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The skins, Hides and Leather Sector

The Global Value Chain

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This is a class assignment on the global value chain of the leather manufacturing industry in Kenya.

Leather Manufacturing Global Value Chain in Kenya: The Opportunities and Challenges.

1.0 INTRODUCTION

This paper examines the concept of the global value chain and the evolution of the leather chain in Kenya. Some brief literature review has been done to illuminate the issue regarding global value chains. An analysis and scanning of the leather value chain has been undertaken. It is however important to note that this is still very much preliminary. The value flows and margins are not yet included which will be the next step of the study. The key actors have been mapped and the relationships analysed. The conclusion of this brief paper is that, Kenya has been integrated in the global leather value chain. However, this has not been done in a manner that is beneficial to the country and the industry players. There is little value addition and 70 percent of the exports from Kenya are raw hides and skins. The analysis also shows an industry that has been neglected after liberalisation and suffers from poor regulation and weak policy support. Production of processed leather has declined and installed capacity utilisation is below 50 percent in all Tanneries. The competitiveness of the sector is weak compared to the Asian countries. In the final analysis, the opportunities and constraints in the sector are presented. List of potential companies for the purpose of fieldwork has been attached. However, this is still very indicative at this stage.

1.1 The Global Value Chain: Brief Literature review.

Gereffi and Porter (1985) have been some of the leading thinkers on the concept of value chain analysis to determine industry competitiveness. In the late 1980's, Porter produced his work on value chain for the firm showing inbound and outbound logistics. On the other hand, Gereffi and Kaplinsky's work (1994, 2000 and 2002) has made significant contribution to the study of global value chains. Many scholars have now focussed on global chain since 1990s. Only a few of these have been sampled due to the limited scope and depth of this paper.

1.2 Global Value Chain defined.

According to Gereffi (1999), a commodity chain encompasses the whole range of activities involved in the design, production, and marketing of a product. The value chain, also called the commodity chain and production-consumption chain, is described as a comprehensive set of activities that are required to bring a product from a concept stage to marketing and consumption of end products. Gereffi goes on to say that it involves a series of components that begin with product design and the selection and purchase of raw materials and intermediate inputs and go through processing, marketing and distribution. The chain continues with the operation of sales of intermediate and end products. The last component of the chain is the consumption of final goods that is regulated by internal and external demands.

Gereffi (1999) has isolated two types of value chains: the producer and the buyer value chain. The leather value chain has the characteristics of a buyer driven chain. It is labour intensive and the global agents and global branded goods exert strong control over the chain. Upstream, the players- the farmer, the slaughterhouse/slabs and local hides and skins trader have a weak position on the chain despite their primary role in the production of the raw materials.

The following is a simple generic chain that shows the transformation process from chain functions to the final products.

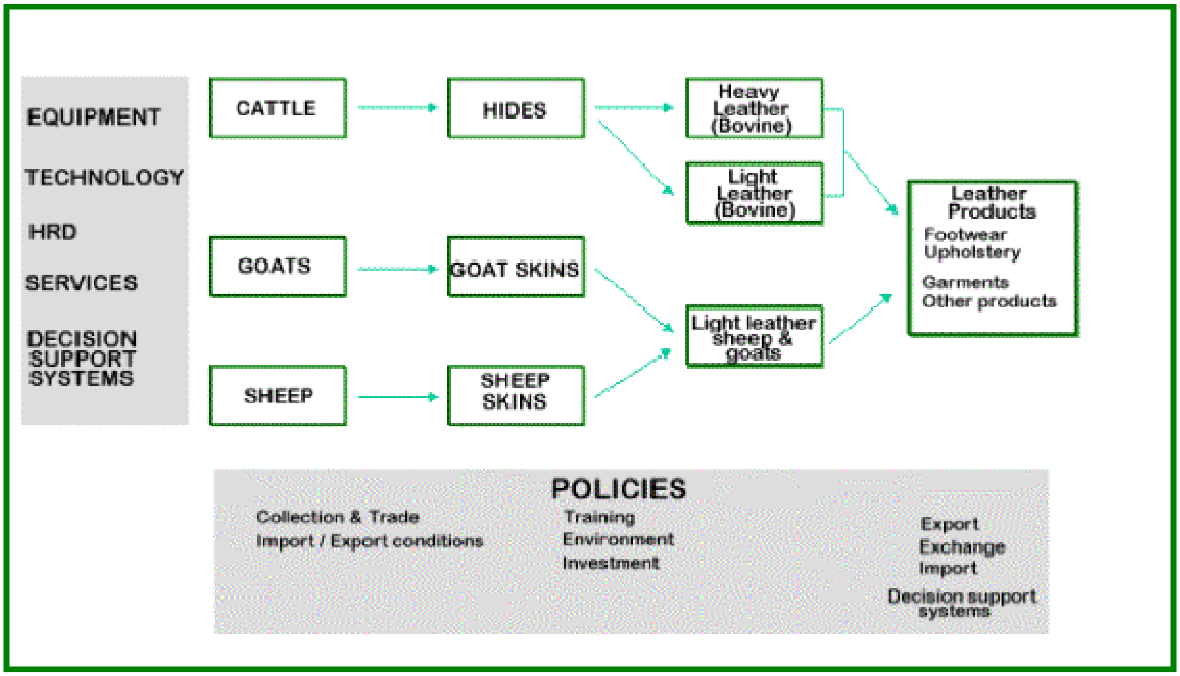


Fig 1: Generic leather value chain. Source: www.factbook.net/leather-components.php

This generic chain however leaves out some important players. These include the skins and hides traders, the slaughter house/slabs, the tanneries, the machine and chemical suppliers and the domestic and export markets. These are important linkages in the economy and provide important source of economic power in Kenya's marginal lands.

1.3 The Leather Global Value Chain.

Schmel (1998) and Magretta (2000) observe that marketing is the core of the modern leather product business and the principal main marketing agents have the necessary trade information and have established a wide network of sales channels that allow them to contract production, provide finance and serve the customer on time (within three to five weeks after placing the order) managing the complex mechanism of supply chain within the strategy of buyer-driven commodity chains. The authors conclude that there are two markets, the local and the export market; the latter is usually managed within the rules of a buyer-driven commodity chain, supply chain and triangle manufacturing.

