A STRATEGIC SECTOR STUDY on the EGYPTIAN FOOTWEAR and LEATHER INDUSTRY

THE INDUSTRIAL MODERNISATION CENTRE

IMC/PS-38

PART I: GLOBAL REVIEW

Cairo November 2005

PREFACE

The present (draft) report covers the completed Phase I & II: of the Strategic Sector Study on the Egyptian Footwear and Leather Industry as contracted by Egypt-Industrial Modernization Centre IMC to STEM-VCR s.r.l. (Italy).

The report consists of the following two parts:

Part I : Analysis of the Global Sector
Part II : Local Assessment & SWOT analysis
Part III : Bench Marking

For this purpose, the following team of consultants have been assigned by STEM-VCR s.r.l. as contracted by the IMC to undertake the task – within the prescribed Terms of Reference:

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A kick-off meeting on 19 July 2005 with the IMC Task Management and the Team has signalled the commencement of the study in line with the Terms of Reference where activities to follow have been planned.

Throughout the course of activities, frequent consultations have taken place at the IMC for follow-up on the progress of activities and progress reporting.

Consequently, a brief presentation on power point was made by the Team to officers of the IMC and members of the Industry Steering Committee on 28 September 2005.

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Executive Summary

In 2001 Egypt initialled an agreement with the EU which among other things specified co-operation in economic development. This is aimed over a period of 12 years at establishing a FTA with EU member states and thereby entering the Euro-Mediterranean free trade zone. For successful integration Egypt needs to upgrade its industrial performance across many sectors. One of the main sectors in the Egyptian economy is the Leather Industry. This consists of processing a natural product, the tanning of leather, to manufacturing goods from it, footwear, personal leather goods and garments. The industry represents about 5% of the total industrial sector of the Country. It employs (together with the textiles sector) about 30% of the Egyptian workforce.

The industry is suffering from cheap imports from the Far East, particularly China, and a lack of success in the highly competitive global export market. Factories are running at 25- 40 % of capacity. The excess capacity so produced presents, in the short term, an opportunity for Egyptian manufacturers to market themselves as sub contractors for international (European) brands rather than trying to become original product marketers. This will bring a lower risk exposure to the global market and allow for the transfer of technical and marketing knowledge by osmosis to the local companies.

With this background in mind this study concentrated on certain tasks:

- **A global review of the leather products industry as defined, footwear, personal leather goods and garments**
- **A local assessment of the present performance of the Egyptian industry sectors**
- **A benchmarking analysis using competitor countries**
- **A strategic positioning of the Egyptian industry internationally and SWOT analysis**
- **A development strategy and action plan for implementation.**

It was found globally that the leather products industry is an expanding market year on year. Some sectors expanding more than others. Footwear in particular showing the strongest international growth. There is a trend, well established, of an aging world population with significant markets among older consumers (50 years +), the so-called "grey" market and an emphasis on comfort, quality and the use of leather (as opposed to synthetics).

Manufacturing presently takes place in the East and the marketing in the West due in the main to cost pressures in the west on mature manufacturing industries. Egypt has an advantage here with relatively low wage rates which are competitive on the world stage. The driving force for manufacturers will still be the large markets of Europe, USA and Japan. (Over 85% of the world export market for footwear). With the concentration of manufacturing in the Far East and the Indian sub continent and the ever increasing

demands of western consumers for change and variety almost on a monthly basis, proximity to the market place and the ability to provide flexible rapid delivery will be a big advantage in the future. This provides Egypt with an inbuilt competitive advantage. This is not to say China and the Far East will decline but at the very least it provides a wedge for Egyptian products to enter the market place with this advantage. The supply chain concept will metamorphosise into a supply circle of smaller, high tech, CAD/CAM, nimble production units, which will work very closely with customers to produce goods in weeks rather than the months it takes at present. The Egyptian industry has a great opportunity to re-organise into a customer friendly sector and leap frog over the more established countries. This opportunity will present itself as the need for sub contractors to replace the declining manufacturing base in Italy, Spain, and France etc.

Egypt has an opportunity to attract FDI with the correct facilitating environment. Among the Middle East countries the World Economic Forum ranks Egypt 9th in their "economic freedom index" after Jordan, Tunisia, Saudi Arabia and Morocco. This position will have to be improved to provide a better business climate.

The local leather products manufacturing industry is clearly divided in two. The majority of products are produced by the informal sector, up to 95% in the footwear sector. That part of the footwear industry which is mechanised and therefore the most likely to export (up to ~5 million pairs, about $75, 000,000) is hampered by low productivity and high overheads due to poor capacity utilisation. This applies also to the personal leather products sub sector. The PLG sub sector tends to be more artisan in nature (even in successful exporting countries) but relies on productivity and keen costing to compete. The Egyptian leather products industry needs to re-structure along the lines of CAD/CAM mentioned above. Owners need to understand *and accept* the realities of dealing internationally – the importance of productivity, modern costing techniques and marketing especially in a business to business (B2B) environment – if they want to succeed.

A further weakness in the local manufacturing environment is the availability of good quality finished leather that is up to international norms. There is no doubt this can be made by tanneries in Egypt. It can probably be made and sold in the Country at less than international prices – a big advantage. However there also exists the old argument between tanners and leather product manufacturers about prices versus quality. And the undoubted incentive tanneries have to export semi processed leather in a sellers market thus starving the local market of the good quality base raw material. For the export process to succeed all players in the supply chain have to work in harmony with the aim to stimulate exports. Other successful exporting countries do this. Egypt has to emulate them.

All of this will not be effective unless there is a committed management in place to supervise the operation from raw materials to conversion into a product and then bringing it to market. The industry lacks the vastly important skill of middle management expertise to manage the conversion, or manufacturing step – supervising the shop floor.

Although there are niche export opportunities available to Egypt to exploit there is of course competition to be overcome. The countries that are of most concern to Egypt are Tunisia, Morocco, Turkey, Spain and Romania. The benchmarking study has revealed the strengths of these countries which allow the Egyptian industry to plan a better offering to the market. As the decline in EU manufacturing continues and the above countries are operating to capacity there will inevitably be market opportunities presented. Egypt must position its leather products manufacturing industry to take advantage of this.

The SWOT analysis revealed major strengths in the Egyptian leather products industry:

- **Proximity to Europe**
- **Trade agreements with EU and USA**
- **Flexible manufacturing**
- **Can be low cost based**
- **Availability of competitive labour**

The major weaknesses revolve round antiquated marketing techniques poor costing and pricing practices and the lack of experienced and *knowledgeable* shop floor management. There are some major opportunities available to the industry:

- **Allow the unencumbered importation of raw materials**
- **Possibility of a safeguard action under WTO rules**
- **Allow the importation of finished leather duty and tax free**
- **Government export promotion schemes**
- **Implement value circles**
- **Train a cadre of shop floor managers**
- **Many markets open to exploitation.**

The major threats to the industry revolve round the continued encroachment of imports from the Far East, the difficulty in obtaining necessary and vital raw materials and components and the imposition of trade barriers, either official or hidden, in target markets.

The international positioning of the sector, having analysed the critical elements which make up a market's attractiveness and taking into account the sectors strengths and competitive advantages, puts all the Egyptian leather products manufacturing sub sectors in the underachievers' category. This means that the industry has probably reached its consolidated base and from this point onwards there is the opportunity to make significant progress.

1. ANALYSIS of the GLOBAL SECTOR

1.1 Social, Demographic and Regulatory Factors

The leather products industry broadly consists of tanning companies, converting by products from the food industry (animal hides and skins) into leather which is then converted by leather product manufacturers, predominantly into footwear, leather goods, and garments.

Every country in the world has a leather products industry in one form or another and every country is a market for finished goods, the biggest of which is footwear. The manufacture of products, especially footwear, pulls through the development of the tanning industry. Tanners and leather products manufacturers are mutually interdependent.

1.1.1. Social Factors

In today's world it is fair to say that most of the population has some sort of foot covering. Even people in the poorest of African and Asian countries manage to obtain a pair of shoes. As populations increase and living standards rise so does the demand for shoes. This may not be the case for leather goods, bags, wallets, belts, garments etc as they are more of a "luxury" item than a necessity. The growth in this sub sector tends to lag behind footwear.

The world footwear market has evolved from simple sandals made from old car tyres to canvas/ rubber combinations and moulded thermoplastic shoes, to leather, the material of choice of consumers. Synthetic leather is also a significant raw material for shoes and small consumer goods due to price factors and the inelastic availability of finished leather. However the trend is more and more to leather. The change to leather in personal products is not quite so fast. Many backpacks, bags and small items are still made from synthetics (nylons) with famous brand names making them an acceptable fashion statement.

With the advent of relatively easy global communications (internet, satellite TV, radio, mobile 'phones, etc) and relatively easy transport systems, people in all strata of society are better informed, better educated and more mobile. They are more affluent (even allowing for today's difficult international trading conditions). Society generally is now more aware than ever what constitutes value for money. Consumers are not easily fooled. Even the poorest ones.

With the rapid urbanisation, particularly in developing countries, there will be more demand for footwear and personal leather goods of better quality. The days of turning out inferior so called cheap products will be over in the next 5 – 10 years. (China is desperately trying to upgrade its leather products and change its image of a mass producer of cheap inferior quality synthetic products)

Coupled with this is an added social dimension about working conditions and the ethical treatment of labour. Sports shoe companies operating in the Far East fell foul of the

international community when it was revealed just how their shoes were being made. A public outcry forced a sea change in working conditions, reducing working hours and increasing benefits for workers. Inevitably this increased costs but it did not increase the prices of shoes at the retail level.

