



## Regional Commentary: Indonesia

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# Indonesia — long on potential

*Indonesia has played a modest role in the world economy since its independence from the Netherlands in the 1940s, and its importance has been considerably less than its size, resources, and geographic position would seem to warrant.*

With a population of some 235 million Indonesia is the fifth most populous country in the world. Labour is cheap and plentiful. Yet it has consistently 'punched below its weight' in the global leather industry. Why is that?

There are several possible reasons. One is

that the country's leather-making industry is quite small. Mr. Senjaya Herlina, of Kulit Murni Asia Tenggara, and vice-chairman of the hide division and government relations for the Indonesian Tanners Association (APKI), says that there are only about 10 tanneries in Indonesia

capable of producing 500,000 square feet or greater. The remaining 90 have capabilities of no more than around 50,000 square feet.

With these relatively small numbers it is difficult to take advantage of any sudden upswing in the market. Such an

## Regional Commentary: Indonesia



Mr. Senjaya Herlina, of Kulit Murni Asia Tenggara, and vice-chairman of the hide division and government relations for the Indonesian Tanners Association (APKI).

opportunity presented itself recently with the European Union (EU) imposing punitive tariffs on leather shoes from China and Vietnam. Indonesia was mentioned frequently as a likely beneficiary of the EU's action but others, India in particular, will probably benefit much more. A view expressed by several within the Indonesian tannery sector itself.

Indonesia's footwear manufacturers, by contrast, are reasonably upbeat about this opportunity. The chairman of the Indonesian Footwear Association, Eddy Widjanarko, explains that in 1993 there were about 500 shoe factories. Today there are only about 200: some 300 closed down due to intense global competition, primarily from China. "They could not compete," Mr. Widjanarko says simply.

However, the EU's anti-dumping measures have led to a lot of interest from investors from as diverse a field as Taiwan, Hong Kong, Italy and even Vietnam. That investment runs from around \$3 million for a small two-line production facility up to an investment by a Korean enterprise of \$50 million.



Eddy Widjanarko, chairman of the Indonesian Footwear Association.

### Prashant Dhall of M D Industries, India

Exhibiting at the recent Indo Leather & Footwear (ILF) 2007, in Jakarta, M D Industries is an established Indian family business which has been selling embossing plates for over 30 years. The Kolkata-based firm sells to the EU, Australia, North America ... everywhere, says Prashant Dhall. "I've even sold in China. Just one plate, one time — and that was to a plate manufacturer."

Last December M D Industries took over the assets of the German embossing manufacturer, Max Plates, moving the production process to India. "No Indian company (in this field) had taken over a German company: it was a cause of great pride," says Mr. Dhall.

M D Industries also produces the Singh range of tanning machinery, which is well established in India, and in Australia, Bangladesh, Canada, South Africa, Kenya, Vietnam and Indonesia.

Selling into Indonesia, which he has been doing for the past four years or so, Mr. Dhall notes that while selling to the big tanneries is "no problem", with the smaller ones there is a marked reluctance to take the money out of their pockets. "It's not easy," he says, "despite the low prices (we're quoting)."

From the perspective of an Indian supplier Mr. Dhall confirms that a strengthening of the Indian rupee is a problem. If the negotiations to buy one of his plates or machines takes three to four months it can make the final price more expensive.

Mr. Dhall believes the market in Indonesia is quite limited but "worth trying".

This investment is mostly into resuscitating existing capacity that had been 'mothballed' so it will not, initially, show up in the ordering of new systems and equipment, but it does permit production to come on-line quickly.

Mr. Widjanarko acknowledges that the industry has been best known for producing sports shoes but there is now a window of opportunity to move to higher-value leather footwear.