Although, the authors leave the possibility of a producer driven chain at the domestic market, this may not be so obvious. On the other hand, it may also explain the low collection rates as farmers retaliate against low prices. Studies in Kenya (KIPPRA 2006) and Tanzania (GOT 2007) show that the east African market is not well anchored in the global value chain. The conclusion arrived at by the two authors is therefore not that clear cut. The market is dominated by low value addition and 80 percent of the trade is still in raw hides and skins.

According to a generic comparison of leather and other leading commodities, (www.factbook.net/leather-components.php, It is obvious that leather is of much higher value than meat and sugar. In the rural economy, skins and hides are only seen as a by product after slaughter of animals for meat. However in the value chain of the livestock sector, Muthee (2007) calculates that the hide fetches 6 percent of the margin. Leather manufacturing is both labour and capital intensive and because of this, it encourages both small and specialty firms and the big players. It is therefore easy to be persuaded by Gereffi's thinking about global economic integration.

> Gereffi et al, (2001:2) have shown that the value chain view of global economic integration for many industries, access to international markets is not achieved merely through designing, making and marketing new products. Instead, it involves gaining entry into international design, production and marketing networks consisting of many different firms.
>
> It is therefore not just about firms from the developing countries upgrading their value chains. There must be an environment internal and external to the organisation that will link the firm to the global value chains in a manner that is beneficial to the players upstream. Depending on the type of upgrading and the chain dynamics, firms in buyer driven chains tend to be in captive governance systems and are merely price takers of lead firms that control and monopolise the markets.

Particular industries tend to be more amenable to global value chain integration than others. The leather industry in Kenya is likely to be more amenable to global integration. This is because of segments in the chain that are polluting and developed countries and global brands find it easier to outsource these to developing country manufacturers. The challenge is to ensure that this global integration is to the benefit of both the domestic and international players. This however tends to be more challenging with the presence of a lead firm that controls the international interface. The state of the industry in Kenya is still underdeveloped, undercapitalised and under-resourced. This condition means the firms and products enter into the global chain on very unfavourable terms.

1.4 Hides and Skins Production

The following statistics shows the hides and skins production of the three EAC countries.

Country	**Quantity of Goat skins**	**Quantity of sheep skins**	**Quantity of Hides**	**Totals- hides and skins**
Tanzania	3.1 Million	0.88 Million	2.6 Million	6.8 million
Uganda	2.04 Million	0.22 Million	1 Million	3.26 million
Kenya	4.2 Million	3.1 Million	1.5 Million	8.8 million

Table1: Estimated Total production of Hides and skins. Source: ESALIA (2002)

This shows that there is adequate supply to develop a vibrant leather industry in any of the three countries. The competitiveness of one country can lead to an integrated EAC leather manufacturing sector.

Vital statistics on Annual Collection Levels of Hides and skins:

Country	No of Goat skins	No of sheep skins	No of Hides	Total hides and skins
Tanzania	1.4 million	0.5 million	1.6 million	3.5 million
Uganda	1.6 million	0.17 million	0.9 million	2.67 million
Kenya	3 million	2 million	1.8 million	6.8 million

Table 2: Estimated Annual collection level.

Source: East and Southern Africa Leather Industry Association (2002)

As can be seen from the statistics, there is a lot of wastage in the uncollected hides and skins. Uganda has relatively good average collection rates, although the entire yield is almost sold out in raw form. This lack of value addition means that Uganda cannot achieve the top prices commanded by the finished products. Tanzania and Kenya lose about 50 and 30 percent of their total production respectively. From the production estimates, the sector has enough raw materials but policy issues regarding revitalisation of a leather manufacturing industry need to be addressed.

1.5 The Hides, Skins and Leather Value Chain (HSL)

Kenya seems to have neglected the hides and skins and the leather manufacturing sector after liberalisation. Although no reliable statistics are available, it is estimated that the industry has been on decline in Kenya[1]. The potential of the sector in terms of jobs is estimated at 140,000 against the current 18,000 according to the Kenya Association of Manufacturers (annual report, 2005). In Tanzania, liberalisation of the sector started in 1985, and contrary to popular economic theory on free markets, the results were immediate. The tanneries were closed and up till now, capacity utilisation is estimated at 20 percent. The hides and skins are exported without any value addition. Employment in the sector declined from about 6,000 to an estimated 1,000 people directly employed in tanneries and leather manufacturing firms.

2.0 VALUES CHAIN ANALYSIS OF HIDES, SKINS AND LEATHER INDUSTRY

Below is an analysis of the leather industry. This is based on the functions, agent and outputs produced from each stage of the value chain.