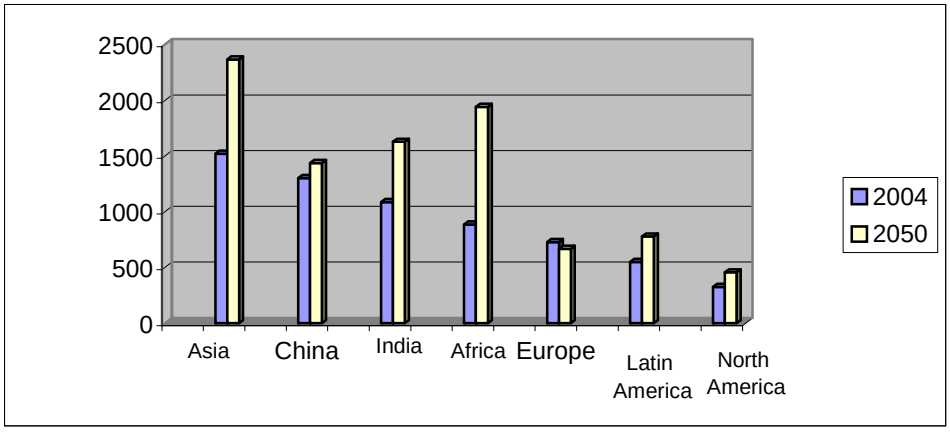
This means that now companies must pay attention to providing good working conditions. No country is immune from this. A happy and contented work force is usually found in the most successful leather goods manufacturers' factories. *Society* demands these norms.

1.1.2 Demographic Factors

According to the International Union for the Scientific Study of Population (IUSSP): "2005 marks a new demographic shock as the ageing population produces a delicate balance between the working and non working." This is also affects the developing countries and will become one of the important changes in the 21st century". Today the world population is just over 6.5 billion and is expected to cross the 9.0 billion threshold by 2050, an increase of 3 billion people.

In global terms population growth will be highest in the Indian sub continent and Asia mainly China. The population in Europe is predicted to decline. In the so called less developed regions Africa and Latin America will increase lead by Niger. Of the developed regions only North America will show an increase.

Chart 1 – Population in Million (2004/2050)



Source: Population Reference Bureau (USA)

The expanding markets for leather products by [1]*potential customers* in terms of size are Asia / Oceania, Africa, India and China. Europe, Latin America and North America are showing a decline or modest growth.

[1] *This does not mean per capita consumption but only by population.*

Although there will be significant surges in population in Asia (including China) and Africa this will be counter balanced by low population growth in Europe and to some extent North America. The average world annual growth rate for the next 6 years is estimated at only an average of 1.125% per annum.

During the next 15 years the predicted swing to a more ageing population is as follows:[2]

Table 1 – Ageing of World Population

Asia excluding Near East: Population: 2005: 3,647,785,597				
	2005	2010	2015	2020
Ages	%	%	%	%
25-54	41.2	42.0	43.1	42.9
55+	13.2	14.9	16.6	18.6

Europe: Population: 2005: 524,168,036				
	2005	2010	2015	2020
Ages	%	%	%	%
25-54	43.1	42.5	41.5	39.7
55+	29.0	30.4	32.5	35.1

North America: Population 2005: 328,667,927				
	2005	2010	2015	2020
Ages	%	%	%	%
25-54	42.8	41.5	40.0	38.5
55+	22.8	24.9	27.2	29.3

C.I.S.: Population 2005: 280,044,164				
	2005	2010	2015	2020
Ages	%	%	%	%
25-54	43.0	43.7	44.1	42.9
55+	20.7	22.2	24.5	26.5

North Africa: Population 2005: 158,603,970				
	2005	2010	2015	2020
Ages	%	%	%	%
25-54	38.0	40.4	42.2	43.2
55+	10.0	11.2	12.8	14.6

Egypt: Population 2005: 77,506,000				
Ages	*%*	*%*	*%*	*%*
25-54	*37.3*	*38.7*	*40.1*	*41.2*
55+	*10.2*	*11.4*	*12.9*	*14.2*

Sub Saharan Africa Population: 2005: 732,560,563				
	2005	2010	2015	2020
Ages	%	%	%	%
25-54	29.5	29.7	30.1	31.0
55+	6.8	6.9	7.1	7.2

For manufacturers of leather products and shoemakers in particular, the shift in the age demographics from a relatively young population to an ageing one is significant. More so in that it is most pronounced in the developed markets of Europe and North America. This will entail new marketing plans, techniques and products to appeal to this particular market segment, based around the attributes described above.

[2] Source for charts U.S. Census Bureau

1.1.3 Regulatory Factors

The personal leather goods and footwear manufacturing industries are regarded as environmentally friendly ones. Very little problem waste is generated in the manufacture of products. Leather scrap is used for the production of bags and children's' sandals to the point where nothing much is left at all! Many thermoplastic materials are recycled including the newer developments in toepuff and counter materials. Solvents are used in sprays and cement attaching. However these are being replaced by water based finishes and adhesives. The result of this clean technology is that there are few extra regulations imposed on the industry.

Buyers in Europe tend to impose their own regulatory standards on their suppliers. Specifications for leather are published which forbids the use of azo dyes, PCP's and nickel derivatives. PETA (people for the ethical treatment of animals) have lobbied hard in the leather goods industry to the extent that some buyers refuse to order shoes made with Indian leather particularly in Germany. For some years the EU has been pushing for an eco label to be used on all footwear signifying its ethical and non polluting origins. This is a voluntary code of practice at present but in years to come will become compulsory either through legislation or by common usage. It is a law and requirement in the EU market that each half pair of shoes must have a"pictogramme" on them identifying what materials the uppers, linings and soles are made from. This is to stop the practice of passing off some materials as real leather.

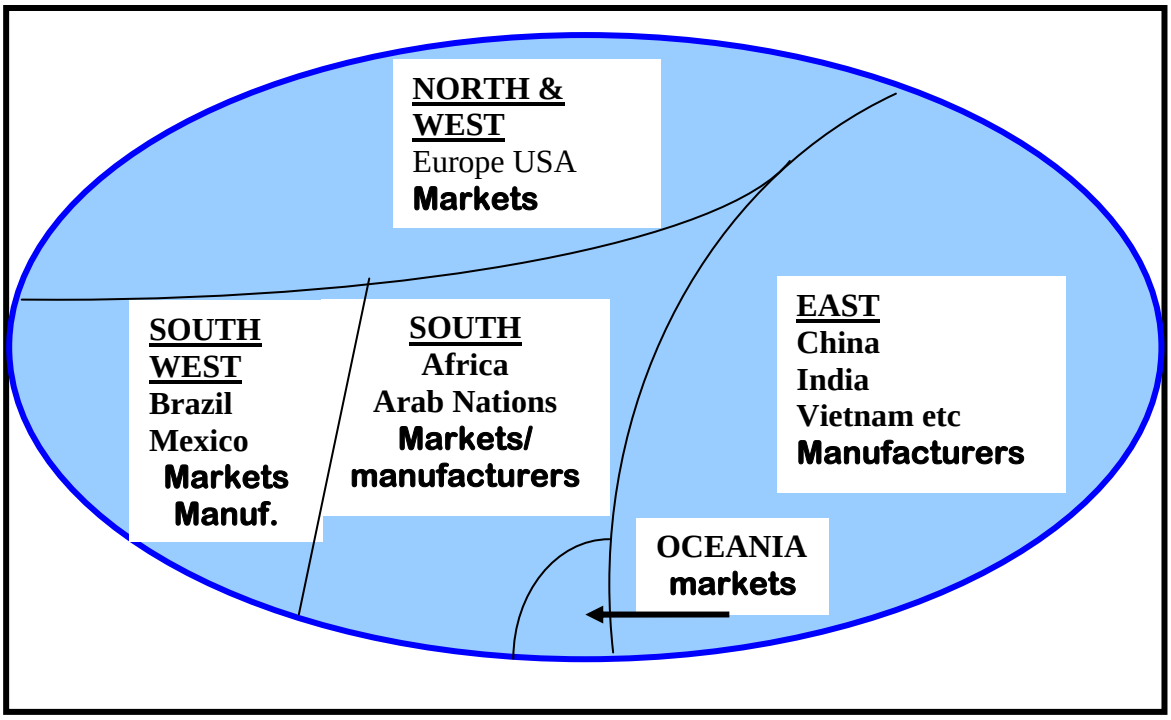
The tanning industry, perhaps somewhat unfairly, has a reputation for not being environmentally friendly. True large amounts of solid and liquid waste is produced in the tanning process but as technology improves this becomes less and less. (Chromium III, used in tanning has the same pollution impact as salt). In the developed markets the operation of a tannery is strictly controlled and the regulations for effluent control are well defined. In the future this same sort of regulation will apply to all countries.

1.2 Market Orientation & Concentration

The manufacturing and marketing of leather products has consolidated in the last 5 years into broad geographic groups. Manufacturing takes place in the East and marketing takes place in the West. The countries which manufacture, hence export, do not have saturated local markets. They have developed their leather products industry as a means of exploiting a particular advantage(s) to gain competitiveness and so gain hard currency. China, the biggest producer of leather products, particularly footwear, in the world does not have a saturated domestic market for its products. It concentrates on exports. It is well known China's source of competitive advantage is a plentiful supply of productive, acquiescent, labour who are willing to work, (at present) for relatively low wages coupled with benign industrial policies set by Government. It is a similar case in India although this country has not yet realised its exporting capacity. It is a "sleeping giant" with an installed production capacity second only to China.

1.2.1 Market Orientation

Chart 2 – Market Orientation Chart



The main open consuming markets in the world for leather products are North America, and Europe (25). These areas are the target markets for every would be exporter. The footwear manufacturing industry (which is a barometer of the rest of the leather products manufacturing industry) in these areas has declined year on year for the past 20 or so. Per capita consumption in recent years has shown a very modest increase. In other words the market is saturated either by imports or by residual local production.

