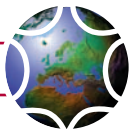


Regional Commentary: South America



Colombian manufacturers are shaking off fears that the export market may be too complex for them to deal with.

Industry under threat as too many hides disappearing across the border.

South America's battle to add value

In looking at the leather industry in South America, it's inevitable that Brazil should take up more of our attention than any other country as an estimated 60% of the entire region's leather production comes from there. Argentina, which also features prominently in this report, accounts for another 15% or so, with Colombia and Uruguay producing around 5% each. This may be one of the oldest trades on the South American continent, but it seems clear that, these days, most of the activity is in the hands of only a few of the 12 countries in the region.

This is unlikely to change in the years ahead, according to the South American regional director of the leather business unit of chemical supplier Lanxess, Tomás Vallendor. With tens of millions of head of cattle going for slaughter every year, Brazil and Argentina in particular are certain to continue to have worldwide importance as sources of leather.

Levels of meat consumption from country to country are changing, with some national tastes moving towards alternative sources of protein (something South American meat companies, farmers and governments are keeping an eye on), but meat is still a critical part of the wider human diet and, while Argentina is the global leader in per-capita meat consumption, Brazil is now the largest exporter of meat in the world, and has taken great strides in its efforts to increase herd sizes through artificial insemination programmes. Their status as key producers of raw material will continue.

Changes afoot

Change is happening in South America, though. Mr. Vallendor confirms one trend in the industry in Argentina in which tanneries are pushing hard to add more value to hides before export, keeping jobs and traditional skills on home soil. "The government and the tanning companies in Argentina are campaigning for the leather

industry there to add as much value as possible," he explains. "This is far from unique to Argentina, though. We see it everywhere we look. Let's say your company tans 1,000 hides a day on average. If you ship them out as wet blue, you might employ 50 people, while for semi-finished leather you'd need 100 people and for finished leather 150. It's only natural for governments to want the industry to keep as many people in work as possible."

Most of Argentina's output for its two big export markets is going as semi-finished at the moment, he says, to the United States for upholstery for the automotive industry, and to China for the shoe and furniture manufacturing sectors. There are moves to make export duty higher for leather exports with less added value, in an attempt to discourage raw and wet blue exports, but it's too soon to say if these measures will come into effect.