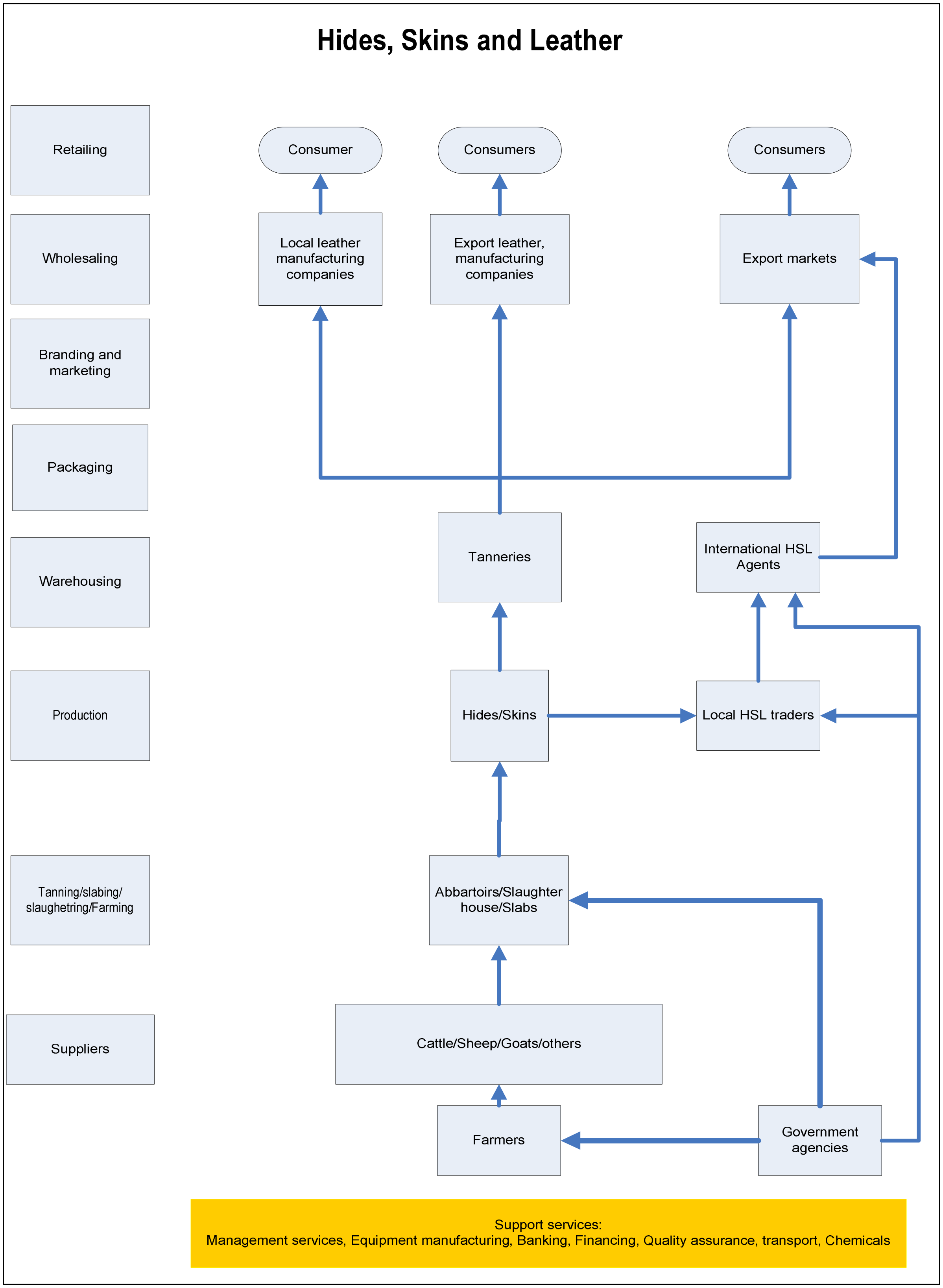
Stage of the Chain	Functions	Agent	Output
	Consumption	Customers-domestic	Buys Leather products

[1] See Institute of Policy Analysis and Research (IPAR) 2006

Marketing		Customers-export	
Marketing	Retailing	Customers-domestic Customers-export	Products Skins and Hides Leather Leather products
Storage	Warehousing	Merchants	Products Skins and Hides Leather Leather products
Primary Marketing	Design, Branding and Marketing	Multinational companies Lead firms Local companies	Brands Brand positioning Marketing materials
Distribution	Distributing	Customers-Exporters Customers- domestic Agents/Merchants	Raw hides/skins, leather and semi processed leather
Production	Processing	Tannery	Leather, crust, wet blue Processes processed and semi processed leather.
Production	Slaughtering and Flaying	Abattoirs/slaughter house/slabs	Hides and Skins Abattoirs /slaughter house produce skins and hides
Production	Livestock keeping	Farmers Ranchers	Cattle, Sheep and Goats Farmers breed and keep
Supplies		Suppliers of chemicals,	Chemical supplier to farmer

	Sourcing	feeds and other inputs, Machinery and packaging	Chemical supplier to tannery Machines and packaging material to tanneries, factories and warehouse
Policies	Regulating	Government and Government agencies, Banks	Bank gives credit to farmers, businesses Government makes policies for banks and industry
Support Activities	Managing	Managers and workers	Capabilities and competencies, Human Resources

Table 3: Analysis of chain functions and outcomes.


Hides, Skins and Leather
Retailing
Wholesaling
Branding and marketing
Packaging
Warehousing
Production
Tanning/slabing/ slaughetring/Farming
Suppliers
Consumer
Consumers
Consumers
Local leather manufacturing companies
Export leather, manufacturing companies
Export markets
Tanneries
International HSL Agents
Hides/Skins
Local HSL traders
Abbartoirs/Slaughter house/Slabs
Cattle/Sheep/Goats/others
Farmers
Government agencies
Support services:
Management services, Equipment manufacturing, Banking, Financing, Quality assurance, transport, Chemicals

The Kenya leather Value Chain. This chain has been adopted from the work of Muthee (2006)

Type	I		II		III		IV		Total	Mean (Shs)
	%	Sh/kg or piece	%	Sh/kg or piece	%	Sh/kg or piece	%	Sh/kg or piece		
Cattle Hides WS/kg AD/kg	34	60 45	32	50 37	26	42 30	8	30 20	100	45.5 33
Goat skins WS/piece AD/piece	36	55 45	34	47.5 35	22	40 30	8	30 20	100	43 32.5
Sheep skins WS/piece AD/piece	38	102 70	33	85 60	21	80 50	8	70 40	100	84 55
Camel hides WS/kg AD/KG	29	20 10	24	20 10		27 20 10	20	20 10	100	20 10

Table 4: Hides and Skins Grades and Prices- Isiolo 2005

Note: Average weight of wet salted (WS) cattle hide = 12kg
Average weight of air dried (AD) cattle hide = 5kg
Average weight of wet salted (WS) camel hide = 18kg
Average weight of air dried (AD) camel hide = 5kg

It is noted that sheep skins were valued more than goat skins with almost a 100% price differential for all grades. Cattle skins fetched good prices. Wet salting has a higher value addition than air drying. The difference being almost 100 percent more. Farmers need to be encouraged to adopt this method.

14 Exports of Hides and Skins and Finished / Semi-finished Leather. Kenya exports a considerable amount of undressed hides and skins and leather. The exports, value and unit price are shown in table below

Products	2000	2001	2002	2003	2004
<u>Undressed Hides/Skins</u>;					
Quantity (MT)	7,555	10,030,	7,181	13,910	18,542
Value (Ksh	494	635	445	551	956

mi)					
Unity Price (Kshs/kg)	65	63	62	40	52
Quantity in cattle hide equivalent (12 kg)	629,583	858,333	598,417	1,159,167	1,545,167
% of total produced	37%	50%	28%	50%	64%
Leather					
Quantity (MT)	5,915	3,847	4,334	4,898	8,646
Value (Kshs.mi)	486	576	601	1,018	1,115
Unit Value (Kshs/kg)	82	150	139	208	129

Table 5 : Export, Value and Unit Price for hides/Skins and Leather
Source: Economic Survey 2004 and 2005

It is noted that Kenya exports on average 11,444MT of undressed hides/ skins with an average value of Kshs. 40 in 2003 but have risen to Kshs.52/kg in 2004. The exported hides/skins would represent 40-50% of total production (calculated on cattle hide equivalent of 12kg wet salted hide).Kenya also exports on average 5,528MT of leather with an average value of Kshs.759 mi/year. The products earn the country about kshs, 1.4 billion annually.

