

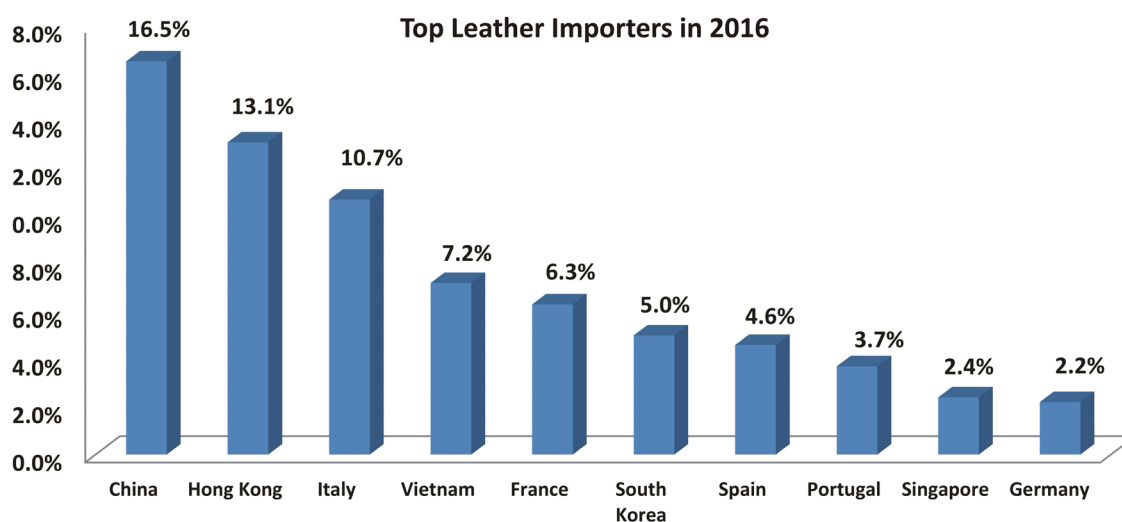
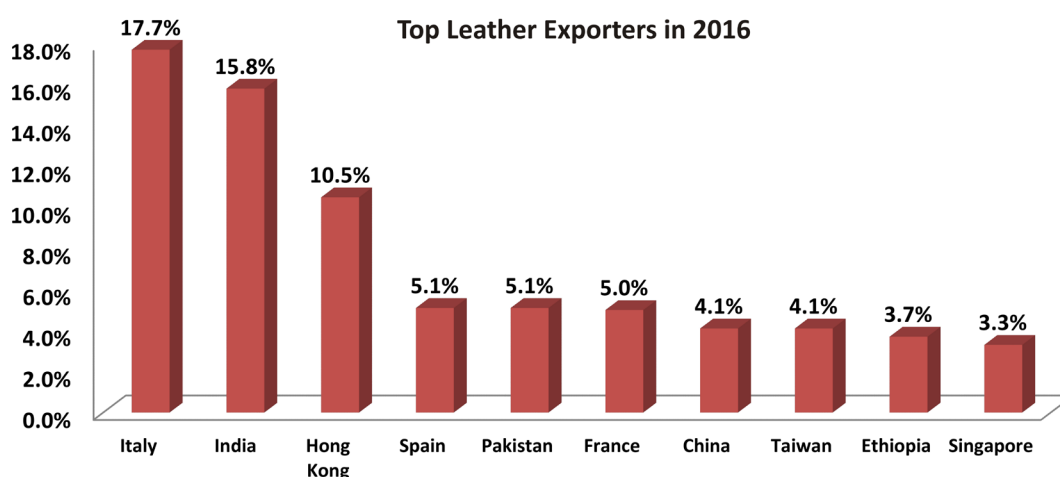
Leather Industry

OCTOBER 2017

INDUSTRY OVERVIEW

Leather is a by-product of the meat industry and its main source of raw material is cattle hides and skins. It is the primary product of tanning sector, and is further processed by value adding industries such as footwear, garments, furniture and automotives. Tanning is the process of treating skins and hides of animals, mostly cattle, to produce leather. Historically, the tanning industry was characterized by small or medium-size family businesses. However, with increase in demand of tanned leather and finished leather products, tanning processes evolved with the formation of larger players in the industry. Today, there are various ways for tanning hides and skins into leather. The quality of hides/skins is largely affected by the livestock management processes, slaughtering expertise, preservation methods and grading techniques through which they are produced.