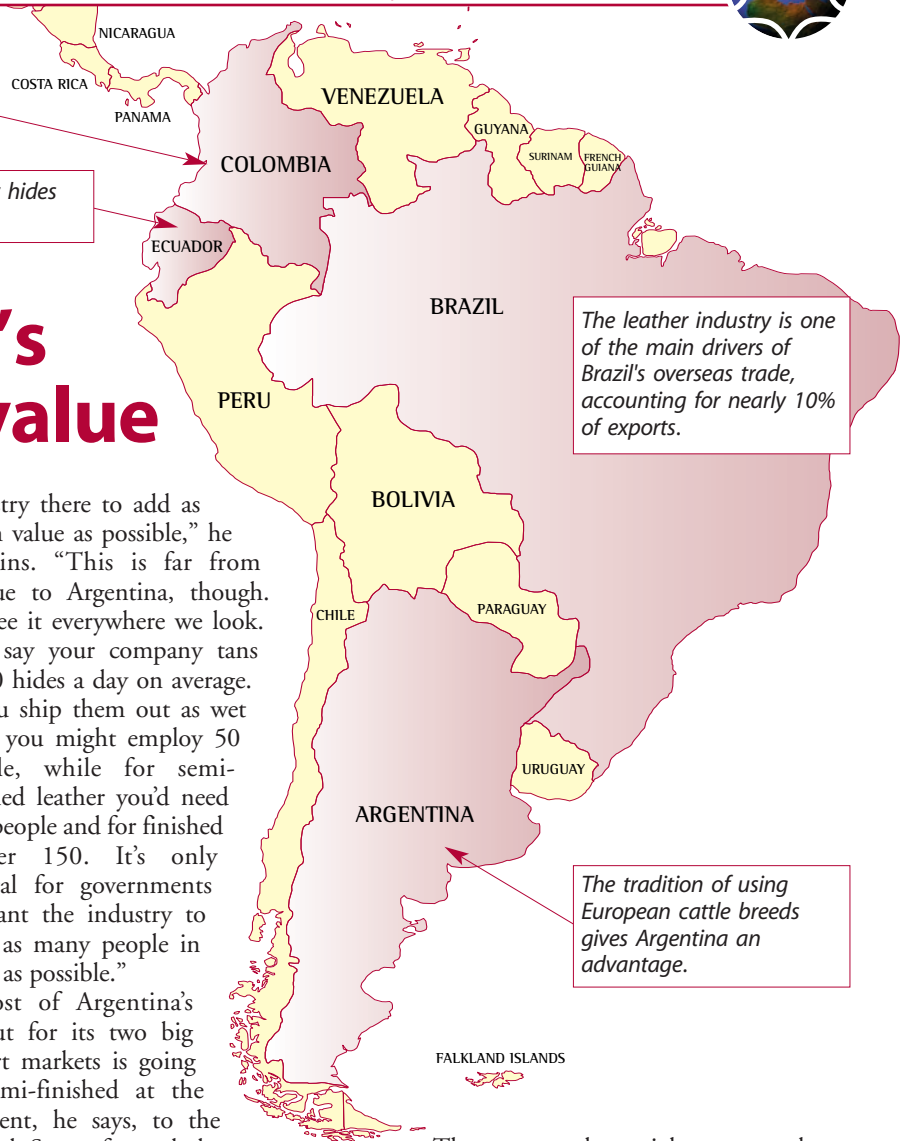
Some big Brazilian tanners are engaged in a similar battle: they, too, want to do more so that they can earn more. However, Mr. Vallendor—who knows the situation in both countries intimately (he returned home to Argentina in December to take up his current regional role for Lanxess after six years as the chemical supplier's country manager in Brazil)—believes other players in the industry in Brazil are happy to export more and more wet blues.

"Wet blue demand from China and Italy appears to keep growing," he continues, "and there are meat companies in Brazil now who have realised that they can turn the hides they have on their hands into wet blue in a few days, without the need for investing in our products, for example.

They export them right away and get their hands on some quick cash. They have no interest in adding value."

There are good reasons why finishing often takes place in the big consumer or manufacturing markets. Colour trends and other aspects of fashion can change quickly, and it's natural to want to have control of these further along the supply chain. However, Mr. Vallendor emphasises that South America has the space, the livestock, the available skilled workforce, and the leather-industry tradition to begin to play those roles itself. In other words, he harbours hope that South American companies—if they take small steps one after another, and secure support from their national governments—may in future be able to set up and run successful furniture factories and upholstery facilities serving the global automotive industry in their own backyard.

"It's not going to happen overnight," he says, "and competition in the international arena is intense, but I hope the industry in South America will take those steps one day. I would be delighted if it did." 🌐



The leather industry is one of the main drivers of Brazil's overseas trade, accounting for nearly 10% of exports.

The tradition of using European cattle breeds gives Argentina an advantage.



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Brazil sets its sights high

As Latin America's largest economy, Brazil posted record foreign trade of \$228.9 billion in 2006, with exports reaching \$137.5 billion and imports hitting \$91.4 billion. The outlook for 2007 is also encouraging as exports are targeted to improve a further 11% to reach \$152 billion. This upward trend in general economic performance has also been reflected in the performance of the country's leather industry, which posted exports of \$1.9 billion in the period January to November 2006, 33% higher than the \$1.26 billion reported for the same period in 2005. And this improvement is by no means a 'flash in the pan' phenomenon. Brazilian leather exports doubled in the five-year period from 2000 to 2005, rising from \$760 million at the turn of the century to achieve \$1.4 billion by 2005.