The effects on imports have been to decimate the local manufacturing industries. Only in certain special situations has the local industry still managed to survive. In Europe the Italian manufacturing industry survives because of innovation in terms of being the world fashion leader. Spain and Portugal survive likewise because of a lower cost base than Italy. France, Germany, UK and USA are struggling to survive in niche markets. However all these industries are showing declines in manufacturing year on year as imports take a bigger and bigger slice of the market.

Market orientation therefore will split into two major areas of activity with sub sectors within these areas. Product development, design, styling and market absorption of leather products, will take place in Europe and North America. Manufacturing will take place in the Far East. The sub sectors will be South America which will have a North South focus and Africa which will have an Eastern influence in terms of manufactured product and a North South influence also of manufactured product. The market here will comprise the whole of Africa and the Middle East.

1.2.2 Cost Pressures

China is the market leader in determining market prices for leather products, particularly footwear. The industry in China has its own set of problems leading to cost pressures.

It is often overlooked the fact that China also has a large domestic market, over 2.0 billion pairs and expanding. It currently has less than 2.0 pairs per capita. This stable domestic base gives it a secure platform on which to export.

There are also problems looming in the industry. China is now a signed up member of WTO which will see tariff barriers falling, the reducing or elimination of trade subsidies and the opening up of the domestic market to imports. There are numerous safeguard measures being introduced or threatened in various countries to try and curb the trading practices of China which takes the form of currency, social, environmental and commercial dumping.

There is increased over capacity in the Chinese footwear manufacturing industry leading to intense competition and very fine margins or even no margins at all. (One can understand this when told of the buying prices of shoes imported to Egypt from China). Cost of living increases in the coastal areas where the industry is established has driven up wages. Chinese factories, because they rely on large volumes to break even, have a very high break-even point. If the volumes decline the factories quickly fall into operating losses.

It is claimed by some economists that if the cost of labour is more than 10% of the total cost of a finished product then it cannot be manufactured in the west. This bears out the switch to offshore manufacturing in the western leather products industry and the delocalisation of factories. The cost break down of leather products between developed countries and developing countries is estimated as follows:

Table 2 – COST BREAKDOWN LEATHER PRODUCTS

COST ELEMENT	DEVELOPED COUNTRIES	DEVELOPING COUNTRIES
Labour	**30%**	**10-15%**
Materials	**40%**	**70%**
Overheads & Profit	**30%**	**15-20%**

Source R. Beeby/Automation

COST ELEMENT	DEVELOPED COUNTRIES	DEVELOPING COUNTRIES
Table 2 - COST BREAKDOWN LABOUR COSTS LEATHER PRODUCTS		
Cutting	**2%**	**1%**
Closing	**15%**	**7%**
Making	**9%**	**5%**
Finishing	**4%**	**2%**

Source R. Beeby/Automation

Selling prices are being driven down all the time from international competitive pressures. These are determined by the market rather than the manufacturer. Successful manufacturers react to this by reducing costs. Efficient manufacture therefore is a must by getting the highest productivity from labour coupled with the efficient costing and utilisation of materials.

1.2.3 Trade Liberalisation

There is much talk about the global market and free trade. The reality is however that there are still substantial barriers in place in certain countries which affect the trade in leather products. There are a plethora of regional trade agreements which are supposed to allow the free passage of goods in and out between partners. In practice some of these agreements are opaque and it is difficult to find out exactly what the regulations *actually are* as opposed to the formal treaty on the statute books. The only real way to get the information is by trying to clear exported goods at the point of entry.

According to the World Bank "regional trade agreements (RTA) have been proliferating and now cover one third of world trade, but their liberating effect has been modest. RTA's can create trade and bring other benefits for members but results are not automatic and depend on design.

The World Bank opinion seems to bear out the situation with inter Africa trade. The regional proliferation of trade agreements now covers 30% of world trade. Apart from Africa there are agreements between North and South America, between South American neighbours, between South East Asian countries and also the Gulf States. And of course there is the European Union

The EU claims that 70% of the worlds markets have prohibitive tariff barriers for European made footwear. Certainly a large market like Japan imposes 30%+ duties and has a world quota of 12.5 million pairs of leather footwear per annum in a market of 450 million pairs.. China, India and Brazil are subject to 8% duty on the CIF value on imported leather goods to the European Union and USA.

1.2.4 Purchasing Power

Even allowing for trade agreements and protectionist measures certain markets are more attractive than others. Obviously USA and Europe have the biggest purchasing power. One method of measuring this is by using the official country figure for Gross National Income linked by a factor to calculate a purchasing power parity to allow "apples for apples" comparisons to be made. The following chart, for selected countries illustrates the point by using figures published by the World Bank in 2004.

Table 3 – Purchasing Power Parity per Capita

COUNTRY	PURCHASING POWER PARITY PER CAPITA *international $*
USA	39,710
Europe (EU15)	31,460 - 22,000
Japan	30,040
Saudi Arabia	14,010
Oman	13,190
South Africa	10,960
Russian Federation	9,620
Mexico	9,590
Brazil	8,020
Turkey	7,680
Tunisia	7,310
China	5,530 (estimate)
Jordan	4,640
EGYPT	**4,120**
Morocco	4,100
India	3,100
Uganda	1,520
Kenya	1,050
Tanzania	660

It is interesting to note that those countries that have a struggling leather products manufacturing sector (USA, Europe and to some extent Japan which is protected) have a high purchasing power and the lower purchasing power countries (Mexico, Brazil, Turkey, Tunisia, China) have a strong leather manufacturing sector represented by the wage rates in the respective countries..

1.2.5 Technological Changes

Technological changes will revolve round giving better support to a continuously and rapidly changing market place. Leather products manufacture is, to a greater or lesser extent (depending on the market niche), fashion driven, coupled with exceptional service to buyers. It operates in a business to business (B2B) environment.

For manufacturers of leather products this will mean a greater emphasis on product development, bringing better and more innovative products to the market. CAD (computer aided design) systems are much more developed now and easier to use. They have come down in price. They are within affordable reach and can be justified as a capital expense by smaller companies. The only way of bringing new products to the market quickly is by using CAD. The systems also allow for the rapid exchange of information between manufacturers, their suppliers and importantly, their customers. They can eliminate the costly and time consuming exercise of making cutting dies which helps to justify the initial investment. Small runs of new styles and developments can be brought to the market quickly for testing purposes with minimum risk.

In addition to CAD, CAM (computer aided manufacturing) is used by successful international companies. The most time consuming and quality critical operation in leather product manufacturing is stitching the parts together. There is now available a whole new generation of computer controlled sewing machines which speed up the operation and give near perfect results every time. They are more expensive to purchase than conventional machines but their productivity is much higher. They can increase output per worker from 10 pairs per day to 25, an increase of 250% in productivity. At these levels it will not take long to justify the investment.

New methods of manufacturing can be introduced at shop floor level to gain greater flexibility and less work in progress. (Toyota sewing circles, rink systems etc). The machines operate in tandem with the CAD systems. The CAD/CAM systems offer speed, reliability and productivity to their users. In the future customers (buyers) will expect these systems to be in place in their suppliers factories.

With the market driven emphasis on shorter runs produced in less time JIT (just in time) manufacturing will become widespread. Apart from modern flexible factories it will be important to get the products to the shops quickly. Presently products are shipped to warehouses and distributed from there to the shops. New logistics control with new electronic laser readers (as opposed to bar codes) will enable inventories to be better managed and products to be sent direct to shops bypassing the traditional warehouse. Closeness to the market will also become more important.

1.2.6 Industry Concentration

The leather products industry operates as two sides of the same coin. The sides are product development and manufacturing. Innovation, styling, design, new materials and components, new leather finishes are developed either in Europe or USA. Because of this, in a sense, the control of the industry is in the western world rather than the Far East – the consumers are in the developed markets.

Globally, product development is very concentrated. The vast majority is done in Italy “the home of fashion.” Footwear, garments, personal leather goods and leather finishes are designed here with Spain a close follower. Sports footwear in particular is developed in USA.

This situation is unlikely to change in the near future. However efforts are being made by the producing countries, particularly China and India, to do their own product development and establish their own brand names. This is their stated policy. It remains to be seen if these two major manufacturing countries can also add the difficult skill of influencing fashion to western tastes.

There is no doubt that manufacturing has rushed to mainland China. However China still remains an unpredictable source. Recently the currency has been re-valued, perhaps only in a small way. This has made prices a little more expensive. But this may be the start of a trend brought about by international pressure, particularly from US. Companies are looking at Vietnam as a more stable source at least for the near term and as an insurance policy in case something goes wrong in China as it did a few years ago in Indonesia. Even allowing for this, the Chinese and Indian authorities are going ahead with aggressive plans to build more specialist "manufacturing cities", especially shoe cities, with the aim of increasing their share of the world markets.

Table 4 – World Supply of Exported Footwear

	Rank	Value $000	%World
Asia	1	22,983,421	49.34
Europe	2	20,078,974	43.10
Latin America	3	1,963,779	4.22
North America	4	868,626	1.86
Africa	5	329,900	0.71
Middle East	6	280,105	0.60
Oceania	7	77,789	0.17

Source. ICON Group Ltd (2003)
www.icongrouponline.com

The above chart shows the geographic concentration of exporters of the most important sector of the leather industry – footwear. Personal leather products and garments tend to follow the same trend. Tanneries and component suppliers (injection moulded products e.g. soles), which are capital intensive plants tend to be less flexible in relocation. However these plants are in the process of relocating from Europe to South East Asia and India to be nearer to their customers.

1.3 Global Capacity & Consumption

With the emergence of new international, efficient, aggressive, manufacturers of leather products in the last 10 to 15 years, namely China, Indonesia, Vietnam, and India, (possibly to some extent, Brazil), there inevitably developed an overcapacity in manufacturing. Word

markets in the last 10 – 15 years have been well served with products - there was no shortfall. These new suppliers forced equilibrium of capacity so that it was brought into line with demand. Western producers stopped being manufacturers and became service industries instead. They left the manufacturing to the more competitive producers.

