC, 2016)

Export Potential of Garment Produces

Garment industry had been a thriving sector for Nepalese entrepreneurs which is also indicated by the fact that total export of ready-made garments in the fiscal year 2001-02 was worth NRs. 12.5 billion (THT-SEZ, 2016). A recent study has highlighted the potential of garment industry to be huge (1 billion USD if only 0.05% of potential of 200 billion USD US market can be tapped) along with 100,000 new jobs creation (THT-GI, 2016). Moreover, a recent US legislation has authorized special trade preferences for Nepal allowing duty-free tariff benefits for upto 66 Nepali products which include shawls, scarves, carpets, headgear, and travel goods (US tariff, 2016).

Nepal Trade Integration Strategy (NTIS) 2015, which is Nepal's main trade strategy document, charts actions and measures of intervention in cross-cutting areas, such as trade capacity building including trade negotiation, trade and transport facilitation, standards and technical regulations, sanitary and phyto-sanitary measures and intellectual

property rights. The NTIS 2015 also identifies priority export potential sectors which includes:

1. agro-foods (cardamom; ginger; tea; and medicinal plants)
2. crafts and manufacturing (all fabrics; textiles; yarn and rope; leather; footwear; pashmina; and carpets)
3. services (semi-skilled human resources; information technology and business process outsourcing) and
4. tourism. (EIF, 2015)

SEZs in Nepal have a mandatory provision to export 75% of all the products. It also subsidizes industries that make use of local raw materials. 15 varieties of potential industries that can be set up in the zone are listed as follows:

- | | | |
|---------------------|----------------------------|----------------------------|
| 1. food products | 7. metal products | 13. electrical/electronics |
| 2. herbal products | 8. sports wear | parts and components |
| 3. leather products | 9. jewelry | 14. IT |
| 4. garments | 10. plastic products | 15. Products identified by |
| 5. hand-made paper | 11. hosiery products | NTIS (SEZDC, 2016) |
| products | 12. assembled electric and | |
| 6. handicrafts | electronics products | |

Garment produces lie in the intersection of both NTIS and SEZ strategies. Garment industry has the potential to exploit global markets given the past experience in global garment export, and the present opportunities provided by new avenues like opening in the US market.

Garment industry value chain and role of technology

The garment (apparel) industry is a buyer-driven value chain. The five main parts that organize the garment value chain is depicted in Figure 1. There are different enterprises working within these five major parts. In raw materials network, producers of natural and

synthetic fibers are present. The textile companies, in the component network, add value to the fibers by turning it into yarn and fabric through processes like spinning, weaving, knitting and finishing processes. Furthermore, garment and apparel manufacturers present in production network are responsible for manufacturing of finished garments. In export network, different brands, trading companies and retail outlets channel the finished goods to the market. Lastly, the products meet the buys through the marketing networks such as department stores, specialty stores, mass merchandise chains, discount chains and similar others. (Gereffi & Memedovic, 2003)

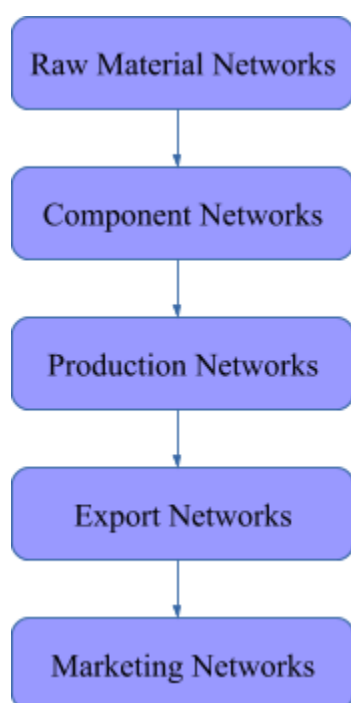


Figure 1. *The Apparel Value Chain. (Appelbaum and Gereffi, 1994)*

The garment value chain clearly states two input materials: natural and synthetic fibers. Since Nepal does not have commercial source of synthetic fibers (oil, natural gas), the focus is shifted to natural fibers. Natural fibers need to be processed to yarn and consequently into fabric as depicted in components networks as in Table 1. Moreover, the GPZ being build in Simara SEZ can be considered as production network.