In a global context, leather is one of the most widely traded commodities in the world. Leather industry plays a prominent role in the world's economy with an estimated global trade value of approximately US\$100 billion per year on average. In 2016, world leather exports and imports totaled around US\$2 billion each¹; the largest exporter and importer of leather goods were Italy and China respectively. Below is an illustration of top 10 leather exporters and importers during 2016:



1) Note: Import numbers rarely match the source exporters' statistics. Reasons for import-export statistical discrepancies include re-exports, time lags, misallocations, distinct trade reporting systems, different quantity measurements and country confidentiality rules. Also, transportation and insurance costs are sometimes added to import totals.

Since the last half decade, Ethiopia, Belgium, Cambodia, Albania and Philippines contributed as the top 5 fastest-growing leather importing countries while Kenya, Zambia, Albania, Serbia and Turkey were the top 5 fastest growing countries with regards to leather exports. Given the current dynamics of the leather industry, both leather imports and exports declined globally in 2016; imported leather declined by approximately 29% while exported leather reduced by 44% from 2012.

DEMAND AND SUPPLY

Mixed views regarding supply of raw hides and demand of leather products have been entertained by researchers. Issues such as spread of diseases among animals and poor storage facilities of these animals are considered negative externalities for leather's supply along with its prices. Existing data depicts potential discontinuities by shortcomings in raw material supply, mostly related to land unavailability and other aspects of livestock development. Another important factor which may adversely affect the supply of animal rawhide is downward trending consumption rate of animals by humans; this trend is largely attributed to increase in obesity and food safety concerns. However, it is believed that this deceleration is going to be gradual. On the contrary, statistics show that growth of world cattle stock and human population has remained closely related. As a result, supply of raw material for leather is expected to grow with world population.

Regarding demand patterns of leather products, as a response to the growing power of major brands and retailers, new tanneries are being set up in order to meet the growing demand in some countries. However, it is clearly evident that uses of leather evolve over time. Leather has lost its prime position as it could not compete with new alternatives developed during recent decades including textiles, plastics, and other natural or synthetic materials. These substitutes are now consumed because of their economical prices, convenience and accessibility.

Overall, the world of business is becoming increasingly volatile, given the fluctuations in currency exchange rates, political uncertainty, world-wide economic slow-down, and increasing competition for energy resources. Thus predictive power has reduced over time.

LOCAL INDUSTRY

Pakistan has a well-established leather industry with abundant supply of raw material. More than 800 tanneries produce finished leather for both exports as well as for domestic consumption in the country. The leather industry in Pakistan is largely export-oriented with top 25 tanneries contributing around two-thirds of total share. Large tanneries are located in three main clusters around Karachi, Lahore and Sialkot.

According to Pakistan Bureau of Statistics, leather industry ranks the second biggest export-oriented industry of the country after textiles. Moreover, Pakistan's share in world leather trade is almost 1%. Leather exports from Pakistan can be categorized under five broad categories: 1) gloves 2) finished leather 3) footwear 4) garments and 5) other leather goods. According to the Pakistan Tanner Association (PTA), leather contributes 5.0% to GDP and 5.4% to the country's foreign exchange earnings. Germany, USA, United Kingdom, Turkey, Japan, France & UAE are major export markets of Pakistani leather products. Some of the major players in the market are Din leather (Pvt) Ltd, Shafi Tanneries (Pvt) Ltd, MIMA Leather (Pvt) Ltd & Universal Leather (Pvt) Ltd.

During FY16, industry revenues decreased from \$1.2b to \$0.9b vis-à-vis last year's corresponding period. This decline can be attributed to a volumetric reduction in sales across all categories; largest decline of unit sales was in tanned leather by approximately 5,000 units. Further decline in exports has been noted during the period ending April 2017 to \$757m from \$812m vis-à-vis last year's corresponding period; showing a decline by about 7%. Sale of value added segments represents 63% (FY14: 59%) of the total quantity of leather exports in FY16.