Companies such as Nike, Reebok, Converse, Timberland, Florsheim, Clarks, Dr. Martens, Salamander, André, and many more all gave up manufacturing. They continue to market and sell internationally, shoes, garments and accessories under their brand names.

Statistics from the footwear sector tend to reflect the overall picture for the consumption of the total leather products industry. The following charts published by SATRA (Shoe and Allied Trades Research Association, UK) show the trends and footwear industry growth patterns.

Table 5 – GLOBAL FOOTWEAR CONSUMPTION OVER 10 YEARS

CONSUMPTION (MILLIONS OF PAIRS)	1998	2000	2002	2004	2008
Asia (all)	4,744	5,222	5,474	5,840	6,528
Americas	3,011	3,274	3,279	3,433	3,611
Europe (all)	2,239	2,396	2,544	2,717	2,886
Rest of the World	1,086	1,187	1,172	1,317	1,399
TOTAL	11,080	12,079	12,469	13,307	14,424

Table 6 - GLOBAL FOOTWEAR CONSUMPTION PER CAPITA OVER 10 YEARS

CONSUMPTION (PAIRS/CAPITA/YEAR)	1998	2000	2002	2004	2008
Americas	3.8	3.9	3.9	4.0	4.1
Europe (all)	3.1	3.3	3.5	3.7	4.0
Asia	1.4	1.5	1.5	1.6	1.7
Rest of the World	1.1	1.1	1.1	1.1	1.1
WORLD AVERAGE	1.9	2.0	2.0	2.1	2.2

In the year 2003 the following was the market in financial terms for exporters of footwear, i.e. the major importing areas.

Table 7 – Major Importing Areas

REGION	US$ 000	% OF WORLD
Europe	23,362,091	50.15
North America	15,718,585	33.74
Asia	4,256,841	9.14
Latin America	1,022,423	2.19
Middle East	903,873	1.94
Africa	689,675	1.48
Oceania	629,106	1.35
TOTAL	46,582,594	100.00

Source: ICON Group Ltd.(2003) www.icongrouponline.com

The market in monetary terms shows a different picture with Asia lying a poor third behind Europe and North America, reflecting the degree of sophistication in each market.

China produces and exports more shoes than any other country by far, (production 2004 about seven billion pairs). It is also the biggest consumer of footwear by virtue of the size of its population. On the other hand its per capita consumption is low – on a par with developing countries.

A further breakdown of the major consuming countries and areas is as follows:

Table 8 – Major Consuming Countries

COUNTRY	CONSUMPTION MILLIONS / PAIRS	POPULATION MILLIONS	PER CAPITA PAIRS /PERSON/YEAR
USA	1,939.7	290.3	6.68
Japan	584.4	127.2	4.60
EU	1,666.5	380.2	4.38
Canada	122.4	32.2	3.80
Taiwan	82.7	22.6	3.66
Australia	72.0	19.7	3.65
Korea	165.4	48.3	3.42
Brazil	483.0	182.0	2.68
Thailand	144.4	64.3	2.25
Mexico	180.4	104.9	1.72
China	2,768.7	1,286.9	1.71
India	1,687.0	1,049.7	1.61
Indonesia	350.0	234.9	1.49

Source FDRA (2004)

The global production of leather products from the major sources can be summarised as follows.

Table 9 - GLOBAL PRODUCTION 2004

PRODUCER	FOOTWEAR 000' pairs	PLG 000' pieces	GARMENTS 000' pieces	LEATHER 000' sq. ft.
China	7,000,000			1,700,000
Vietnam	480,000	37,000 (bags)	32,000	35,000
India	1,736,000			595,000
Brazil	650,000			340,000
Europe	705,090			(Italy)765,000

In summary it can be said that global capacity in manufacturing terms is in line with consumption. The only unknown is the supply of finished leather. Even if there is a short fall here more sophisticated synthetic materials are available to fill the gap. The main emerging markets will be China and India. These will be difficult to penetrate with unbranded products.

However they will take up more and more of the manufacturing capacity of these countries which will leave less capacity for exports. This may give some relief to hard pressed manufacturers in other countries. The CIS with a large population, who in the past, have enjoyed a fairly high standard of living, will gradually get back to its former level, thereby creating an emerging market for leather products.

Japan also will be forced by international treaties and the WTO to reduce its tariffs on imports of leather products, particularly footwear. The footwear associations of the EU are already lobbying ministers to get some relief. It is only a matter of time before these trade barriers are removed.

Africa also is an intriguing emerging market. Some of the sounder economies (South and East Africa) are good potential markets. South Africa has ready access by sea. With the current political will to reduce poverty in Africa and the insistence by the donor community for prudent government, this may produce commercial opportunities. There is a demand in Africa for inexpensive, fashion neutral, strong leather shoes.

1.4 Global Sourcing and Value Chain

The procurement process for footwear and personal leather goods by the mass marketers tends to be rather complex. Over the years companies have become more expert at managing the supply chain. However even allowing for the advances in international inventory management it still takes anything from 3 to 6 months from inception to get a leather good into a retail shop. The main driver of soucing is of course the ex factory price of the product. This is only one factor (maybe a major one) in the *total cost of procurement.* Much is said about the shorter and shorter lead times demanded by retailers. Presently the system used by manufacturing in the east and selling in the west mitigates against this. Yes lead times have come down from 18 months to 6 months. But 6 months is still a risky time frame when dealing with a seasonal, fashion driven commodity.

1.4.1 The Concept of Value Chain

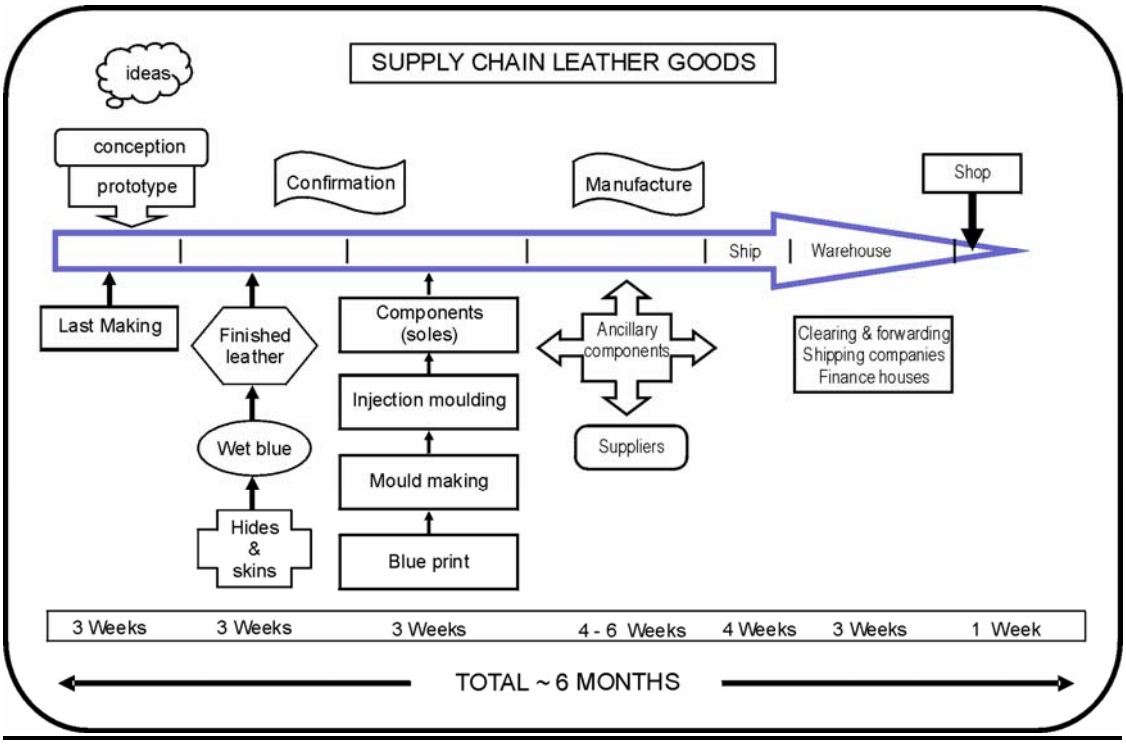
In the case of the leather products industry, footwear and other leather goods are the result of an integrated industrial value chain, where the quality and commercial success of both intermediate and end products is determined by many different factors in the stages of the chain. (I.E. in the selection and purchase of raw materials and components, in the production processes, in marketing, distribution and sales - and finally by consumer demand both at home and abroad). The value chain, presented graphically in below, begins with animal husbandry, the source of its raw materials. It then has four stages – three processing stages and the marketing[3], composed of several elements that are critical to the functioning of the chain:

[3] Manufacturing agents (retailers, branded marketing agencies and branded manufacturers) establish global production networks, principally in developing countries. Enterprises in developing countries produce the finished goods under sub-contract, in accordance with the specifications provided. Through the mechanisms of sub-contracting or joint-ventures, members of the local value chain are connected to the global value chains, accelerate the transfer of technology and learn about the design and functioning of markets.

marketing of hides and skins, the basic raw material, and the marketing of intermediate and of final products.

The leather value chain, with all the inputs, policies and support systems that it requires, is clearly a highly complex system, where problems and constraints and the search for their solutions are interrelated the whole process works as follows:

Chart 3



1.4.2 Dynamic Changes in the Global Value Chain

The need to compete in the Global market is encouraging product diversification and technological developments together with an accelerated regionalization of sourcing. Decision making on the localization of outsourcing depends on the availability of raw materials, lower wage scales and the abundance of labour, among other factors. Moreover, markets are becoming global in character and local consumers in different income levels are becoming more demanding.