### Two-year window

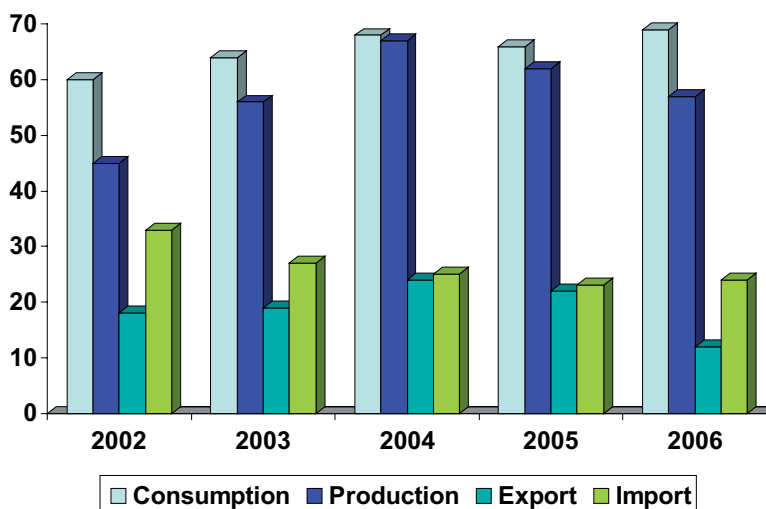
For the leather making sector the issue is how to ride this opportunity—which many believe will last no more than a

couple of years. The Tanners Association's Mr. Senjaya says sales are predominately in the domestic market for footwear manufacture as it is. He reckons that local tanners are utilising no more than 40% of their capacity of around 150 million square feet.

The government's estimate varies slightly with capacity at 140 million square feet with around 52% utilisation. Government figures also estimate that the industry employs no more than 6,100 workers country-wide.

The tanners, pretty much unanimously (well, among the larger ones at any rate), bemoan what they term 'government

### Finished cow leather statistics





## Regional Commentary: Indonesia

### Paolo Turato of Turato Asia and Italware (Asia)

"I love this business," says Paolo Turato, managing director of the Asian division of Turato/Italware, a family-owned Italian company with a 40-year history. "I'm a tannery-holic," says Mr. Turato, another exhibitor at the ILF 2007 in Jakarta.

His company sells components, spare parts and reconditioned units. In 1992 it went from selling nothing overseas to 100% export sales. Today it sells into 88 countries. Within the last few years it established an operation in Asia, in Malaysia, to look after the regional market, which accounts for about 75% of sales. "While we used the Italian lira there was no problem (with currency rates)," says Mr. Turato, "but there was also the prospect of a strong euro."

His fears about the strengthening euro have proved well founded.

"In 1998 we saw a boom in Indonesia," he continues. "All the tanneries needed parts and for four years we supplied maybe 90% of the tanners. Then, in 2002, nothing. Before, every time I visited Indonesia I came back with orders, now that's very rare."

It seems strange that Mr. Turato made such inroads immediately after the Asian financial crisis, which began in July 1997. He thinks one explanation may be that customers were determined to keep old machinery running rather than replace it with new machines: ideal for his company's niche.

Mr. Turato believes in maintenance: the trouble is, he explains, that all too often in Asia companies don't put so much importance on this subject. "It's a cultural thing," he says. "They're reluctant to consider it and invest." He adds that, all too often, he can prove to a potential customer that poor maintenance can be very expensive—costing far more than the investment he asks them to make.



Paolo Turato, managing director of Turato/Italware (Asia).

interference'.

A sore point with them is the tax imposed on the export of domestic raw hides (at 25%) and wet blue (at 15%). These taxes, which were common enough for emerging economies anxious to 'add value' to exports, came in before the 1997 Asian financial crisis.

Then, the International Monetary Fund (IMF), which had been called in to support the national economy, classified them as a "restraint of trade" and mandated they be discontinued. But in 2005 the Indonesian government brought them back. (However, wet blue made from

imported raw hide is not subject to the tax if re-exported.)

Major markets of semi- and finished leathers are Hong Kong, India and Bangladesh primarily, and are valued at some \$113 million. Imports of leather, by contrast, were no more than \$42 million.

