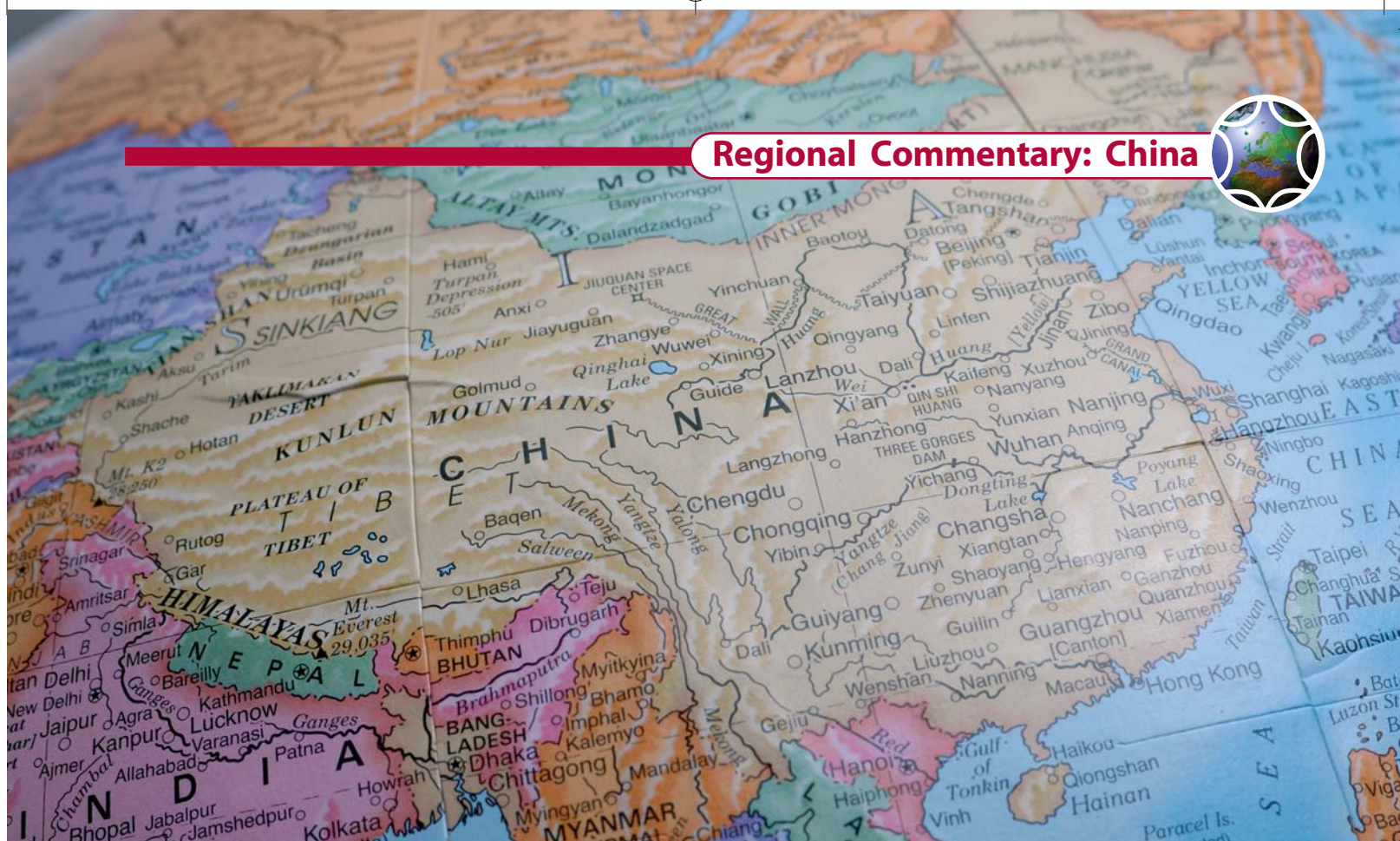




China: only the strongest will survive

The Chinese leather industry seems certain to enter a new phase in 2008, which may lead to consolidation among smaller players in the sector and force larger firms to improve their waste management and, perhaps, increase their prices if they want to stay in business.

Sources in the country have confirmed that the cost of raw materials for tanners in China is rocketing, and the government is stepping up its efforts to impose environmental protection regulations. Anecdotal evidence emerged during 2007 that stricter policies on effluent treatment have already forced a number of smaller tanneries to shut down.

As an interesting aside, DuPont's president for China, Douglas Muzyka, is one of only two non-Chinese nationals, and the only one with any connection to the leather business, to appear on the shortlist of 24 for the third 'Green Chinese' awards. The candidates for the ten awards also include three film directors, journalists and people from environmental pressure-groups; all were nominated by the public.