The issues influencing global trends in the leather products sector are summarised as follows in Table 10 -

1. Product Related Issues	2. Technology Related Issues	3. Market Related Issues
Life cycles are shortening Product upgrades are more frequent Product families are introduced simultaneously on a global basis	**Technology complexity is increasing** Technologies are becoming more sophisticated Technologies have a stronger impact in manufacturing	**Markets are becoming global** Competition is becoming more global Markets are progressively served by multinational companies capitalizing on larger scale opportunities Norms and standards are being harmonised Countries are actively participating in regional marker communities
Product diversification is increasing Differentiated products serve different market segments, as more consumers are demanding more specific features	**Technologies are more demanding** Multidisciplinary skills re required as well as modern management processes More systematic investments in manufacturing processes	**New markets are emerging** Markets in Eastern Europe, Asia Pacific, South America and Africa are becoming more attractive and accessible New market needs are promoted by social issues, (population growth, age profiles, living standards)
Product performance requirements are increasing Consumers are becoming progressively more sophisticated and demanding	**Technologies life cycles are shortening** Substitution technologies appear more frequently	**Local consumers are becoming more sophisticated** Consumers are more aware of new competitive opportunities Consumers are more concerned about health, ethical and environmental issues Quality and durability have become dominant features even in low income markets
Prices are eroding faster Product proliferation accelerates price erosion on recently introduced products Consumers are becoming more price sensitive		

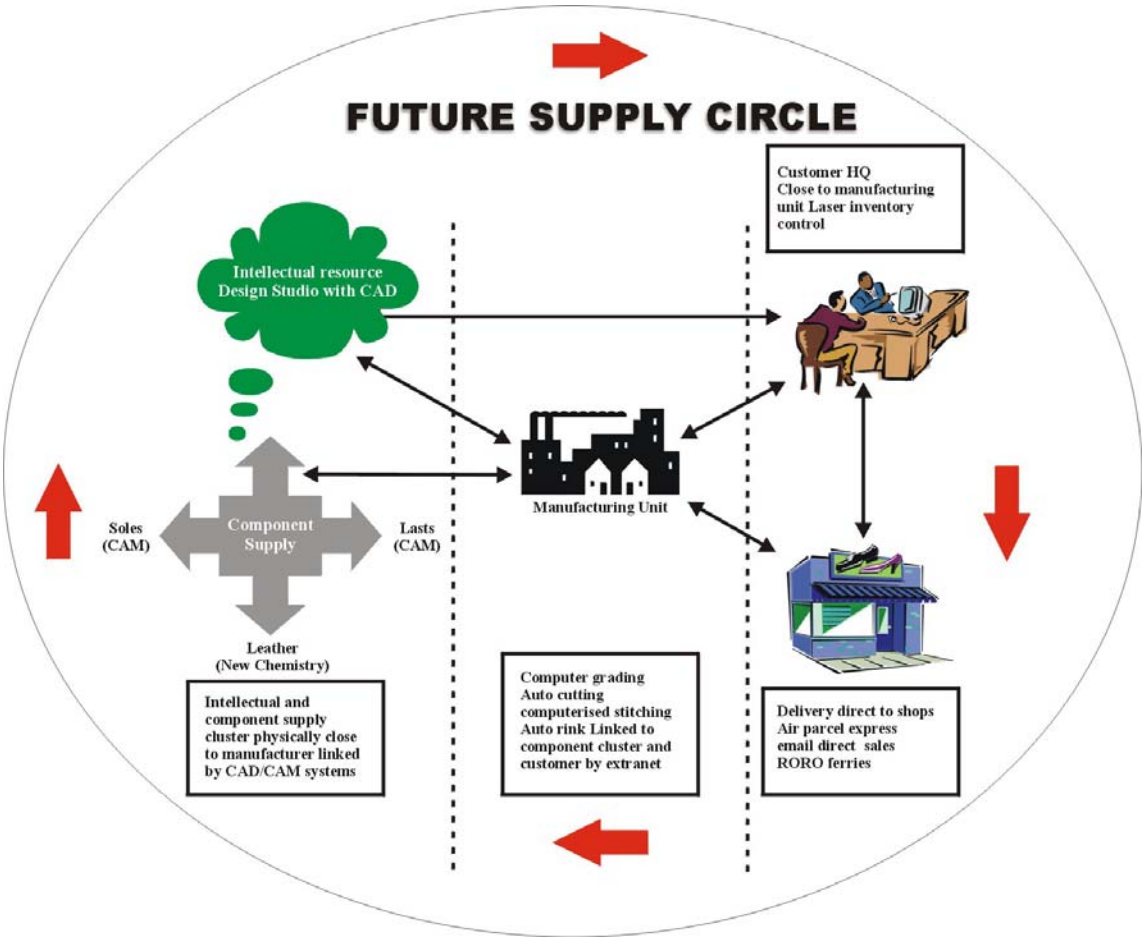
Source: adapted from UNIDO-Gherzi, Study on the Nigerian Textile Industry, July 2003

The huge consumer market of the USA has a big influence on the market. The enormous volumes required by the various retailers at volume ex factory prices means that production remains in the low labour countries where the high volume factories are located. Other markets around the world benefit from the American model in that they ride the coat tails of the system and also get their products at lower prices than they would if they were to order on a stand alone basis. However astute marketers and retailers are starting to reduce the time frame and hence the risk for orders. They also have the flexibility to get the best selling goods on the shelves before the competition. By doing this they develop loyal customers. Zara a Spanish retailer of clothes changes its styles monthly and has a system to always keep the best selling items in stock. Benetton keeps a stock of undyed clothes ready to transform immediately when it becomes clear which colours are in demand. Last year the National Shoe Retailers Association of America (NSRA) set up their “buying alliance”. This is system to get footwear direct from the factory to the retail shop, bypassing the traditional wholesaler / distributor, thereby speeding up the process.

The result of this will be an increase in local sourcing for certain items. In order to achieve the efficiencies in supply small flexible high tech factories are required equipped with CAD and CAD systems closely linked to upstream (product development companies) and downstream customers. This will shorten the time frame for product development and manufacturing. It is not uncommon presently to have leather goods designed in Italy, made in China, from leather tanned in Spain, components sourced from India, goods shipped to Holland, for distribution in the UK. This is a cumbersome and eventually unsustainable supply chain.

The following illustrates the future. Rather than being a chain the future supply system will be a circle, with each component in the circle able to communicate directly with another for the dissemination of information and for the fast reaction to customers needs.

Chart 4



1.4.3 Finished Leather

The manufacture of finished leather is becoming a fractured industry. Much of the raw material for the tanneries, hides and skins, is in rural economies. This encourages the establishment of tanneries which process only up to the wet blue stage of manufacture. This so called “dirty end” of the tanning process is the most polluting. Many tanneries in developed countries have abandoned this part of the process and buy from underdeveloped countries the semi processed and stable wet blue materials. They then finish these and sell the resultant material on the world market.

The problem is that the developers of fashion (the EU tanneries) have a strategy and a vested interest not to encourage their suppliers of wet blue to develop further. However it is doubtful that this strategy is tenable in the long run.

1.5 Global Exports and Imports

1.5.1 Global Imports

For serious leather product manufacturers who wish to enter export markets Europe provides the most potential. If "Greater Europe" (EU 25) is taken into consideration, it is the biggest import market in the world. It is also the most diversified. Europe imports cheap quality low-end shoes and high quality designer leather goods (bags and PLG) plus everything in between. There are differences in market characteristics between member states and differences in distribution methods. Some countries are easier (less difficult?) to export to than others. The size of the markets in individual countries also varies due to population and consumption trends. There is a move away from the cheaper shoes to more comfortable leather footwear. Quality personal leather goods are required as well as fashionable well made garments. Fashion plays a big part in the mass market. There is a substantial trade among the EU partners, especially from Italy, who exports to every other country in the EU.

The biggest consumers of footwear and leather goods in the EU are Germany and UK followed by Italy, France and Spain. Germany in particular, and France, Italy to some extent, have had depressed economic climates and are showing limited growth potential. UK is probably the most buoyant market in the EU at present.

The other major markets are of course the USA followed by Japan. However Japan is at present a protected market but should open up in the future. Other markets are in Africa particularly East and South Africa.

The characteristics of these markets judged by historical imports and purchasing power parity for the various product groups is as follows:

	Table 11 - GLOBAL IMPORTERS BY PRODUCT GROUP						
			Imports in US$ 000' in 2003				
COUNTRY	P.P.P	Footwear	PLG	Garment	Leather H. & S.	Leather All Types	Component (uppers)
USA	39,710	16,412,655	3,434,433	2,114,291	136,377	1,171,232	187,247
Japan	30,040	3,077,957	763,947	339,093	194,985	246,977	132,863
Europe	27,585						1,343,532
UK	31,460	3,959,555	526,592	310,677	100,018	402,449	
Netherlands	31,220	1,259,813	147,117	144,420	101,532	188,822	
France	29,320	4,064,967	472,614	352,039	115,849	546,273	
Germany	27,950	4,680,651	567,197	647,904	193,900	845,996	
Italy	27,860	3,804,994	339,983	291,709	998,679	2,338,795	
S. Africa	10,960	272,979	27,539	12,083	28,882	71,425	
E. Africa	1,076	31,017	5,386	1,162	317	176	465
World	8,760	57,809,088	9,626,500	6,249,901	6,402,647	20,411,984	
SIC		64	420211/231	84819/11	21	611	640610

ITC Comtrade statistics

The EU market is large and diversified. It is also very competitive, with all aspiring exporting countries trying to penetrate it. The market is full and occupied. The only way to enter the market is by conquest marketing i.e. beating out a competitor.

The EU is not proactive when looking for new suppliers. It is up to them to present their offering to the buyers for consideration. For buyers to take note a competitive advantage must be established and a value proposition made.

The current intra Europe suppliers, Italy, Spain and Benelux are well established and are at leading edge of the market in terms of product development. They operate in the medium to high end of the market.