Stakeholders in the Hides and Skins Value Chain

The stakeholders in the hides and skins value chain include livestock keepers/home slaughter, slaughterhouses/slabs, county/municipal council, banda /store owners, VSD/MOA, customs and transporters. Some of these exert economic rent on the chain as shown in table 64.

Institution	Requirements	Associated Costs
MOLFD	Movement permit for collection	Kshs.5,000/year
Veterinary	H/S Buyer Licence	Kshs 4,000/year
	Banda licence	Kshs 500 / year
	Slaughter man's Licence	Kshs100/ year
	Slaughter man's Folder	Kshs 2,500/year

	Dispatch Notes	Kshs.100/dispatch
	H/S Buyers Folder	Kshs.250/year
	Export Licence	Kshs.150,000/year
	Veterinary Dept. Export Levy	2% of export value on raw hides and skins 1% of export of wet blue 0.5% of export value of processed leather
Country/Municipal Council	Cess H/S Trader Licence	Cattle Kshs.7-15 Goats Kshs.2-4 Camel Kshs.7-05 Kshs 1,500/year
Customs Railways	Documentation Transport	Kshs.1,000/lot 2.5% per MT

Table 6 : Economic rent on hides/skins value chain

The statistics above show there is considerable economic rent imposed on the chain but there is also need to harmonise taxation at the different Government levels.

HIDES AND SKINS TRADE: THE CASE OF TEGEMEO LTD ISIOLO

Started I 1998, this is a sole proprietorship hide and skin trader whose main sources of hides and skin are the Osiolo slaughterhouses and home consumption slaughter. These by-products are mainly bought wet but few numbers of home dried ones are also bought.

Value addition activities

This is mainly by:

(a) Salting wet hides and skins. This attracts more market and fetches higher market price

(b) Washing and further skinning to remove any fat and meat by inadequate hurried skinning.

Buying prices related Costings

Wet skins and hides are bought either by weight basis or per piece. Shoat skins are bought at fixed prices per piece. The size of the by-product plays negligible role in pricing.

Species	Buying price (Kshs.)	No.bought /day
Cattle hide	25 per kg	10
Sheep skin	60 per piece	60-70
Goat skin	90 per piece	60-70
Camel hide	10 per kg	70-80

Table 7: purchase price of Hides and Skins

Costs incurred during buying

- Transport to slaughterhouse-Kshs.100
- Cost of transporting the by products – Kshs.50
- Communication costs – Kshs.100

Value-Addition Costs

- 4 bags of salt 50kg each Kshs. 3,800
- Transport to store 100
- Water for cleaning dirt 100
- Two cleaners @100/person/day 200
- Security per month 2,000
- Rent per month 2,000

MARKETING OF HIDES AND SKINS

There are mainly sold to dealers in Nanyuki and Nairobi. Mt. Kenya Hides and Skins Traders is the main market. The selling price varies depending on quality and demand. Currently, there is strong demand for goat skin and cattle hides. Camel skins are graded and sold on weight basis.

Selling prices and related marketing costs

Species	Kshs/Kg
Cattle hides	65
Camel hides	30
Goat skins	60
Sheep skins	50

Table 8 : Selling Prices of Hides and Skins

- Transport costs self to Nanyuki Kshs. 400
- Transportation of by-products (pick up hire) Kshs. 3,000
- Food per day Kshs. 200
- Accommodation per day Kshs. 200
- Telephone Costs per day Kshs. 100

The hides and skins dealers have to meet extra costs as shown above, this eats away at their margins. The value addition costs are high, especially monthly rent and security