Table 1. *The Apparel Value Chain explained. (Appelbaum and Gereffi, 1994)*

1.	Raw Material Networks	Natural fibers (<i>Cotton, wool, silk, etc</i>)		
		Synthetic fibers (<i>Oil, natural gas</i>)		
2.	Component Networks	Yarn (<i>spinning</i>)	Fabric (<i>weaving, knitting, finishing</i>)	
		Petrochemicals	Synthetic fibers	Fabric (<i>weaving, knitting, finishing</i>)
3.	Production Networks	Garment factories, Garment contractors, Subcontractors		
4.	Export Networks	Branded-named apparel companies, overseas buying offices,, trading companies		
5.	Marketing Networks	Department stores, specialty stores, mass merchandise chains, discount chains, off-price, factory outlet, mail order, retail outlets		

The challenge that remains in this value chain is the concern about processing technology of Nepali produces. Garment Association of Nepal has been advocating for the AZO compound making and testing technology for long which shows how lack of technology is creating barriers for garment entrepreneurs. Technology has been bottleneck for to ensure productivity as well as quality of elements in the raw material network in Nepal. Cotton, silk or wool farmers in Nepal do not have access to proper technology by making use of which they can add value to their produces. Without improving on this raw material network, GPZ Simara will not see local raw materials being used for export-ready garments.

Government Policy to promote Garment Industry

The decision to establish Garment Processing Zone (GPZ) within Simara Special Economic Zone (SEZ) tries to address the lack of organized production network in Nepal. GPZ will have dedicated space and infrastructure for garment processing facilities which is a welcome policy intervention. However, what is missing in the value chain link is the ideation about the raw materials network and component networks in the backward linkage. The support system that is required to enrich the input value chain has not

received proper attention from the government.

On the other hand, Government of Nepal has also envisaged to provide appropriate technology for local industries and entrepreneurs by establishing Technology Development Fund (TDF). The aim of this fund is to make technology attainable and affordable to local industries and entrepreneurs in order to help Nepali produces to improve their cost and quality competitiveness in global market. Directive for TDF was formulated in 2013 and operating procedures was drafted in 2014. However, since then TDF remains dormant with fund of NPR 30 million unused in its account.

Recommendations

The major recommendation of the study is to activate good but dormant policy like TDF through linking it to both good and active policy like that of SEZs or GPZs. TDF is a good policy however lacks implementation due to lack of clarity in various grounds. Besides the dilemma like whether the fund is to be given as loan or grant to whoever receives it, the major problem remains is who actually is eligible to receive funds allocated in TDF. This confusion stems from the vague and open ended meaning of technology, and variety of industries that exists in Nepal. There is no clarity on drawing the rationale for selecting the industries and their technological needs. Therefore, if TDF can be linked with GPZ, this will narrow down the type of industry to garment industries and their technological needs.

Broadly, if TDF can be linked with GPZ then the criteria will be narrowed down to the value chain of the select garment industries that can be established within Simara SEZ. That way the fund in TDF can be funneled to farmers, entrepreneurs, and enterprises in Nepal which can potentially provide input materials to the garment factories established within GPZ of Simara SEZ. This helps in use as well as promotion of national produces that can be popular in global market.

The second recommendation would be to quicken the implementation process of essential policies for economic development. SEZ was planned in 2000, however the SEZ bill was

passed only in 2016. Similarly, construction of SEZ in Bhairahawa began in 2003 which was inaugurated only in 2013, and selection of industries is ongoing in 2016 as well. These equal to 16 years between planning the SEZ to passing the SEZ bill, and 13 years in between start of physical construction to lot assignment to industries willing to establish their facilities within SEZ. Thus, if implementation of TDF would have similar fate, then strengthening of raw material network of garment value chain in Nepal will be a mute spectator to potentially thriving export oriented garment industries in Simara GPZ.

Limitations

The study has been based on qualitative methods by using methods like observations during interaction programs, semi-structured as well as ad hoc interviews, and desk research. Due to the lack of quantitative measures, there is lack of numeric evidences which might have validated the findings of the research. Secondly, only handful garment entrepreneurs could be reached due to limitations of time, budget, and geographic distance which has hampered in uprooting the real technological needs of enterprises active in garment value chain in Nepal. Lastly, the recommendations of the study require changes in existing policies. Therefore, future researches can focus on what ground work should be completed before amending existing policies in Nepal.

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