At about the same time, the central government announced big incentives for industry to clean up its act on waste

management. It said it was preparing to spend more than \$80 billion on water treatment across China, around \$75 billion on improving air quality and a further \$25 billion on controlling solid waste. It also announced a new \$9 billion reward scheme to encourage companies to reduce emissions and save energy.

Industrial output across China is still growing, but growth appeared to be slowing a little towards the end of 2007. The rise in industrial output for October was 17.9%, down from 18.9% the month before, and short of the government's target of 18.3%. Some observers, including financial analysts in Hong Kong, said specifically that this was because the government's attempts to tackle pollution were hitting "low-end industries" including footwear and leather production.

There is no shortage of cynics who claim that this new-found appetite for greening the Chinese economy is part of a giant publicity stunt in the build-up to the 2008 Summer Olympics, which will take place in Beijing from August 8 to August 24. But the funding measures outlined above, and the enthusiastic sounds officials made in November when the president of France, Nicolas Sarkozy, invited China to "join a new global contract for an ecological and

economic New Deal", suggest that the changes will be longer-lasting and further-reaching.

Making life difficult for polluting industries

Two of the ways in which the government has brought its weight to bear on industries it perceives as the worst polluters have been a removal of tax-breaks and the refusal of planning permission to expand facilities or set up new ones.

In truth, tax has been an increasingly heavy burden for Chinese tanners since 2005 and the most obvious change in the two years since then is an increase in the tax imposed on, and consequently an increase in price of, imported hides and skins. This, coupled with constraints in domestic supply (see below), seems to have affected good-quality, high-priced hides and poor-quality, cheap ones in equal measure. On average, both types of raw material increased in price by between \$15 and \$20 a piece in the course of 2007; some items increased by more than \$30 per piece. Once further tax changes come into full effect in the course of 2008, costs will increase further by at least 23%. Some observers believe this could prove to be a fatal blow to those tanneries that rely on imported hides.

Leather exports will be affected too. ➤





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For more than a third of companies in the leather pipeline in China, export earnings contribute between 20% and 50% of turnover. For 8.3% of companies, export earnings are the source of between 50% and 80% of total turnover. That means that proposed tax increases on leather exports will make life difficult for an important proportion of leather and leathergoods producers in China.

Raw deal on raw materials

This brings us to the constraints there have been in the domestic raw materials supply chain. China's own traditionally abundant raw hide resources can no longer meet demand. In an attempt to ensure supply of raw materials, big tanning groups—in addition to maintaining their relationships with slaughterhouses and importing substantial numbers of hides

from overseas—frequently travel now to villages to collect raw hides on site.

This is a new development and it is making it more difficult than ever for their smaller competitors to secure supply of decent-quality domestic hides. These companies are also looking beyond China to bring in the hides they can afford from Africa, the US, Mongolia and other countries, but for the tax reasons ➤

Government sets the standard

Government-run agency for promoting the footwear industry, China Shoe, has announced a new standard that will cover footwear production across the country.

The vice-president of an affiliated research body, the China Leather and Footwear Industry Institute, Yan Huai Dao, travelled to some of the major European footwear events towards the end of 2007 to present the new directive to the global industry.

The standard, QB/T 1002-2005, governs ten areas. These include familiar subjects such as abrasion resistance, flexing resistance and low-temperature flexibility of vamp materials. Other issues it covers are heel bond strength, upper pull-off strength and peeling strength, which, for men's shoes, must be greater than 70 newtons per centimetre and, for women and children's shoes, 50 newtons per centimetre.

The remaining four areas the standard looks at are unit sole heel hardness, insole fibre board flexibility, the physical mechanism properties of the steel shank of leather shoes and, finally, what Mr Yan refers to as the "sensational quality" of leather shoes made in China. Rather than a

marketing message, this last item refers to the way all the components in a shoe will feel to the wearer.

"We should have standards no matter what we do," said Mr Yan said on announcing the development, "so it's only natural to want to have standards for the leather shoes we produce."

While insisting that China's introduction of QB/T 1002-2005 was, partly, an attempt to boost communication, cooperation and mutual progress with trading partners throughout the global footwear industry, he also made the point that there was something different about this standard that lent it extra weight.

He claimed that the central government's role in imposing the new measures on China's footwear manufacturers gave them extra importance. He said: "In other countries, governments don't impose footwear standards. It's only manufacturers or industry associations that do that. So you can see how seriously the Chinese government is taking this."

He went on to say that the new standard also aimed to encourage manufacturers in China to improve the quality of what they



produce, although he acknowledged that it's "the market" that makes the final decision about quality. The Chinese official avoided the subject of the anti-dumping measures that the European Union has in place for imports of leather footwear from China and Vietnam at the moment, and clearly wanted to look forward to a time when leather shoes from his country would be welcome again in the European market.