The calculated value chain is as shown in figure below

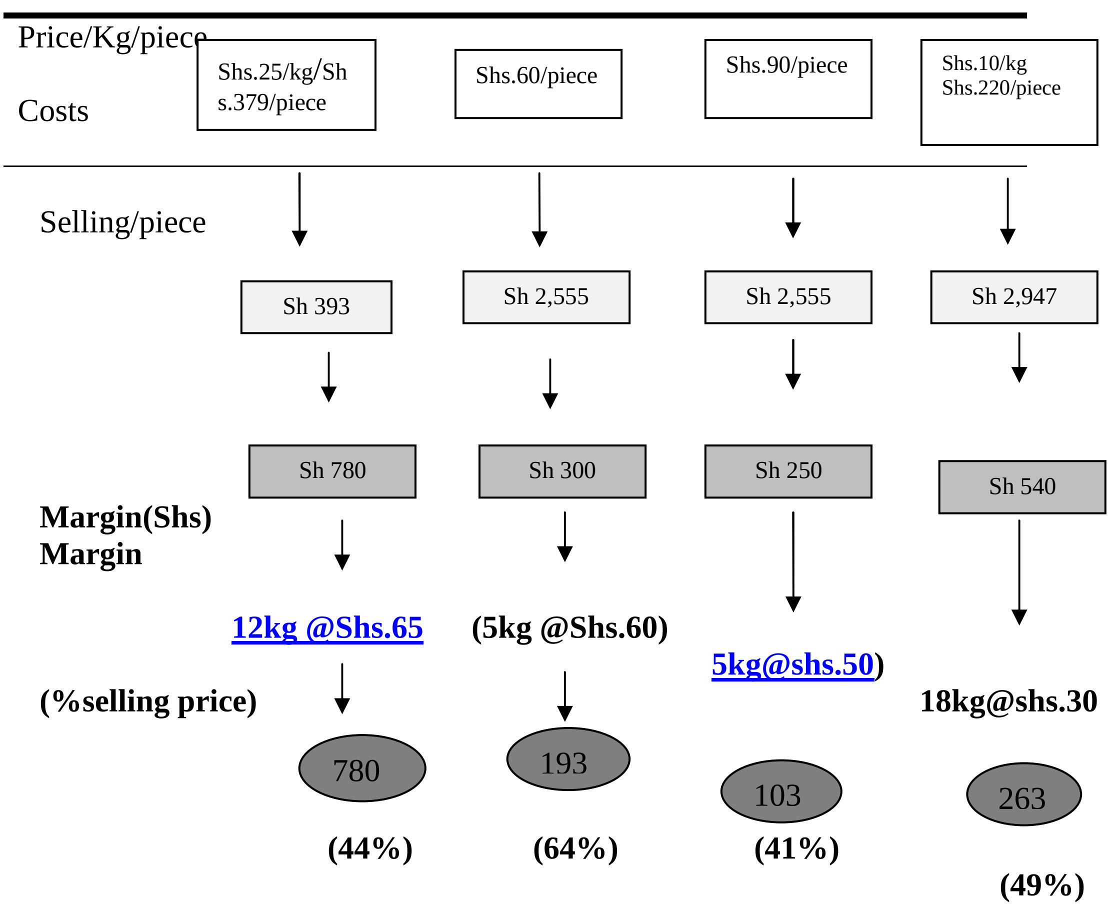


Figure 2: Value-Addition in Hides and Skins Trade (Tegemeo-Isiolo)

These figures can only be considered indicative as procurement value addition and marketing costs of Kshs. 12,350 were apportioned for 215 hides and skins and not by actual costs per type of hide or skin. The weights for wet salted shoats skins were also assumed. The main cost variables in value addition were salt (31%of total costs), rent and security (16.2% each), marketing costs (31.6%), and other costs (5% of total). Based on the estimated costs and weights, the percentage margins were 46%, 64%, 41% and 49 for cattle hide, sheep skin, goat skin and camels hide respectively. These margins were calculated as a percent of the sales price

2.1 THE KEY ACTORS

For the purpose of this study, key actors will refer to actors within the chain who:

i. Own the product being studied

ii. Influences the strategic direction of the chain, it's profitability , growth and chain governance

iii. Provide necessary services without which the chain profitability and sustainability will be adversely affected

2.2 Local

The following are the local actors:

The livestock farmers are the primary producers of hides and skins. They are both small and large scale ranches. The small scale farmers mostly sell their stock to local markets who in turn sell to abbatoirs for slaughter. At times, the animals are slaughtered for food and ceremonies, then the skins and hides are sold to the local slabs for slaying, drying and batching. Only a sample of farmers in each country will interviewed.

2.2.1 Local butcher: these usually buy animals for meat to sell to the local population and the skins and hides are sold to the local skins and hides traders or the slabs. A sample of butcheries in representative towns of each country will done.

2.2.2 The slaughterhouse/slabs: These serve as collection centres and preparation is done before they sold off. They act as collecting agents of the middlemen who sell to tanneries or export merchants. A sample of these will be interviewed in major cities.

2.2.3 Local hides and skins trader: They are the link between the local trade and national trade. In terms of chain governance, they have the final say in terms of setting prices and quality.

2.2.4 Local Trade Association: This is a rare feature of the local value chain. The industry association tends to be weak and is skewed towards traders with big turn over. Many times, it is not representative and represents minority interests of a cartel. Industry Associations will be interviewed. In Uganda, the Uganda Leather Association, the Kenya Leather Association, Tanzania Leather Association. The Confederation of Tanzania Industries, Kenya Association of Manufacturers and Uganda Manufacturers Association.

2.3 National Actors

2.3.3 Merchants: The national merchants are organised as cartels and try to control the local chains through proxies. They have access to credit and local tanneries or overseas trade. They belong to the industry association which represents their interest. They have the muscle to lobby and influence government.

2.3.4 **Tanneries:** The tannery is the most important link to the national value addition. This is a heavily polluting activity and also very expensive. As a result, clusters are necessary to share effluent facilities. Machines and chemicals are extremely expensive and many tanneries are struggling due to inefficiencies and low productivity. The success of the sector largely depends on this activity as it does on quality of hides and skins.

2.3.5 **Leather shoe companies:** The leather shoe companies are many but the output is low and utilisation of installed capacity is estimated at 50 percent in Kenya and just about 20 percent in Tanzania and Uganda. Tanzania has 3 shoe manufacturers, two in Uganda and about 100 in Kenya.

2.3.6 **Manufacturers of Leather products and accessories**: There are many leather product producers in terms of variety and quality. These leather articles include folders, decorations, handbags, travelling bags and other articles mostly sold to tourists and for export.

2.3.7 **Government agencies**: There are government ministries responsible for policy formulation and regulation. The tax authorities and ministry of Finance also play a big part in terms of setting both fiscal and monetary policies that affect both domestic and export trade.

2.3.8 **National skins and hides Merchants:** These are supplied by the local slabs/slaughterhouse and also the local skins/hides dealers. They are the price givers and have a lot of control on both downstream and upstream trade. They are mostly on the driver's seat in the National Industry Association.

2.3.9 **National Leather Associations**: This is a membership Association. In Uganda it is a limited company while in Tanzania and Kenya it is a membership organisation. The Tanzania associations is perceived as weak and not representing the interests of the industry. Some of the companies, especially in Arusha and Moshi are not even members. Properly organised though, this offers the best form for the development and growth of the industry. In Kenya, about 280 companies dealing in leather are members of the Kenya Association of Manufacturers (KAM annual report 2005)

2.4 International Actors

Multinational manufacturing companies of Leather products: At the international scene, the multinational firms play the role of the lead firms. They are play critical role of designing, branding and marketing of the final products. They have vast resources and link the national producers to the global value chains. The lead firms keep a firm grip on the governance of the chain and posses superior core competences and capabilities. In the East African scene, there is only one multinational, the Bata shoe company which is involved in manufacturing, designing, branding, marketing and retailing of shoes.

2.5 **International buyers of hides, skins and leather**: These are buyers of semi processed- wet blue and also raw hides and skins. They are middlemen out to get a good deal and are therefore very demanding on quality.

2.6 **International Associations of Leather manufacturers**: This is an international industry lobby group and helps to maintain links with buyers but also to lobby governments. In the case of the study countries, the Eastern and Southern Africa Leather Industry Association has been very active in supporting the industry.

2.7 **Buyers of finished leather products**: These are the end consumers of the finished products. In the developed countries, they are very quality and health conscious. They worry about the polluting nature of the leather industry and have healthy concerns about leather tanning processes and especially usage of chrome. Some chemicals are reputed to be carcinogenic and this exacts heavy standards on the manufacturers. The domestic market is indifferent to the health standards and instead is very price sensitive.