Operating in the European market has other advantages. Inevitably companies are exposed to the latest fashions, technology and market trends; this is a big help when exporting to other less developed markets.

The Far East is a factor, it always is. It dominates the white shoe market supply in Europe. Far East countries compete among themselves for this market. European suppliers have more or less abandoned it. However as this market is becoming saturated Far East suppliers are turning more and more to “brown shoes” from leather and pose a threat for the future.

USA has the biggest individual market in the world for leather products. Like a magnet it attracts almost all manufacturers. However the realities of operating in the American market are harsh – it is very competitive, very big, and very unforgiving if mistakes are made.

The majority of consumer goods sold in the USA, the mass market, are sold through large chains of shops, with thousands of stores per chain. Footwear and leather goods are no exception to this fact. This type of operation needs like sized suppliers to feed the large volumes involved. This is why main stream USA looks to the Far East for its suppliers who are compatible in size.

However there are other channels of distribution that in American terms are relatively small, but for small and medium size exporters offer opportunities. Recently (August 2004) the NSRA (the National Shoe Retailers Association of America) launched their buying alliance. The NSRA represents independent retailers who generally operate small chains of shops, with an emphasis on footwear, that are family owned. (Bags and small leather goods are also sold). The buying alliance is looking to purchase for its members, private brands which are not available in other shops in USA. They aim to buy direct from producers and import directly to their member’s stores.

1.5.2 Global Exports

China has emerged as the dominant player in leather products exports, particularly footwear, because of its high capacities installed, (at least for the USA), infrastructure, and component supply industry. It also gives excellent service to its customers.

It is difficult for a non Far East country to compete head to head with China. The answer is not to, but find market niches China does not do particularly well. For example in leather footwear - trumocs, side wall stitch, McKay stitch and St Crispin construction. These shoes are a bit more difficult to make and do not lend themselves to the automated production lines prevalent in China. They are also in constant demand in the market. Boutique shop operations for bags and personal leather goods.

Vietnam is becoming a competitor to China. It is easier to deal there with smaller companies and less official bureaucracy, costs compare favourably with China. Vietnam is building up its infrastructure aiming to become a serious player and has normalised its relationship with USA. It produces footwear, garments and PLG equally well.

In parallel with these developments India was also targeting its large somewhat informal leather sector to modernise. Through Government legislation the sector aims to become one of the dominant leather shoe supplying countries.

Today the main international suppliers of low cost footwear and PLG from Asia are China, Vietnam Indonesia and India; Thailand follows. Buyers therefore looking for supplies tend to look at these countries. However there are some problems associated with dealing with the Asian region. In today's market retailers are looking for production flexibility, i.e. the ability to react quickly to market demands. They also look at the *total procuration cost* to get products into their warehouses. This includes a calculation of transportation costs, delivery times (cost of finance) fast turn round of repeats (keeps stocks down), of procurement rather than, in the past, just the price. This can put the large volume producers in the Far East at a disadvantage. China and Indonesia are not so flexible. (India and Vietnam are more flexible). Far East producers traditionally have demanded large orders (50,000 to 100,000) pairs per style for shoes. They are also far away from the main markets of USA and Europe.

Large orders are fine for large global distributors. However there is a market trend today to be more individual, requiring smaller orders of different styles more often. Large Far East factories are not geared up to this new trend (yet).

The performance of the major exporters by product group in 2003 is as follows:

	Table 12 - GLOBAL EXPORTERS BY PRODUCT GROUP					
		Exports in US$ 000' in 2003				
COUNTRY	Footwear	PLG	Garment	Leather H. & S.	Leather All Types	Component (uppers)
China	12,954,805	2,358,182	3,945,465	9,669	1,144,073	278,148,896
Vietnam	1,913,005	9,390	70,388	4,759	18,108	-
Brazil	1,622,242	3,558	3,509	4,932	1,057,071	50,696,776
Italy	8,375,820	513,181	628,884	135,507	3,666,491	130,305,033
Indonesia	1,182,185	112,394	10,438	1,582	70,338	25,726,246
India	758,211	26,137	432,822	3,361	548,753	183,478,410
Spain	2,297,420	61,459	108,516	217,511	598,798	14,127,718
Tunisia	338,960	7,981	18,435	632	20,970	163,772,320
Turkey	183,788	156,713	258,590	34,046	45,859	4,265,114
Romania	1,420,673	16,446	37,315	23,213	56,718	425,616,000
World	44,353,104	7,758,472	7,178,669	6,448,823	18,104,592	
SIC	64	420211/231	84819/11	21	611	640610

As expected China has a dominant position in almost all product groups with the exception of leather where it is a net user. China produces about 60% of the world's footwear. About 40% of these shoes are made from leather, however this percentage is growing year on year as the world markets demands more and more leather footwear, recognising the fact that Chinese synthetic items by and large are not value for money.

Vietnam, although only 15% of China's size, is investing strongly in its leather products industries – footwear, PLG and garments. It is also encouraging the investment in tanneries. Much of this development is encouraged by USA who is trying to rely less and less on China because of its dominant position in USA markets.

Romania emerges as the strongest supplier of uppers due in the main to its proximity to EU, in particular Italy, and a competitive cost base.

Italy is the world leader in terms of fashion and design. It also has a vibrant leather products machinery making industry based on progressive technology. It is a major supplier of components to the world. Other countries in Europe, particularly Spain also contribute to this concentration of knowledge and development. In Europe there is a vast supply industry supporting local manufacturers (as well as exporting to Asia).

Because of this accumulation of experience over many years Europe is still a significant exporter of leather products. This is concentrated on the medium to high end of the market. It supplies the demands of more sophisticated consumers, intra Europe as well as the rest of the world. You can see upmarket Italian shoes in juxtaposition with cheap Chinese footwear in most international cities, including Cairo. Even British made expensive ($350 per pair) goodyear welted shoes are in high demand in Italy and France as well as USA and the Gulf States.

However although the European industry is fighting hard to survive it is still loosing market share in exports. In 2003 exports of footwear from the EU were down 13.2%. Italy alone suffered an import increase in footwear of 16.9%. Other countries have similar experiences.

1.6 World Leaders and Distribution Channels

Webster's dictionary defines a leader as a guide, conductor, or commander of a faction. Leaders come and go, some successfully others less so. In the world of leather products manufacture, not so long ago Japan (1960 -1970) was a leader, then South Korea and Taiwan overtook them. Today some say China is the leader. If the purpose of identifying world leaders in the leather products manufacturing industry is to then try and emulate them with the purpose of upgrading local manufacturing practices, a set of objective criteria should be used to make this evaluation.

It used to be said that marketing was the key to any successful operation and that if you were good at it you would be successful. However this is not necessarily so in the leather products industry. Being involved with consumer goods that are fashion driven, almost a necessity of life (footwear) and complicated to make (sizes, left and right, genders, age groups), an overcapacity in manufacturing leading to intense competition, a combination of factors is necessary for success. This is not like making ashtrays. To be really successful a combination of complimentary skills, working in harmony must be in place to complete the manufacturing and marketing processes.

1.6.1 World Leaders

World leaders in different disciplines come from different countries. The leather products industry follows a sequence to bring products to the ultimate consumer. This is as follows: In each of these areas there are industry recognised leaders

Chart 5 – Leather Products Industrial Chain

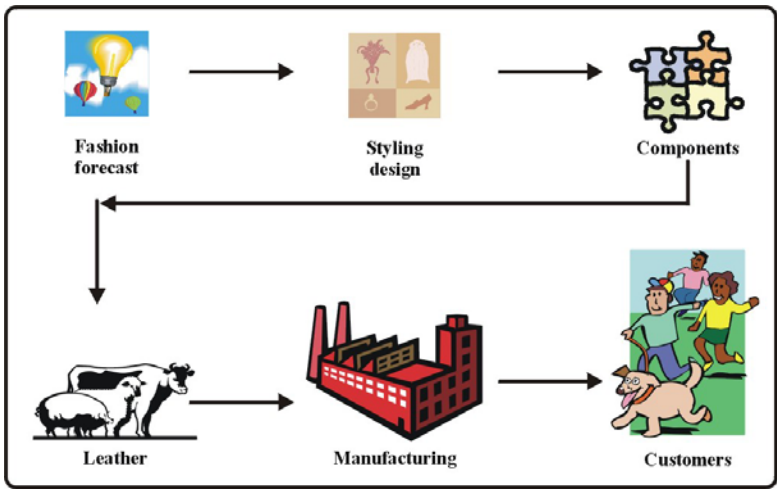


Table 13 – World Leaders area of Expertise

AREA OF EXPERTISE	WORLD LEADER
Fashion forecasting	**Modeurope Fashion Council** has been around for decades and so far no substitute. Sits in Zurich at present.
Concepts, styling and design	**Italy** the "heart" of leather goods creative thinking and design, followed by **Spain.** For sports footwear this done in **USA**.
Component design and manufacture Lasts Soles Ancillary materials Zips, buckles, handles, eyelets etc Reinforcing materials	Varies from country to country **Italy/Spain/USA** (sports shoes). **Italy/Spain/USA** (sports shoes). **Italy/Taiwan/China** **UK/Italy** (Controlled from Europe made in Far East and Europe).
Finished leather manufacture	**Italy/Spain/USA(**But tanned in Far East) **/Brazil** (semi processed leather bought from any country)
Product manufacture Small units Medium units Large units	 **Italy/Spain** **France/Germany/Mexico/Tunisia/India** **China/Vietnam/Brazil/India**
Marketing Retailing Distribution	 **USA/UK** (Many varieties of shops) **Romania/Tunisia/Italy/Mexico/Brazil** (Located close to main markets)

For comparison purposes the top 10 producers in the leather goods manufacturing industry should be evaluated against the most important criteria which would give an indication of their individual degree of excellence.