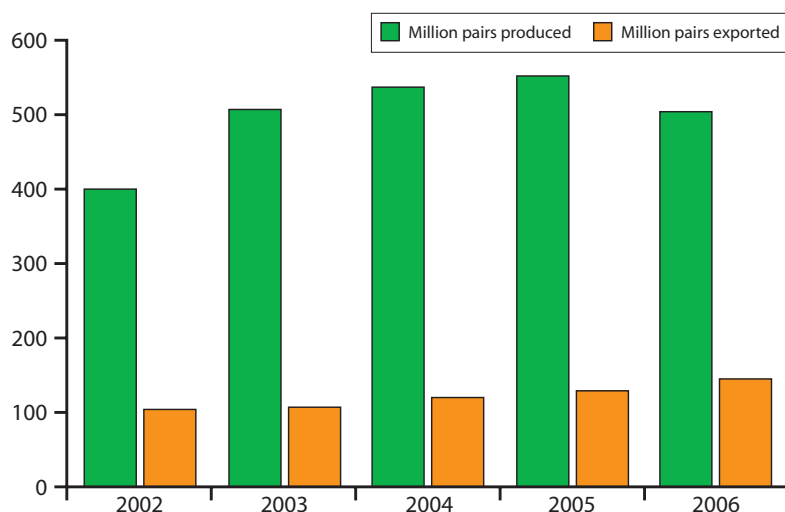
### Wash by hand

Domestic hides are generally of good quality and include sheep, goat and cattle. The 'Java Hide' is especially valued as a lightweight hide, being unusually free of imperfections. Small farmers, with just a few cattle, hand-wash their animals each

day in the river and tend to them scrupulously.

But with a move towards more intensive farming techniques and larger herds, plus tropical diseases not previously encountered entering from overseas, the Java Hide may be heading for endangered species status.

### Footwear production vs. exports \*Latest available figures



## Regional Commentary: Indonesia



### Kadarwin Liong, president, and Eldon Leo of Lengtat Tannery, Jakarta

Eldon Leo represents the fourth generation of the family business of one of Indonesia's largest tanneries, Lengtat Tannery. There is a capacity for 1 million square feet per month but, as Mr. Leo acknowledges, it is currently running at between 50% and 60% of that figure. That may be reflected in an annual financial turnover that ranges from \$10–20 million. Much of the raw material the tannery uses, especially goat, is purchased locally: sheep skins are imported, as is what Mr. Leo refers to as "better quality" raw material.



*Kadarwin Liong (right) and his son Eldon Leo, of the Lengtat Tannery, one of Indonesia's largest facilities.*

The company has a good client roster, which includes Nike (glove leather) and the German footwear brand Ara. Over 70% of production is exported.

Mr. Leo recognises the opening for the industry brought on by the EU restrictions on leather footwear from China and Vietnam. "It could be very helpful," he agrees. He notes too that recent changes in China—new environmental regulations and changes in VAT export rebates, together with increases in the value of both the Chinese and Indian currencies—could provide a boost.

What Indonesia has to do now, he believes, is to get as much feedback as possible, and work more closely with clients. "There is very good potential," he insists.

His father, Kadarwin (Alex) Liong, is more circumspect due, perhaps, to many years' experience. He acknowledges that there are opportunities opening up for Indonesian leather but says there needs to be less government intervention. "There are too many (government) ministries involved, and too much bureaucracy. Too many documents that each require an official stamp."

Domestic sheep are coarse-woolled, suitable for certain types of glove leather. For shoe leather they are known generally under the name of cabretta.

Another grouse from the industry concerns recently introduced labour laws. Basically, it has become more expensive to fire staff and workers.

### Hidden cost of corruption

"Too much bureaucracy" is a common complaint from business worldwide, but in Indonesia especially it's often used as a shorthand for corruption.

It's foolish to pretend that Indonesia is free of graft. In the Transparency International (TI) Corruption Perception Index 2006 finds Indonesia listed near the bottom of the table, number 130—out of 163—tied with Zimbabwe and the Central African Republic. Regionally, only Cambodia (151), Bangladesh (156), and Myanmar (160) score worse. China and Vietnam, two of Indonesia's most ferocious competitors, are ranked at 70 and

111 respectively.

The TI list, it is important to bear in mind, is compiled on the basis of "the perception" of corruption, rather than actual instances. Still, perception can be a very important factor in the decision to invest in a country or do business there. Also, leaving aside the ethical considerations, corruption invariably leads to higher costs. The fact that they are 'hidden' makes them no less a cost which has to be figured into the total, and the country's very high placing suggests that total could tip the balance against investment.