Country	Capacity utilisation in %	No of Tanneries	No of Leather manufacturing companies	Total direct employment	Value in dollars in millions	
Tanzania	10	7	Under 10	1,000	8	
Uganda	10	7	Under 10	Not available	18	
Kenya	50	9	240	20,000	100	

Table 9: State of the leather Industry in Tanzania, Uganda and Kenya. Source: ESALIA, Kenya Association of Manufacturers, (KAM 2005)

3.0 INSTITUTIONAL AND ORGANISATIONAL ENVIRONMENT

Value chain for hides, skins and leather is to a large extent influenced by the local, national and international context within which the Value chain operates. This section provides a brief analysis of both the institutional and organization environment.

3.1 World Trade Organisation

The World Trade Organisation (WTO) is a members organization with the mandate to regulate and facilitate global trade. The organization works under the General Agreement on Trade and Tariffs (GATT) 1994. The study countries, Tanzania, Kenya and Uganda are members of GATT and are therefore bound by all the multi- lateral agreements negotiated under WTO. Hides, skins and leather products fall under the agreement on trade in goods and commodities and are subject to negotiated tariffs.

3.2 Membership in Regional Trade Preferential Areas.

The study countries are members in different trading regimes. Tanzania is a member of Southern Africa Development Community (SADC) while Uganda and Kenya are in Common Market for Eastern and Southern Africa COMESA. These overlaps cause duality in implementation of trade policy within the countries with a potential to either facilitate or impede trade. COMESA has had a preferential trade area with 22 member countries while SADC has 13. Tanzania still retains membership to some COMESA institutions even after cessation of its membership. Each regional trading block is working towards a Customs Union by 2012. In the recent past there have been attempts to harmonise the operations of the two regional blocks to avoid conflicts, duplication and redundancy evident in the current arrangement.

3.3 East African Community

The irony of Regional Trading Arrangement is the resurrection of the old East African Community (EAC). As explained in the section above, the three study countries belong to different and bigger regional economic groupings. It would be more prudent to belong to only one configuration or strengthen the EAC which is more advanced than either SADC or COMESA. Kenya enjoys prominence in both COMESA and EAC due to its superior industrial base relative to that of other members. COMESA offers a huge market for Kenya; about Usd 500 million in export market. This creates a dilemma as to whether Kenya will be in a position to pull out of COMESA. The EAC exports in turn are about USd 200 million per year. Both Tanzania and Uganda enjoy relatively free entry into the Kenya market part from the occasional. The three countries have just negotiated an Economic Partnership Agreement (EPA) with the European Union. This agreement opens new opportunities and challenges. In view of this, a brief overview of the EU as a trading block is necessary.

3.4 The European Union

The EU covers much of Western and Eastern Europe. This is the world's single largest market. The EU has influence on processed leather globally but most its purchase is still from Asia. Spain and Italy are major players in leather manufacturing especially footwear. One area which has impacted negatively is the introduction of European standards on safety and quality. These have directly affected the trade in general. In addition the major global players are increasingly becoming more vocal in issues of environment, health and safety. Another area of concern is the level subsidies enjoyed by producers within the EU, shielding them from competition from products from developing countries including the EAC countries. Through EPAs, trade with Europe will be on a reciprocal basis as tariffs come down and 82 percent of all trade will be on tariff free, quota free basis by 2025. The preparedness of the leather industry to these changes will be tested to the limit.

3.5 National level

3.5.1 **Macro economy**

The macro-economic indicators in both countries are relatively stable, although has a high inflation rate at 20 percent as of January 2008. This has largely been fueled by high prices of foodstuffs and high oil prices. Inflation rates in both Uganda and Tanzania are below single digit but could still break through with persistent and unpredictable oil prices. Interest rates are relatively low in Kenya at below 17 percent while Tanzania and Uganda have interest rates above 20 percent. The Kenya shilling is at 10 year high strength while Tanzania and Uganda shilling have been depreciating against hard currencies in the first quarter of the year, 2008.

3.5.2 Politics

The Kenya politics have taken a negative turn after the 2007 elections and ethnic tension is now a real threat to national stability. In Tanzania, strong ruling party machinery keeps the political scene fairly stable and predictable. Uganda has a fragile political stability with the civil strife in the north, and turbulent opposition politics and strong tactics by the ruling party.

3.5.3 Security

The security situation is Kenya is fragile and there has been increase of organized crime. The security machinery is poorly equipped and demodulated and seems overwhelmed by organized gangs and militias. Uganda has a fragile security situation and has long standing security issues in the north. Tanzania has a relative low crime rate in comparison with the other two countries.

4.0 Value chain upgrading.

4.1Process upgrading

Leather processing is classified as a polluting industry, some tanneries use chemicals such as chrome and other substances that are classified as pollutants. Effluent and solid waste management is a real challenge. But the modern trends have seen more chain upgrading in production processes that are more efficient and less wasteful. The use of chrome is now declining and more environment friendly processing methodologies are being used. However, much of the ‘dirty and polluting’ activities still take place in developing countries. The developed countries mostly buy processed or semi processed leather and this means that many countries either need to move up the ladder in the value chain and avoid exporting raw leather. This presents a process upgrade to process and sell leather rather the wet blue exports, that are now common. The three countries have imposed export tariffs to discourage trade in raw hides and skins but more innovative policy measures need to be taken to create a robust and competitive Hides, Skins and Leather manufacturing sector that upgrade its processes within the value chain.

4.2 Product upgrading

There are many opportunities of product upgrading. The Leather industry is now versatile and branding and marketing is taking centre stage as customer needs and tastes change. Uganda and Tanzania have the biggest opportunity for product upgrading as trade in the sector is largely raw hide and semi processed or processed leather. There is opportunity for innovation in both design and marketing of leather products to be sold in EAC, COMESA and SADC trading blocks. Most of the leather manufacturing firms are small family owned businesses that produce small quantities for niche markets. There is an opportunity to cooperate and move from small to large orders. Some firms can also move from mass market to specialized and expensive leather articles. The Moshi Leather Industries in Tanzania has capitalized on this.