Five years Export of Leather and Leather Products

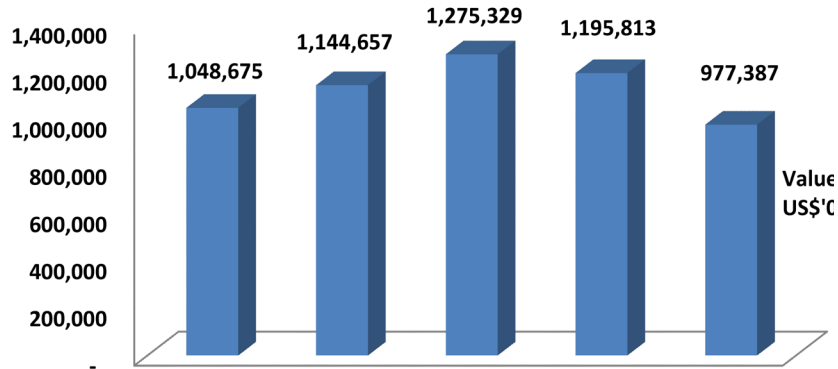
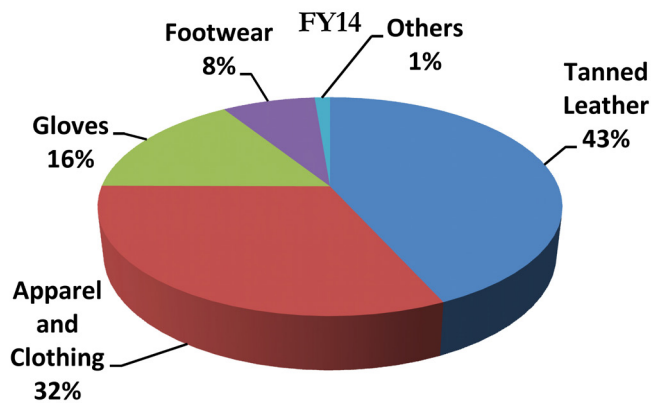
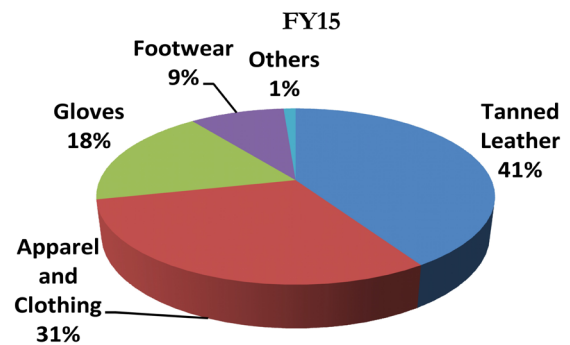
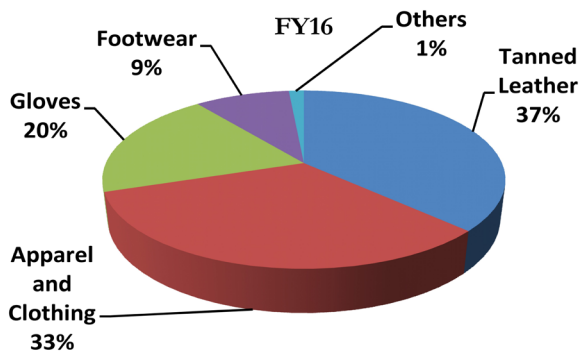


Table 3: Category wise export of Leather

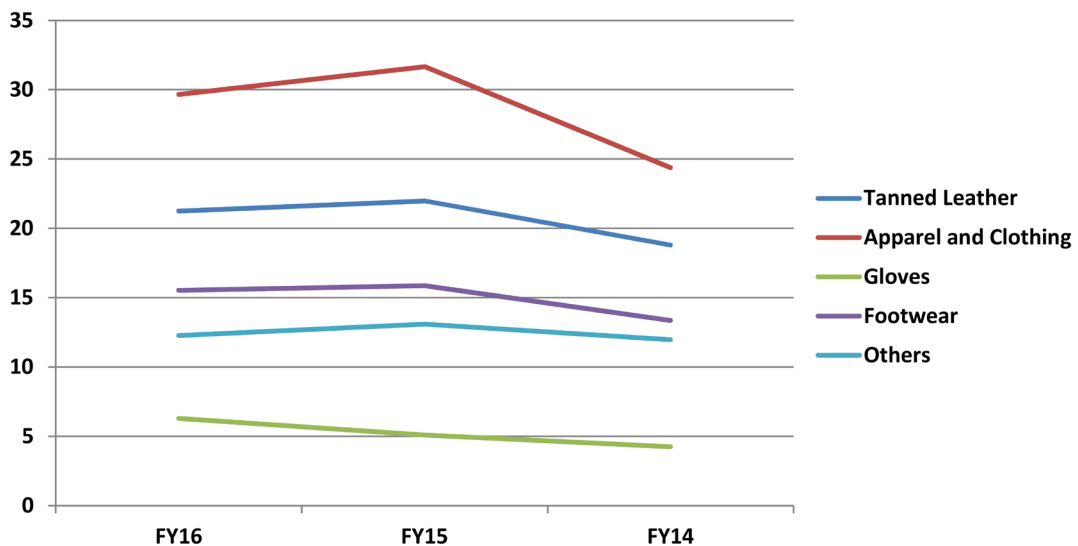
	July-June 2015-16			July-June 2014-15			July-June 2013-14		
	Quantity	Value ('000 \$)	AUP	Quantity	Value ('000 \$)	AUP	Quantity	Value ('000 \$)	AUP
Tanned Leather	17,072	362,753	21.25	22,272	489,412	21.97	29,349	551,413	18.79
Apparel & Clothing	901	320,525	29.65	963	365,738	31.65	1,389	406,255	24.37
Gloves	5,067	191,157	6.29	7,094	216,914	5.10	7,947	202,548	4.25
Footwear	5,744	89,151	15.52	6,919	109,761	15.86	7,396	98,803	13.36
Others	1,150	14,098	12.26	1,068	13,988	13.10	1,364	16,311	11.96