This improvement in exports has been achieved through several different strategies. In recent years, with the ever-increasing competition from lower cost countries in Asia, and particularly in China, Brazil has refocused the industry to concentrate its exports towards more value-added products such as finished leather, footwear and leather goods. This is reflected in the fact that whilst the value of imports increased 33% in 2006, volumes only rose 25% and this has led to a change in the targeted consumers, with Brazilian exporters now aiming for higher end export markets such as Europe. This appears to have proved a successful strategy as in 2006 Italy imported 51% more Brazilian leather than in 2005 to top the list of export markets, accounting for 26.43% of the total. However, China remained second in line with a 20.11% share and Hong Kong was the third largest at 15.39%, followed by the traditional markets of the USA, South Korea, Indonesia, the Netherlands, Portugal, Taiwan and Vietnam. The Middle East has also become an increasingly significant market for Brazil as leather exports to the League of Arab States increased 78% in 2006 to reach \$1.79 million. Although this may appear to be relatively low compared with the country's overall export revenues, the region is seen as a promising prospect in the years to come as Brazil continues to focus on new and alternative markets.

The Brazilian Association of Shoe and Leather Components Industries,

Assintecal, also recently sent a consultant to Africa in order to look for new business opportunities for Brazilian leather and footwear companies. The representative travelled to Morocco, Egypt, Tunisia and Sudan where he held meetings with companies as well as visiting a footwear factory and a large tannery in Sudan. Despite the geographical distance between Brazil and Africa, it is believed that the Latin American country has the products, knowledge and technology to compete with European producers and to win a significant market share in these countries, particularly in view of the fact that Brazilian goods have already penetrated the markets in Egypt and Tunisia.

Going global

The leather sector has also significantly increased its international presence through an Integrated Sectoral Programme funded by the Brazilian Export Promotion Agency (APEX -Brasil). Established over five years ago, the programme has involved numerous events and projects that have boosted Brazilian leather's exposure in the international arena through the organisation of Brazilian pavilions at international trade events around the globe and buyers' projects, through which foreign buyers are invited to events in Brazil where leather and

leather goods are presented.

In order to increase its value-added exports the Brazilian government has taken specific steps to encourage higher revenue products such as reinstating export duties on wet blue. Following requests from the Brazilian Association of Tanners of the State of Rio Grande do Sul (AICSul), the Brazilian Chamber of Foreign Trade recently increased export duty on wet blue to 9% from 7% in an attempt to discourage exports in order to generate jobs and increase revenues further down the leather pipeline. In the private sector individual companies and associations are also working hard to gain international recognition as quality producers.

One example of this is Bertin Couros, which was recently certified by UK-based technology centre SATRA in the Laboratory Quality Management System and Leather Grading System categories, making it the first Latin American leather sector company to be accredited by the internationally-recognised centre.

In spite of these initiatives, many members of the industry remain dissatisfied with the present situation due to the exchange rate of the Brazilian real. The majority of companies involved in exporting goods believe that the current exchange rates are hampering industry ➤

CICB celebrates 50th anniversary

The Centre for the Brazilian Tanning Industry (CICB) celebrated its 50th anniversary at Couromoda, held in São Paulo in late January. Founded on January 15, 1957 in Rio de Janeiro, the organisation has tirelessly defended the interests of the Brazilian tanning sector for half a century.

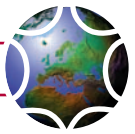
Speaking at the event earlier this year, Umberto Cilião Sacchelli, current president of CICB, highlighted the organisation's history and the important role it plays in the Brazilian leather chain and, indeed, the Brazilian economy.

CICB's activities include exploring new export markets through annual agreements with the Brazilian Export Promotion Agency, which provides the funds necessary to promote the sector. This collaboration has resulted in the 'Brazilian Programme for Increased Leather Exports', also known as 'Brazilian Leather', which offers assistance to higher-end Brazilian tanners so that they are able to participate at international exhibitions and in trade missions. The objective of the programme is to increase the country's leather exports to \$2.4 billion by 2008.