4.2 Functional upgrading

As developing countries, there is a real opportunity for EAC countries to upgrade into more lucrative functions. The Chinese investors offer the best chance as they try to relocate some of their leather manufacturing into East Africa due to stringent environmental conditions at home. There are opportunities to take on functions that are currently under pressure to relocate from Europe and other OECD countries.

5.0 Opportunities and constraints

5.1 **Review of major Opportunities**

There are many opportunities in the hides, skins and leather sector. The return on investment for emerging market is still high, compared to developed world and therefore opportunities exist in tapping the potential market. Available statistics show that there is a growing national and international market for hides, skins and leather products. China and India will dominate the market for raw hides and skins while Europe and America will dominate in the market for high quality leather products. In addition, the economies of the three countries have registered positive GDP growth in the past decade, with Tanzania and Uganda registering a GDP growth averaging in excess of 6% and Kenya averaging 3%. This means also a growing regional market. There are plans, though at infancy stage, to combine all the three southern and eastern Africa based Regional Economics blocks into one. This will bring together a market of about 500 million people.

5.2 Value chain channels.

From the value chain, opportunities exist in form of upgrading the channel and establishing backward linkage with farmers, slaughterhouse and slabs. This linkage objective will be to have quality skins and hides to consistently meet customer demands. The link between the local value chain to both the national and international chain can be strengthened to create benefits and redistribute the margins across the entire chain.

5.3 Creating a market for the product.

The market for hides and skins cannot be met. Due to lucrative orders in foreign markets, the three Governments have had to impose export tariffs to assure the domestic leather industry of raw materials. Even then, there is still illegal cross border trade out of the official channels to avoid taxation. The domestic manufacturers have therefore to increase their competitiveness to serve both domestic and foreign markets. There are many imports of second hand leather products and especially shoes that need to be banned altogether.

5.4 Branding

One of the reasons why Kenya seems to do well in export of leather products is because of dominance of Bata Shoe Company which is a multinational serving markets from its production facilities in Kenya. Bata brand is very strong and is ubiquitous across the African continent. Opportunity exists in creating a strong brand name for the purpose of penetrating both the local and international market. While this is happening in Kenya, it can be strengthened in a whole range of products. Tanzania and Uganda can do more to enjoy higher returns.

6.0 Processing and Manufacturing

Numerous opportunities exist for the processing of raw hides and skins into finished products. This however requires very high demands on quality. While it offers higher returns in the entire chain, international or triangular manufacturing needs to be explored.

6.2 Review of major constraints

Finance costs

Leather manufacturing from the tanning to product assembly lines is a capital intensive business. The financial landscape in the three countries is very diverse. In Kenya, credit facilities are available and relatively affordable to small and medium businesses. In the doing business report Kenya scores and ranks highly on this at number 13 globally. The case for Tanzania and Uganda is quite the reverse. Credit facilities are limited, narrow and when available, are quite expensive. In addition to the high cost of borrowing, collaterals are hard to come by.

Finance for initial capital outlay, expansion and working capital remain a major constraint. Setting up a modern slaughter house or a tannery is an expensive undertaking.

6.3 Infrastructure costs;

The infrastructure in the three countries: Kenya, Uganda and Tanzania is unreliable and costly. The road network is poorly maintained and coverage is low in all the countries. The Ports of Mombasa and Dar Es Salaam are inefficient resulting in long delays in cargo handling and as result adding up to the cost of doing business. Uganda is landlocked and all exports and imports incur high transportation costs across poor roads. There is underinvestment in the energy sector. In Tanzania and Uganda, power rationing has been ongoing for the last two years. Electricity supply is not only unreliable but also expensive. Within the COMESA region, for instance, cost of power in Kenya is almost thrice the cost of power in Egypt. The cost is even higher in Uganda and Tanzania.

All this will add up to the cost of doing business making an otherwise viable entity a loss making firm. In the value chain, the constraint affects the channel and firms will most likely decide on a channel that optimizes returns. The option is to pass the cost to either the downstream actor in each case or the upstream actor depending power asymmetries in the chain and secondly on the price elasticity of the product in question.

6.4 Labour market

All countries have a large pool of unskilled labour. However unskilled labor requires a higher level of labour supervision (World bank, 1995), adding to the business cost.

At the moment, the cost of labour in Uganda, Tanzania and Kenya is favorable compared to the Western countries. Unlike in Kenya, labour unions are not as strong in Tanzania and Uganda, but the issue of skilled personnel remains a challenge within the sector. Tanzania and Uganda have relatively cheaper labour costs at both top and lower end of the job market.

6.5 Business Regulatory procedures

The business regulatory environment in the three countries is rigid with constraints to business relating to starting a business and licenses requirements.

The Doing business 2008 report ranks Kenya at number 72, Uganda at 118 and Tanzania at 130. This implies that it is easier to do business in Kenya than in Tanzania and Uganda.

In starting a business it takes 12 procedures in each country whereas in the high income countries (OECD) it takes on average 6 procedures. Duration required to start a new business is 28, 44 and 29 days in Uganda, Kenya and Tanzania respectively. It only takes 15 days in High income countries.

To deal with business licenses and other regulatory issues in Kenya, there are ten procedures, 18 in Uganda, while in Tanzania they are 21. Duration is 100 days for Kenya, 143 in Uganda and 308 days for Tanzania. Corresponding statistics for OECD is 14 procedures and the duration is 153 days.

6.6 Organisation and management

This is a major constraint especially to small and medium size businesses. The inability of the tanneries and exporters to operate in clusters limits the advantage to economies of scale and hence opportunities to access high value markets. In addition many lack business development as well as entrepreneurial skills; hence the business mortality is quite high. The linkage of the local chain to the global value chains is weak and therefore its potential and benefits have not been well exploited.

6.7 Firm level constraints

At firm and farm level the constraints include:

- Low productivity and poor quality of skins and hides largely due to small size of animals
- Poor livestock keeping techniques in the bushy and thorny grassland. This leads to torn skins and hides and affects the final quality of the leather.
- There has been neglect of the sector by the government in the three countries. The government policy on the sector has been perceived as weak and therefore the potential impact and benefits to the population has been minimal.
- At the Ranch or household level there are high cost of inputs especially veterinary services and feed stock while at the firm level prices of chemicals and other inputs are high.

6.9 Processing constraints

These include:

- Poor flaying techniques, hand flaying is the most common practice within the study countries.