A major issue encountered by the leather exporters was the declining sales volumes on account of a global recession observed in the outgoing year. Moreover, in line with the development of technical textile, cheaper alternate named 'synthetic leather', demand for pure form of leather is reducing. Prices across all products remained approximately the same during FY16. Average unit price of leather products for the past three years is illustrated in the table below:

Table 2: Average Unit Price of Leather Products – Industry Statistics (All Figures in USD/Sq.ft)

	FY16	FY15	FY14
Tanned Leather	21.25	21.97	18.79
Apparel & Clothing	29.65	31.65	24.37
Gloves	6.29	5.10	4.25
Footwear	15.52	15.86	13.36
Footwear	15.52	15.86	13.36



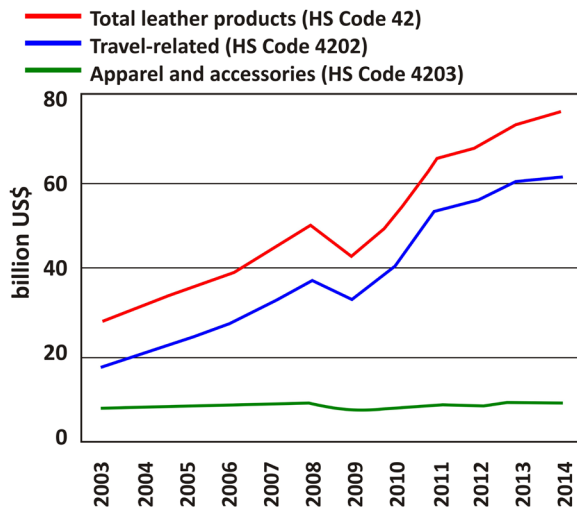
CHALLENGES FACED BY THE INDUSTRY

Currently the industry is experiencing a downturn; facing a challenging operating environment with significant pressure on sales and margins. Last three years have been the toughest for the industry with an approximate 25% fall in export value. Fall in exports has been led by a large decline in textile and rice with significant decreases in export of leather goods. Downward trajectory movement in exports is mainly due to slackness in international demand, continuous market recession and a slowdown that gripped Europe. Euro depreciation resulted in a dip in both sales price and receivables including export tax rebate. Countries in the euro zone have historically remained the largest importers of Pakistani leather. However, given a slight appreciation in the exchange rate witnessed in the second half of FY17, margins are expected improve in the coming years. On account of 78% of the nation's total leather and leather production serving as exports to the country, a mass of adverse external factors largely affected the local leather industry. The graph below shows leather exports on a timeline both locally and globally:

2) <https://tribune.com.pk/story/1455575/shell-pakistan-says-pay-fine-bahawalpur-tanker-fire-killed-217/>

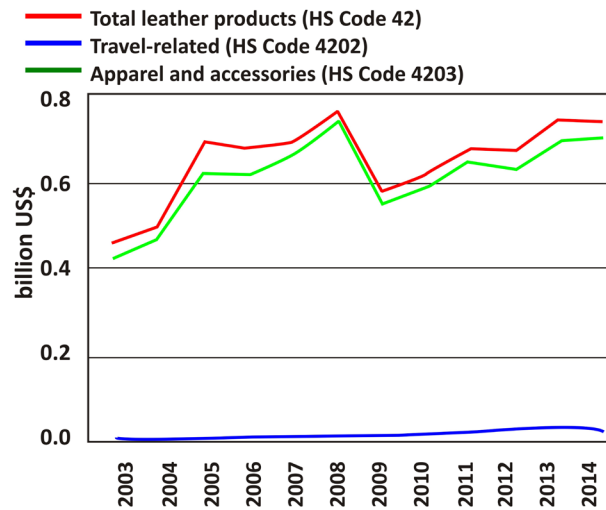
3) Pakistan Oil Report 2015-16, OCAC

Figure S3.4a: Global Export of Leather Goods



Source: International Trade Center

Figure S3.4: Pakistan's Export of Leather Goods



Source: International Trade Center

Not only external factors but certain internal factors also contributed highly to the demeaning performance of leather industry. These factors include high utility and labor costs, scarcity of skilled labor, outdated machinery and infrastructure, energy & water crises, low grade quality of hides & skins and delay in export rebates. As per industry's claims, over Rs.200b refunds are presently pending, which adversely affect the cash flows of exporting firms. Troubled internal security situation is an additional negative externality for the industry.