The following chart selects the top 10 leather goods exporting countries. The criteria used are those which a country needs to excel at to be successful in world markets. A straight score out of 10 (10 being the best 1 being the worst) was given to each criterion by country. A total score was then derived for each country for comparison purposes. While the chart is somewhat *subjective* it does help to try and create some sort of *objective* statement as who the true world leaders really are. Surprisingly it suggests that China is not the "world leader", although it certainly is in terms of output, but this is only one of the criteria used to make the judgement. China lags behind other countries in many of the other areas. This not to say that this is a static situation. The world of commerce is continually changing and China may well improve its current performance and become the true "world leader". In fact if the developments purported by the Chinese authorities come to fruition China may well gain the number 1 position in its own right in the not too distant future. Vietnam, although showing poorly in this comparison, is a bit of an unknown quantity. The likelihood is that in the coming years it will develop strongly and become a producer of choice for leather products - shoes, garments and bags.

Table 14 – Country Ranking – World Leader Indicator Table

CRITERIA	China	Vietnm	Brazil	Italy	Indon	India	Spain	Tunisia	Turkey	Roman
Original ideas/styling	5	4	7	9	5	6	8	6	6	4
Components supply industry	8	5	7	9	6	6	8	5	6	5
Availability of finished leather	7	6	9	9	6	7	9	4	7	5
Manufacturing expertise	9	6	7	8	7	6	8	7	6	6
Distribution, closeness to market	5	5	7	9	5	6	9	8	7	8
Quality v. price	8	8	8	6	7	7	7	7	7	8
Marketing expertise	5	5	7	8	4	6	7	5	5	5
Ease of doing business	6	5	7	7	4	5	7	7	6	7
Total score	**53**	**44**	**59**	**65**	**44**	**49**	**63**	**49**	**50**	**48**
RANKING	**4**	**9=**	**3**	**1**	**9=**	**6=**	**2**	**6=**	**5**	**8**

source: consultant's accumulated experience

Italy comes out top because of its creativity in styling which in turn is supported by dynamic component and leather supply industries. It is also part of the largest market in the world for leather products and supplies intra EU (25). Its main weakness is the price v quality criterion. Whereas nobody criticises Italian quality, the selling prices are becoming difficult for buyers to absorb. Spain has the same attributes but is smaller. Brazil is in number 3 because of a long tradition in leather working due in the main to the large leather tanning industry. It is also close to the USA and benefits from real time market information there. Brazil supplies the regional South American market.

[4]China has strength in the structure of its manufacturing industry – large factories churning out large volumes at low prices. (Some would argue the manufacturing methods are not sustainable because of the propensity of employing many people at low wages rather than looking towards mechanisation). However it falls down on original thought, distance from European/USA markets and marketing expertise (it is production oriented). The quality v price criterion is in a sense good, simply because the prices are low and the quality, to an extent, is acceptable for the price asked for the goods. On the other hand to be a true "world leader" a large amount of original thought is required.

1.6.2 Distribution Channels

In the international leather products manufacturing industry, distribution is taking on a greater and greater importance. Retailing is becoming international. Companies like Timberland, Ecco, Clarks, Benetton, Nike, Addidas, all have stand alone stores in many countries that they either own and operate or control through franchising. In the supply chain power is shifting towards the retailers. Many leather products are seasonal. One of the biggest fears and worries for a buyer is getting his product into his shops on time. If this does not happen, then no matter what price the article was purchased at or how well it was styled, means anything. Simply because of late delivery sales will inevitably be lost and are not recoverable - the season moves on. Consumers expect high levels of customer service and if they do not get it they will take their business to the competition. In the end the consumer is the ultimate driver of the business (or

[4] Another part of China's success in exports is the alleged hidden export subsidies granted by official bodies - some say in the order of 13-15%.

should be). The power in many international markets is moving down the supply chain to the person who walks in the shop expecting to find the product they want.
This means distribution channels are becoming increasingly important. Before, this used to be the last thing on the shopping list after price, styling and delivery dates.

Increasing levels of competition means that today buyers want more and more from their distribution chain. They require:

- Well organised, streamlined transportation systems
- Flexible delivery times
- Guarantee of quality
- Reliability in terms of deadlines
- Accommodation of volume needs high or low
- Elastic financial arrangements

Countries like Italy, Spain and Romania being very close to the EU (25) market can satisfy all of the above needs. Their industries structure is one of small, flexible units, delivering a high quality product. Tunisia has a very efficient RoRo (roll on roll off) system of container transport to mainland Europe. Turkey also benefits from its proximity.

In the past suppliers made the product as requested and at the end of the production line tried to find low cost methods of delivering it to the customer. Today *logistics* companies have evolved. These companies have taken over the work of the traditional warehouse distribution systems. They take delivery of the products from the factories and distribute them according to the customers needs. They will deliver to a warehouse shop or drop off point on a particular day in an agreed time slot. Even sometimes to the assortment required of sizes and colours by design. Laser readers have been developed that can read a whole container at one pass. These companies focus more on the ultimate customers' demands rather than a cost cutting exercise. Companies like Peter Black in UK supply Marks and Spencer with their shoes; Pentland Industries do the same thing for British Home Stores.

More and more the internet is being used to control the movement and distribution of goods. Some companies in sophisticated markets have developed an *electronic data exchange* (EDI). When required the buyer posts on its external network what it requires. Pre-approved suppliers are invited to bid for the needs of the buying company giving details of delivery times, prices and terms. Nordstrom (a successful USA department store chain) is trialling this method for textiles and footwear.

Interestingly the Chinese have lately developed new distribution methods. They have opened up warehouses in Dubai and Aqaba in duty free zones, stocked with shoes. It is claimed shoes can be bought here for cheaper prices than from the mainland factories and are open to any customer who wants to buy. They have recently opened a similar operation in Alicante (Elche region), Spain, home of the Spanish shoe manufacturing industry. This brought huge protests from the local industry. However the Chinese prevailed to the extent they have also opened individual retail shops. This means they control the whole chain from manufacturing to

distribution to retail customer. This model may well be replicated in other EU (25) and USA markets.

Distribution methods therefore can play an important role in the buying (or selling) process. A small shoe manufacturing unit in Addis Ababa (capacity 1,000 pairs per day) was successful in getting export business to Europe by quoting CIF prices which included sending the goods by airfreight on orders of 2,000 pairs. The cost of freight was a preferential rate given by Ethiopian Airlines. The actual ex factory price of the shoes was more than the competition but the fast, safe delivery was the thing that got the orders.

In terms of component supply, this sub sector of the industry is now beginning to chase after its customers. They realise that the distribution pipe line need to be shorter. Companies from Italy making unit soles and lasts have relocated factories to India. Likewise Germany and the UK. They want to be (are forced to be) closer to their customers.

1.7 Investment Requirements & Constraints

The leather products manufacturing industry is labour intensive (with the exception of tanning which is capital intensive). Factories are mobile and flexible. It is not difficult to move a shoe factory from one country / location to another and even easier for personal leather goods manufacture. Consequently the industry has continually tracked the most attractive operating areas. When, for whatever reason, these areas have not remained competitive, the industry moves on to somewhere else. Chasing low labour rates has been one of the factors.

In six years EU production of footwear has declined by 50%. Imports have doubled and exports have declined by 39%. This trend is not likely to change in the near future in spite of the recent EU Commission intervention by the application of safeguard measures against China. The situation is the same with personal leather goods. Some companies caught in this environment will disappear either voluntarily or through market forces, others will re-align themselves by relocating elsewhere in some form or another. These companies have a choice of strategies – move their manufacturing units off shore (Ecco) or close their manufacturing and become marketers (Clarks).

1.7.1 Requirements

Attracting new investment is based on three things:

- Political Stability
- A facilitating environment
- Emotion

i) Political Stability

Political stability is a must. Indonesia suffered irreparable damage to its industrial base particularly footwear during the political unrest and the financial crisis. Some companies closed down their operations and transferred their factories to China. The major buyers in the USA lost confidence and moved their purchases to Vietnam and China. Businesses hate sudden changes and surprises.

ii) Facilitating Environment

Governments and agencies can easily design business friendly environments, if the political will is there. The environment depends on three things Industrial Infrastructure, Financial and Human Resources and Commercial Advantages.

One of the most successful exporting countries in the region, Tunisia, is probably the bench mark to aim for *and surpass* in terms of a business friendly environment. Tunisia has advertised well its industrial zones, its preferential trade agreements, its incentives to start businesses (especially in economically deprived areas). Its labour laws are benign from an employer's point of view and it has excellent expatriate working conditions. It is also close to Europe and has very quick shipping services to the French and Italian gateways. Bureaucracy is kept to a minimum. There is a "one stop shop" system to enable foreign and local investors to start up a business.

The design of investment packages should be a major incentive for foreign investors to locate in a particular country. These usually revolve round tax holidays, retention of profits, provision of premises etc on a sliding scale from short term 5-10 years, medium term 10 – 15 years and long term 15-20 years. Obviously the better the package the more likely investors will listen. The World Economic Forum based in Washington DC has developed a model for comparing countries according to their "investment friendliness" – the "Economic Freedom Index". Rankings for the Middle East are as follows:

Table 15 – Economic Freedom Index for the Middle East

Country Rankings	
1. Qatar	7.Saudi Arabia
2. UAE	8.Morocco
3. Bahrain	9.Egypt
4. Oman	10.Algeria
5. Jordan	11.Lebanon
6. Tunisia	12.Yemen

Source: World Economic Forum 2004

The index is based on 50 variables. The major ones are Trade Policy, Monetary Policy, Wages and Prices, Regulations, Capital Flows and Foreign Investment.

Financial and Human Resources revolves round the banking system with the access to capital, loan policies and interest rates. National wages rates, social security payments by employers, training schools and the availability of skilled middle management are also under the control of Government macro policies.