Brazil's leather industry is one of the main motors of its foreign trade, accounting for almost 10% of the country's total exports. In 2006, leather exports reached \$4.5 billion—7% higher than the \$4.2 billion exported in 2005. The leather sector is made up of 10,000 companies which employ some 500,000 people.

Of the 43 million hides produced in Brazil, 65% are now exported as wet salted or wet blue to producers of furniture and motor vehicle upholstery leather as well as to leather footwear and garment factories thanks to the growth in the Brazilian commercial herd and reduced leather demand from local manufacturing sectors.

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as they are reducing the competitiveness of Brazilian products on the open international market.

The unfavourable US\$/real exchange rate has also been a significant factor in the decline of Brazil's exports of leather and footwear machinery, which fell by 4.03% to \$8.78 million between January and September 2006, from \$9.14 million in the same period in 2005. Leather machinery exports decreased 6.41% from \$2.13 million to \$1.99 million, while footwear machinery fell 3.31% from \$7.02 million to \$6.79 million.

However, in spite of these negative results, the machinery sector the Brazilian Association of Manufacturers of Leather and Footwear Machinery and Equipment (Abrameq), remains positive about the sector's future, thanks to the intensive promotion work carried out by Abrameq and Apex-Brasil, particularly in the Mercosur region. Although Brazilian products are struggling to compete in foreign markets, machinery companies maintain a leading position in the Latin American market with Colombia and Mexico as the main export markets on the American continent. Colombia imported almost \$1.3 million worth of Brazilian machinery in 2005 and, by September 2006, export figures had already reached \$735,659, whilst Brazilian exports to Mexico reached \$3.3 million in 2005.

Putting their foot down

In spite of the concerted effort by associations and manufacturers alike to combat the problems of reduced competitiveness due to the negative impact of the exchange rates, there have been many victims along the way—and nowhere more so than in the important footwear sector.

Footwear exports of \$1.7 billion in the first 11 months of 2006 were on a par with 2005 figures, which had been 20 million pairs fewer than in 2004. And, with the outlook no more promising with estimated figures for the full year of 2006 only \$1.88 billion, the industry is struggling. The problem has been further exacerbated by the significant increase of Chinese footwear imports into Brazil, which rose by a staggering 14 million pairs in 2005, which has led to job losses in the domestic industry. According to the Footwear Industry Association, Abicalçados, hundreds of footwear manufacturing facilities were closed and some 12,000 jobs were lost in the Brazilian shoe industry in 2006. This led to a great deal of unrest and in May last year some 3,000 representatives of the leather and footwear sector, supported by the major relevant associations, took part in demonstrations in Brasília to protest against the government's economic policy and the volume of Chinese imports entering the domestic market.

In response to their complaints the government released R\$400 million (\$170 million) in special credit lines for over 3,000 companies to use as working capital, and provided two additional unemployment benefit payments for workers that had been dismissed, however, the organisers of the protest claim that has done little to assist those affected and was no more than an attempt to placate those involved and avoid

Steps to counter competition

At the end of February, the Brazilian Association of Footwear Manufacturers (Abicalçados) announced that Milton Cardoso was its official candidate to take over as president of the organisation in July. Mr. Cardoso is the managing director of Vulcabrás do Nordeste, a manufacturing firm based in Jundiá in the state of São Paulo, with 9,500 employees, a turnover of R\$560 million (\$268 million), and subsidiaries in Argentina and Uruguay. Mr. Cardoso, a former university professor, has worked in the shoe industry for more than 20 years. He has wasted no time in speaking out in support of the policies of outgoing Abicalçados president, Élice Jacometti, and pledging to carry them forward. "Abicalçados will continue along the same path of untiring defence of the interests of this sector and of our country," he says.

In the short term, he aims to convince the federal government of Brazil to introduce "compensatory measures" for its shoe industry, allowing companies throughout the sector to charge what he calls "competitive prices". This is a clear reference to the competition Brazilian shoe production companies face now from competitors in China and other Asian economies.