Among other internal factors, another significant issue contributing negatively to the leather industry is continuous load shedding, especially in Punjab. Such issues give rise to the probability of the unmet targeted export orders in time as well as fetching foreign exchange for the country. Tanning industry must be relieved from these problems in order to keep up with the demand of importers and protect itself from exchange rate fluctuations.

According to Pakistan Tanners Association (PTA), Pakistan is the only country that experienced a negative growth in exports as opposed to the positive growth in its regional competitors namely India, China and Bangladesh. Industry players are of the view that the government has not been following export-led policies as compared to regional countries' governments. Governments of competitive countries are highly supportive in terms of providing reduced tariffs, competitive devaluation and export rebate incentives. Apart from the internal support which these countries receive, healthier political terms with the importers of their goods allow them to capture a large market share. A primary example is the duty free imports from Bangladesh to Japan. Impediments have restricted the growth of leather industry in Pakistan and thus lost the export market to foreign countries. There have been a few initiatives taken by the local government to boost the dwindling exports of leather. In the federal budget 2016-17, government of Pakistan has provided an exemption of leather industry from sales tax. In addition to this, export re-finance rate has also been reduced to 3% from 3.5% in federal budget 2016-17. Impact of these initiatives is yet to be seen.

In 2013, the GSP Plus status given to Pakistan was expected to increase export volume. As per Generalized System of Preferences (GSP) Plus status, almost 20% of Pakistani exports were allowed to enter the EU market at zero tariff and 70% at preferential rates. Impact of GSP Plus status was evident given the increase observed in Pakistan's exports to EU during FY14. However, appreciation of rupee and real effective exchange rate (REER) after implementation of GSP Plus added to the woes of exporters. At the same time, major importers of Pakistani goods were facing an economic slowdown which resulted in currency devaluation. Other countries as a response to reduced commodity prices and balance of payment crises have considerably devalued their currencies. Comparison of Pak rupee (PKR) with the currencies of EMs (Emerging Market) shows that PKR devalued to the least against U.S \$ compared to its trading competitors since January 2013.

STRENGTHS AND OPPORTUNITIES

One of the factors which may act as a boost in level of exports is the fall in oil prices owing to the lower cost of production, slightly neutralizing the effect of PKR appreciation. However, as opposed to the delayed effect of reduction in oil prices, benefit of a cut in the benchmark interest rate quickly reaches its intended beneficiary. Hence, there may be another relief for the industry in view of the decline in interest rates that may lower cost of acquiring financing as well. In this regard, there is anticipation of higher economic activity in future which is expected to boost credit uptake. Provided that the due support, facilities and incentives from government is received, revenue generation via leather exports is anticipated to improve in future.

Despite a host of problems faced by the industry, some opportunities are yet to be realized. With the closure of tanneries in Europe accompanied by the fact that China, India and Bangladesh are moving towards value added goods, Pakistan may foresee these countries as potential buyers for tanned leather. The leather industry in Pakistan has largely remained export oriented with low domestic demand. However, the trend is tilting towards small producers entering market eventually raising local demand for tanned leather; pace of the same is very slow. Another upcoming challenge for Pakistani exporters is addressing the concerns of international buyers regarding environmental issues caused by the tanning industry. Efforts like alternatives to chrome tanning, which has been the dominant method, of making leather is under process. These alternatives include aluminum tanning & vegetable tanning. Moreover, it is important for tanning companies in Pakistan to play its role in being quality consciousness in order to keep up with the hygiene requirements raised internationally.

Given that leather industry of Pakistan earns huge foreign exchange and provides significant employment to the country, institutional support for technical, design and marketing services can result in efficient utilization of available resources. Local availability of raw materials, export market in Europe, USA and Far East and low wage cost gives the country a competitive edge in the world market. Despite easy and cheap access to resources, capacity of this sector is highly under-utilized. The industry needs reforms and modern technology with increased confidence among SMEs for further growth. It is undisputed that there is a positive link between research, training and industry development that needs to be maintained JCR-VIS.

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