Understandably, individual tanners are reluctant to speak 'on the record', but it's easy to see that with numerous documents required for all sorts of transactions, the choice is between progress being very slow—or quicker, but at a price. Adding to the plethora of documents, and cost, is that several government ministries are involved in what should be straightforward import and export transactions.

One tanner, who did not want his name mentioned, said that a little while back the World Bank loaned Indonesia a substantial sum for developing the local leather industry. The money was meant to be distributed via local banks. "We've never seen it," the tanner explained. "What happened to the money? Where did it go?" We have not been able to verify independently the story but the fact that it was told is significant: some obviously believe it to be true (emphasising once again that just the perception of corruption halts investment).

### Island life

In fairness there are several other problems facing Indonesia which are not of their own making. Geographically, Indonesia is comprised of 13,670 islands (7,000 of which are uninhabited); there are 300 ethnic groups and some 250 different languages. The predominant religion is Islam—Indonesia is the largest Muslim country in the world in population terms—but there are strong Buddhist and Christian communities too. It has never proved to be an easy country to govern.

As if that were not enough Indonesia is subjected, variously, to earthquakes, active volcanoes and, frequently, very severe ➤





## Regional Commentary: Indonesia

### Suryana C Jamhur of Cisarua Tannery, West Java, Indonesia

This family company started back in 1949 and is today one of Indonesia's largest in the sector. Their main product line is for full grain leather. Raw materials, both local and overseas, include hides—cow and buffalo, goat and sheep skins. Wet blue consists primarily of cow hides from Java, Madura, Bali and Australia. Drum-dyed crust leather and finished leather is from cow, buffalo, goat and sheep.



*The Cisarua tannery in West Java.*

Major customers include Nike, adidas and Gear. Total capacity is around 1.5 million square feet although at present the tannery is working at about two-thirds capacity: 1 million square feet. Nonetheless, there is considerable investment under way in expanding facilities at this tannery.

When asked what he would like to see to improve his business Mr. Jamhur replies: "A bit less government involvement."

He would appear to speak for many others.

Idris, in a foreword to a new directory on the country's leather industry, points out that there is huge potential for the sector since local tanners are supplying a mere 0.35% of a global demand, valued at over \$17 billion. The trend, from 2002 to 2006, goes some small way towards supporting this optimism. It shows both a considerable boost in exports (\$57 million in 2002 to \$113.3 million in 2006) and a steady decline in imports (\$118 in 2002 to just \$41.5 million in 2006).

Government targets are to increase leather exports by 24% per year to reach a total of \$268 million, and boost utilisation to 75%, both by 2010.

Indonesia could support a larger tanning industry. There is a regular supply of domestic raw material and a local footwear manufacturing industry of some size, and which has good growth potential. The government has indicated that it appreciates that leather-making is an industry worthy of support. The tanners may feel that action speaks louder than words. 

weather conditions. Recently a hole appeared in the ground and spewed forth vast quantities of liquid mud, which covered the surrounding area for miles around.

The Indonesian province of Aceh suffered massively from the tsunami of December 2004. (A little good news: the scale of the disaster forced both the Indonesian government and the insurgency in the Province to commit themselves more fully to making good on a cease-fire between them that was in danger of breaking down.)

A more upbeat assessment of the potential for the sector comes from the government. Industry minister, Farmi

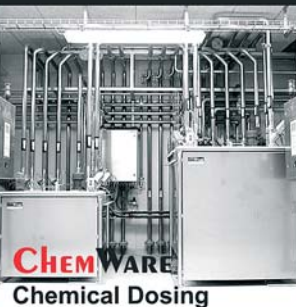


*Indonesia's footwear industry has good potential for growth, with brands such as Fortuna.*

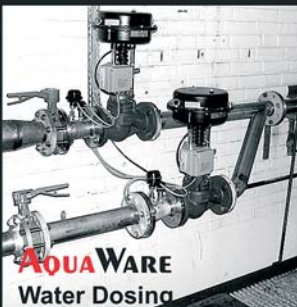


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16

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