The president-elect insists, like many in the industry, the federal government's policy on currency exchange—which has kept the value of the real high—has made the situation even more difficult because it makes it more difficult for them to expand footwear exports. Alleviating this problem is a priority, he believes—maintaining market share and, possibly, even the survival of many footwear companies could depend on it. Influential figures in President Lula da Silva's federal government, including Labour Minister, Luiz Marinho, have recently added their voices to the calls for the government to act on exchange rates, agreeing that this will boost exports and create new jobs.

For Mr. Cardoso, encouraging a wider industrial policy that is more favourable to business and, especially, to businesses that are active in the export market, is a medium-term goal. Longer term, he wants nothing less than "the effective and complete lifting of tax on export goods". Interest rates that help keep Brazilian footwear manufacturers competitive in the international market and more flexible labour laws also form part of his vision.

Committing to the future

He has emphasised his commitment to the entire footwear supply chain in Brazil, including tanneries, textile producers and machinery manufacturers. He calls it "a complete chain of production, which few countries could maintain on their own." He also stresses the success Abicalçados has already had in encouraging companies throughout the chain to work in partnership with one another, which, he argues, has made the whole industry more competitive.

Footwear exports are increasing, as a result of improvements in quality and productivity, and thanks to moves into new export markets. Mr. Cardoso's figures show that footwear exports from Brazil have grown by 9.6% in the last four years. Over the same period, however, footwear imports into Brazil have rocketed by 264%. Brazilian producers have been able to secure higher prices in export markets for their goods—the dollar price has gone up by 17%—while the average import price has fallen by 14%. The implication is that the export market may now be more attractive than the domestic one.

The president-elect believes that these figures are a reflection of protectionist measures that some of Brazil's competitors in Asia have adopted. He is also critical of those competitor countries over their low labour costs; he says these low costs are only possible because of poor working conditions for workers there, especially with regard to long working hours and a lack of insurance and pension provision.

"Plenty of other economies—including those of the European Union, Mexico, Argentina, Venezuela and Colombia—have already taken steps to counter the predatory competition of Asian countries that are not democratic, and do not adhere to market-economy principles," he says. "This has been the main focus of Abicalçados under the current president, and will continue to be the main focus for me."



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further aggravation. In a more concrete step Abicalçados has urged the government to impose a 35% duty on Chinese footwear imports, following China's rejection of the Brazilian shoe industry's proposal to impose voluntary restrictions.

The problems faced by Brazil's footwear industry have led to a split between the sector and the Brazilian leather industry that is enjoying a far more favourable situation at present. Whilst Chinese imports are 'flooding' the domestic market and placing a burden on the shoe industry in Brazil, China is a



significant market for leather exports and Brazilian leather is found in many of the shoes made in Asia which, in turn, compete with footwear made in Brazil.

The Brazilian tanning industry is no

longer dependent on the local footwear industry to grow and has sought business elsewhere, sometimes at the expense of the domestic footwear industry, due to increased demand from abroad and the fact that the Brazilian footwear industry now often uses other materials such as synthetics and fabrics rather than leather. This situation is not a new one as it began back in 1994 when the Brazilian shoe industry was hit by a major crisis following the Real Plan, but it has escalated as China has grown in stature as a footwear production hub. 🌐

Argentina pushes price and quality

Leather has always been important in Argentina: you would expect nothing less from a country with 50 million head of cattle, mostly from European stock—from breeds such as shorthorn, Aberdeen Angus, Hereford, Charolais and Holstein—and a slaughter of around 13 million head a year.

For most of this decade, however, Argentina's economic situation has been delicate at all times and desperate for long periods. One industry source, the Chamber of the Argentine Tanning Industry (CICA), believes the leather and tanning industry has shown great commitment to overall government initiatives to keep inflation low—to the detriment, some believe, of the cattle-meat-leather value chain—by performing well in a difficult export market, bringing in much-needed foreign currency.

According to CICA's own statistics, in 2006, the value of tanned hide exports from Argentina was a little short of \$780 million, a small increase on the previous year's figure of \$755 million, and a respectable return, perhaps, considering the pressure on prices in the global market last year.