- Limited information flow from global markets
- Capital outlay (for leather tanning and processing) for purchase of new equipment and technology, this limits new opportunities.
- Poor slaughtering methods at the local butchers and in homesteads resulting in poor quality leather

6.10 Marketing and Retailing Constraints

- Competition from China, India and Pakistan. These are low cost producers and are backed by very proactive government policies in their home countries. They outsell east African producers at the processed leather and finished goods in international markets.
- International competition for finished products (The EU and US markets are dominated by Asian and South American companies)
- Access to markets for skins and hides has been controlled by cartels
- Oligopolistic market dominated by one multinational (the Bata shoe company) that is based in Kenya and services the east African market. This tends to stifle competition.

7.0 CONCLUSIONS

There are still gaps that need to be filled in through further research and analysis. Inspite of ESALIA’s efforts to collect and collate data and information on the sector, availability of upto-date data on Leather manufacturing is still a challenge. In Uganda’s case, data is scanty and its reliability is low. Several donors; Dutch and Italian governments and several UN agencies have been involved in the development of the sector. This has maintained the industry at survival levels but more proactive government support through policy and regulation is necessary. If the EAC members are to integrate into the global value chain in a way that is profitable, value addition and quality control has to happen right from the farm level. The global value chain for the leather industry shows that it is directly to poor communities in the village. A competitive and performing leather manufacturing industry can contribute to better quality of life. Corporate Social responsibility within the sector can provide environmental protection and promote equity in resource allocation and utilization.

The industry is characterized by exports of raw hides and skins and low capacity utilization. The installed capacity in many cases was funded and was not matched with the business needs of each factory. There has been some effort at creating clusters in Kenya at Athi River and in Thika and at Moshi in Tanzania. However, these efforts have not gone far and benefits associated with clustering and economies of scale have not been fully utilized. There is need to study how the industry can be grown profitably through a Global Value Chain approach. There seems to be more potential in terms of functional and product upgrading for the EAC members. This however is still a tentative conclusion and research and analysis will be done to provide the industry with a road map for further growth and development of the industry.

Leather Manufacturing offers potential in terms of sustainable development by contribution to rural economies, job creation and increase in income and its equitable distribution along the value chain. On the other hand, policy wonks had predicted that if the industry was to make this contribution it needed to become more competitive. The prescription to achieve this objective was liberalization of the sector alongside the rest of the economy. Contrary to expectations, the sector growth has declined and jobs have been lost. Free trade agreements were signed to provide expanded markets but there has been only a surge in exports of raw hides and skins. To reverse this trend, the EAC members resorted to high export tariffs of raw hides and skins. The impact of this move however has not been sufficient to create conditions for a competitive and sustainable leather manufacturing sector. The loud question is: How can the global value chain of the leather industry be made to contribute its share of GDP, competitiveness, wealth and employment creation within the EAC members? This will be interrogated in the field study.

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Annexes of Potential Organisations to be interviewed

Kenya

Kenya: Companies

Company Name	Products
Abdulwadood Tanners	Wet blue - Wet salted - Air/Frame

Ltd	
AFSO Exporters Ltd	Wet blue - Wet salted - Air/Frame
Ashieng Footwear Ltd	Children's shoes - Women's shoes - Men's shoes - Shoes components - Military - Sandals
Aziz Tanneries Ltd	Wet blue - Wet salted
Bahati Hides and Skins Co Ltd	Wet salted - Air/Frame
Brasbuckle Ltd	Belts - Large leather goods - Small leather goods
Crown Industries Ltd	Boots - Men's shoes - Shoes components
Dog Bones Ltd	Wet blue - Footwear - upper leather - Industrial leather - Split leather – Leather goods leather - Industrial gloves - Large leather goods
East African Hides Limited	Wet blue - Wet salted
Khan Limited	Other - Women's shoes - Men's shoes - Large leather goods - Sandals
Leather Masters Ltd	Large leather goods - Small leather goods
Leather Tech. International Ltd	Wet blue - Wet salted - Wet salted
Leathertech	Furniture - Other - Belts - Large leather goods - Small leather goods
Merit Marketing Services	Other - Belts - Large leather goods - Small leather goods - Saddlery & harness
Nakuru Tanners Limited	Wet blue
Nalina Ltd / Adelphi The Leather Shop	Large leather goods
New Market Leather Factory Ltd	Wet salted - Air/Frame
Quality Hides Ltd	Wet salted - Air/Frame
Sagana Tanneries Ltd	Wet blue - Wet salted - Dry salted - Air/Frame
Santa Teresa Shoes Ltd	Men's shoes
The Palm Prints	Furniture - Small leather goods
United Footwear Ltd	Boots - Military - Safety
Yslam Mohamed & Sons	Wet salted
Zingo Investment Ltd	Wet salted
Bata Shoe Company	Leather Shoes and Sandles

Government and Other Agencies

Kenya Industrial Research Institute

Ministry of Livestock Development

Ministry of Trade and Industry

Kenya Association of Manufacturers

Institute of Policy Analysis and Research

Kenya Institute of Public Policy Analysis

Kenya Bureau of statistics

Kenya Leather training Institute

Kenya Revenue Authority

Tanzania, United Republic of: Companies

Company Name	Products
Afro Leather Industries Ltd.	Wet Blue
JAET Ltd.	Belts - Chrome crust - Footwear - Lining leather - Footwear - Upper leather - Garment Leather - Industrial Gloves - Jackets - Coats - Large Leather Goods - Leathergoods Leather - Small Leather Goods
Lake Trading	Air/Frame dried - Pickled - Wet Blue - Wet salted
Ngozi Centre	Air/Frame dried - Wet salted
P. M. Tito's (Twins) Leather Goods	Belts - Jackets - Coats - Large Leather Goods - Small Leather Goods

Bata Shoe Company Leather Shoes

Moshi Leather manufacturers

Tanneries:

Moshi Tannery

Himo Tanners

Morogoro Tanners

Arusha Tanners

Government Agencies

Ministry of livestock Development

Ministry of Trade, Marketing and Private Sector Development

Confederation of Tanzania Industries

Economic and Social Research Foundation

Tanzania Revenue Authority

Uganda

Uganda Leather Tanners and Manufacturers

Uganda Manufactures Association

Hides and Skins Exporters

Ministry of Livestock Development

Ministry of Trade and Industry

Bata Shoe Company

Uganda Revenue Authority