Commercial advantages refers to the existence of preferential trading agreements for recognised markets, non restrictive imports of machinery, raw materials, equipment and components. Tax free exports and an adequate shipping capacity are very necessary in world trade.

iii) Emotion

A Country/Government can design the best incentives in the world to create a business friendly environment and not necessarily attract the entrepreneurs. Having weighed up all the facts sometimes decisions are then made on the basis of “instinct” “gut feeling” “comfort” and the like. Part of this reaction is the “perception” or “image“a country has in the mind of the investor. This really is a question of marketing the opportunity and the country in the correct way so that any irrational thoughts are eliminated.

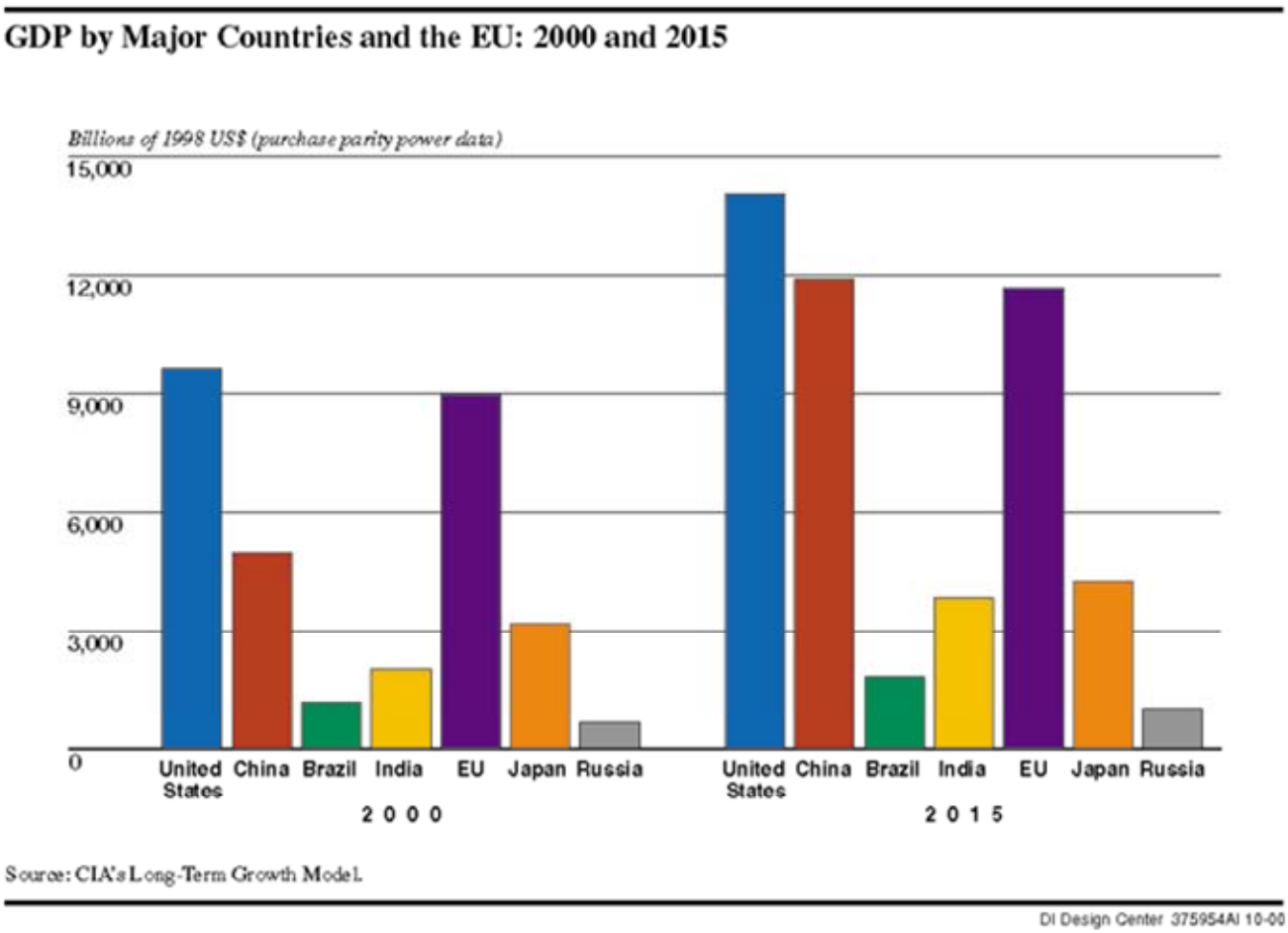
1.8 Industry Growth

The leather products manufacturing industry is a mature industry. There unlikely to be any major changes in terms of technical operations which will drastically change the present situation. The industry will track the changes in economic growth and world population. The pattern of growth will vary from region to region. In terms of population growth China, India and sub Saharan Africa will show growth in absolute numbers around 1.8% per year, i.e. the rate of natural increase. The more developed world will show an increase of 0.1% and the world as a whole 1.3%.

With an increase in world population there should be an expected increase in consumption of footwear and leather products. Experience shows that the market for leather products will only significantly improve if there is a corresponding increase in living standards. (Sub Saharan Africa will have a significant population increase but this does not mean to say there will be a corresponding increase in the consumption of leather products).

The growth in GDP of an area or country will be the real determinant of the industry growth. North America and Europe will still be the major markets for leather products but will be seriously challenged by East and South East Asia, particularly China and Japan. The Indian sub continent will be next in terms of growth.

Chart 6



The emergence of China as a growth economy is significant. However by 2015 its economy will be about the same size as Europe but with a much larger population. In time the probability is that China will overtake Europe as an economy, and become second after USA. World GDP is predicted to increase by 60% by the year 2015 from the year 2000 base. This represents a 4.3% increase year on year.

Although East Asia shows a spectacular growth trend, these markets are notoriously difficult to sell into. China and India tend to have protectionist instincts, especially for their leather industries. Japan also has a degree of protection currently for its leather industry but is under a lot of pressure from the WTO, USA and EU to remove the present barriers. In all probability the rapidly expanding markets in China and India will be serviced by their own dynamic manufacturing industries, in a sense making room for other suppliers in the global market.

The regional markets of the Middle East show reasonable growth patterns and should open up opportunities. Sub Saharan Africa, although bottom in the growth chart, is an area that is neglected by international marketers. It is thought of not being a “serious” market. However with the predicted growth, increased standards of living by the emergence of a middle class and

the planned assistance packages by the international community there will be opportunities here also.

Taking the leather products industry as a whole the growth trends are estimated as follows:

Table 16

		LEATHER PRODUCTS GLOBAL EXPORTS GROWTH TREND					
				000,000 US$			
YEAR	GROWTH DUE TO		GROWTH DUE TO		AVERAGE	AVERAGE %	
	POPULATION		GNP		GROWTH	YEARLY GROWTH	
2004	76,768		76,768		76,768		
2006	77,766		80,069		78,918	1.40	
2008	79,801		87,103		83,452	2.87	
2010	81,889		94,755		88,322	2.92	

These figures show a modest market growth year on year reflecting the maturity of the industry and the capacity available in the world manufacturing plants, which always keeps pace with demand.

1.8.1 Potential Export Products from Egypt

In terms of the global market the biggest export markets are as follows:-

Table 17

PRODUCT LINE	SIC	EXP.VALUE BILLION. US$ 2004	% OF MARKET	MARKET PROJ. 2010	% INCREASE
Footwear	64	49,947	65.0	57,409	14.9
Finished Leather	611	18,198	23.7	20,932	15.0
Leather Garments	84811/19	4,446	5.8	5,123	15.2
Personal Leather Goods (PLG)	420211/231	2,223	2.9	2,562	15.2
Components (Leather uppers)	640610	1,955	2.6	2,296	17.4
TOTAL		76,769	100.0	88,322	15.0

From the above it can be seen that footwear and finished leather offer the largest markets to sell into. These markets combined represent 88.7% of the world trade. The footwear market is a saturated market, hence very competitive. Finished leather on the other hand tends to be more of a sellers market because of the inelastic nature of the raw material supply (raw hides and skins) and the continued demand from consumers for the natural product.

Egypt has a choice of target markets in which to develop an export marketing plan. These vary in potentiality and area. Realistically Egypt has 4 main areas of potential operation and a 5th *pioneering* area. The areas are The Region - Europe – USA – Africa - Pioneers (CIS, Russia, Far East, Asia, South America).

In an effort to determine which areas offer the highest potential by product group the following market matrix was used:

	Table 18 ESTIMATE OF POTENTIAL EXPORTABILITY					
PRODUCT LINE	EXPORT POTENTIAL	REGION	EUROPE	USA	AFRICA	PIONEER
	high					
Footwear	medium					
	low					
	high					
Finished Leather	medium					
	low					
	high					
Leather Garments	medium					
	low					
	high					
PLG	medium					
	low					
	high					
Components	medium					
	low					

Obviously Egypt should target those markets with a high or medium potential. In footwear this is the regional markets of North Africa (including Turkey) and the Gulf States and the COMESA countries of Africa, particularly East Africa, Kenya, Tanzania and Uganda. Europe and USA are also potentials in the medium category. Marketing in these areas will be helped by the FTA's and QIZ. Finished leather will be somewhat of a sellers market making it easier to get customers. Europe, particularly Italy and Spain would be prime targets. Others would be the pioneer countries which have an established leather products manufacturing industry and are in need of a constant supply of raw materials. Leather garments are more of a difficult sell due to the relatively high quality standards demanded on the global market. If standards can be met and fashion understood then Europe has the demand. Target countries would be Germany (quality conscious) and UK (less quality conscious but competitive price wise). This would also apply to PLG with the same marketing profile. Leather shoe uppers are a bit of a declining market. It is not long after importing uppers for domestic cost reasons, that shoe manufacturers eventually turn into full shoe importers or close down. However while there is a demand, particularly in Italy, it can be exploited.