Interestingly, though, CICA's figure for overall tanned leather exports for 2006 is \$884 million (99.5% from bovine leather, with caprine and reptile leathers accounting for just over \$4 million worth between them). The clear suggestion is that the industry in Argentina has moved to add more value (more than \$100 million worth) to its leather on home soil before exporting it as, for example, material for upholstery in the automotive and aerospace sectors. This may help to explain a drop in export values last year to countries such as Mexico—down to \$47

million from \$75 million the year before—and Thailand—down from almost \$43 million in 2005 to \$36.8 million last year.

Nevertheless, some of the 2006 figures for tanned hide exports are impressive. The total value of exports to China was 25% higher last year at \$231 million. The figure for Uruguay was up by 50%, and the one for Spain by 55%. And while the totals for important markets such as the USA, Italy, India, Canada, Australia and Brazil have remained reasonably static, some export markets appear to be booming for the Argentine tanning sector.

Setting an example

According to Pedro Lievendag, a Buenos Aires-based veteran of buying and selling leather in the region, the Koreans and the Croatians are displaying good judgement in investing more heavily in hides from Argentina. He is adamant that, in terms of value for money, and the relation between the quality of the material available and the asking price, there is nothing on the world market to beat Argentina at the moment.

He argues that the tradition of using European breeds, of applying one small brand-mark to each hide, of relatively few problems with damage from horn fly bites and other pests, give Argentina a huge advantage over its competitors in the region, most notably Brazil.

More leather manufacturing countries should take note, he says. And European tanners—"the few that are left"—should shed what he calls their "fixed ideas" and have a go at working with hides from Argentina. "It's not as if there would be a problem with the machinery they use," he adds. "There would be no problem at all from a machinery point of view. I think it's

just that European tanners don't know how to work a hide that has not spent its whole life in a shed."

At the same time, Mr. Lievendag is of the opinion that government measures to control inflation are beginning to add pressure to the tanning sector in Argentina.

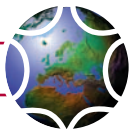
He explains, "The government is still trying to keep inflation as low as possible and, of course, the main product in the shopping basket of Argentine people is beef. So they've been trying to avoid price-increases. Nevertheless, in the first three weeks of March, the price of meat went up by 15% at the meat counters of supermarkets, and people have felt they had no option but to pay the higher prices."

The expectation is that the government will want to push the price back down if it can. The principal problem here is that the government's inflation controls have served to set a maximum price for cattle. According to Mr. Lievendag, the Mercado de Liniers near Buenos Aires (claimed by some to be the most famous cattle-market in the world), used to auction off 20,000 head of cattle every hour, or hour-and-a-half. Now, only around 3,000 head are moving through the market, even on good days.

If this continues, the leather expert fears that farmers will devote more and more land to soya and wheat. He says, "If they can't make money on cattle any more, they have to change. And they will put the cattle they still have out to graze on their worst fields."

Even so, none of these concerns will make him change his view that, in an argument about quality and value, nothing in today's leather market can beat Argentina. And he is confident things will return to normal in time. 🌐

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A fight on two fronts for Colombia

The Colombian leather industry is concerned about the future, even though exports of goods right across the value chain are increasing in volume and value. From a total value of just under \$150 million two years ago, figures for 2006 suggest that exports of leather, shoes, footwear components and leather goods from Colombia reached \$183.7 million. These figures refer to the period between January and October each year and come from a comparative study that the Colombian Association of Leather and Footwear Manufacturing Industries (ACICAM) carried out recently.

The association says a strong final quarter of the year could push the overall 2006 total to the \$240 million mark, representing a 32% increase in exports of leather, 16% in footwear (encompassing finished shoes and components), and an 8% rise in leather goods. Leather accounts for 47% of Colombia's exports in this sector, footwear for almost 28%, and leather goods for the remaining almost 26%.

The breakdown of the main markets to which Colombia exports is interesting. For leather goods, the United States (in which

the Colombian authorities include Puerto Rico for the purposes of these calculations) is the clear leader, accounting for 52% of leather goods produced in, and shipped from Colombia, with handbags and leather covers for diaries and other books proving particularly popular. The second country on the list is Venezuela, which ACICAM describes as "a natural market for Colombia". Mexico takes third spot in the ranking.

As far as footwear exports are concerned, Venezuela is the most important market, followed by another neighbour, Ecuador, with the United States (and Puerto Rico) in third place. ACICAM is encouraged not only by the increase in volume of footwear going for export, but also by a rising average price of Colombian shoes in the external market.

The association believes that fears are fading among Colombian manufacturers—often fairly small businesses—that the export market may be too complicated for them to tackle. It has provided direct help and advice to make it easier for businesses across the country to take care of logistics, to manage overseas currencies and so on.

Its training programmes will continue, and expand to all parts of the country in the near future.

While accepting that this is good news, and maintaining optimism about further growth, many ACICAM members are still uneasy. The reason is the rise of imports, particularly shoes, into the country. The import total for 2006 in the nine-month comparative study was \$175.5 million, so industry exports only outstrip imports by \$8.2 million.

Of greatest concern to ACICAM is the fact that imports have almost doubled since 2004. According to the association, however, the Colombian government has begun to realise the social consequences of cheaper imports from Asia flooding the domestic market, particularly in footwear, which accounts for around 75% of the import total. It explains, "So much of what we produce, in footwear and in leather goods, is labour intensive. The government has realised that communities can lose many jobs if a leather business has to close down. The impact is really very large, so the government has taken measures, such as imposing stricter controls on Asian imports coming to us through Panama."

Unfortunately, these stricter controls led the Panamanian government to raise a complaint about Colombia at the World Trade Organization last July, claiming Colombia was forcing importers to pay excessive duties and taxes on footwear imports. The two countries reached an agreement on this issue before the end of 2006, exposing Colombian manufacturers to fierce competition again. The association's hope is that the government might focus future help on helping Colombian companies raise their profile at home and abroad, emphasising the quality of their products to the entire global market.

ACICAM's contention now is that the higher margin manufacturers can make on home-produced leather goods and shoes should allow them to keep competing against imported goods that are under severe price-pressure. Colombia has a population of around 45 million, the second highest in South America, so its domestic market is an important one. This is something ACICAM wants its member companies to keep sight of, while, at the same time, continuing their expansion into attractive overseas markets. 

INDUSTRY IN ECUADOR UNDER THREAT

Tanneries, shoe manufacturers and leather goods producers in Ecuador have complained that a shortage of hides in the country is putting the industry under serious threat.

One tannery owner, Francisco Suárez, told Quito-based newspaper La Hora in March that the cost of hides has doubled since last June and that supplies are now of inferior quality, smaller size and in poorer condition. He accused commercial agents inside Ecuador of ignoring the domestic market to sell the best hides to Colombia, Peru and China, at a higher price than local competitors could pay, but at a big discount on the prices they would have to pay if they were following correct trading practice. He suggested this trade was taking place through secret channels and called on the Ecuadorean government to intervene.

The managing director of another tannery, Gonzalo Callejas, agreed, saying the high cost of raw materials was putting thousands of jobs in danger. The cost of locally made shoes has risen, forcing consumers to buy cheaper imports from Asia.

The president of the National Association of Ecuadorean Tanners, Eduardo Lanas, said his organisation was working to try to understand how many hides were leaving the country, and by what means. "At least 50% of our supply is going outside Ecuador," he said, "much of it without any benefit or any kind of added value for the industry here." He estimated that Ecuador has lost 40% of its leather production capacity in the last four years as more and more facilities close down. He claimed that, since the last few months of 2006, the leather industry in Ecuador has been in crisis.

Mr. Lanas said his association still believed Ecuadorean companies could produce leather, shoes and leather goods of a high enough quality to make an impact on the international market, but that they had to have the raw material to work with.