To that end, he encouraged buyers from the European Union and elsewhere to use the new standard to help them build strong relationships with their footwear suppliers in China.

"In any procurement exercise, you can pay attention to the standard and use it to understand your manufacturing partner better," he said. "Too many overseas buyers make do with looking at samples, but you need to have a much more detailed discussion about quality and testing."





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Buyers at a recent exhibition discuss the move towards higher-priced leather shoes in the Chinese footwear industry.

CREDIT: DONGGUAN INTERNATIONAL SHOE EXHIBITION



Small-scale cattle rearing in China is becoming a more costly and less rewarding activity for rural communities.

CREDIT: WORLD BANK

outlined above, this is becoming more and more expensive.

Environmental concerns notwithstanding, keeping a continuous raw materials supply has, probably, become the most important challenge that Chinese tanneries have to tackle. There is less and less domestic raw hide and skin resource. The quantity of cattle hide and goat skin is much less than

several years ago, a reflection, perhaps, of the way ancient rural traditions in China are crumbling.

In China, cattle and goats are normally fed by families working the land in country areas. For what reports reaching us describe as “complicated reasons”, country people have lost confidence in raising animals by this method. Keeping

animals in this traditional way is now open to considerable market risks because of price-fluctuations and the possibility of an infectious disease putting an end to your entire investment.

The cost of feed for these animals, especially corn, has increased in China as it has everywhere, leaving very little profit left for small-scale farmers. The other factor to

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Painting the leather industry in China by numbers

The latest figures released by the China Leather Industry Association (CLIA) are for the first six months of 2007. The report shows a further increase in the value of leather exports, although it also shows that there is now an established trend towards aiming for higher value goods, particularly in the footwear sector.

In terms of volume, the country's total shoe exports increased 9.7% to 4.29 billion pairs while leather footwear—still subject to anti-dumping measures by the European Union—fell by 2.2%.

However, in terms of value, total footwear exports improved 18.3% to \$11.46 billion, while, in spite of the drop in volume, the value of leather shoe exports rose 10.3% to \$4.43 billion compared with the same period in 2006.

China also imported higher value and higher volumes of leather footwear during the six-month period at 4.3 million pairs worth \$110 million, up 43.7% in terms of volume and 48.1% in terms of value. However, the chasm between unit prices still remains all too evident with the average unit price of imported leather shoes standing at \$26.80, while the average price of exported leather footwear is only \$6.80.

The move towards higher-priced products is also evident in the leather goods sector with the value of luggage and bag exports reaching \$4.07 billion, 22.5% higher than the year before. China imported leather and leather goods worth \$4.1 billion during the six-month period, up 33.7% from \$3.1 billion in same period last year.

The lucrative pet-toy market also showed an increase. Exports of leather balls reached \$159.6 million compared to \$140.8 million in the first half of 2006.

However, leather garment exports fell to \$625.8 million from \$655.1 million and fur garment exports to \$114 million from \$197.9 million. Finished leather fetched just \$803 million compared to \$863.4 million for the corresponding period in 2006.

bear in mind here is that the group of people willing to take this work on is growing smaller (and older) as the precipitous population drift towards the cities continues.

Those tanners who work with pigskin are going through an even more difficult time. A rise in meat prices is the main reason for an important increase in the cost of this particular raw material. Food inflation began to hit Chinese consumers in May and by mid-November, the country's premier, Wen Jiabao, took the step of visiting low-income families in Beijing to offer reassurance that the government was working to keep food prices under control. But, by this time, the price of pork was 54.9% higher than it had been in the autumn of 2006.

With pork reaching such a high price, abattoirs have been refusing to sell pigskin to tanners as before. Selling the skin to meat-processing factories instead is earning them higher profits, which leaves many in the leather industry struggling to reach their targets.

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Olympics to spur the rise of Chinese brands

It's happening in white goods with Haier and in desktop and notebook computers with Lenovo, and now it's beginning to happen with footwear and apparel manufacturers too. Chinese brands are breaking out and becoming global.

In fashion footwear, Chinese manufacturers have enjoyed substantial volume growth over the last decade, but no brand name has really come to prominence. This is certain to change, as companies in China build up their knowledge of design and global marketing to add to their dominance of production and manufacturing.

Perhaps it's hard to imagine Keira Knightley turning up at the Oscars in shoes made by Kangnai just yet, but perhaps one day. Before 2006, commentators might have said it was hard to imagine NBA superstar Shaquille O'Neal promoting a Chinese brand of basketball boots, but he is, all over Chinese television.

The brand in question is Li Ning, whose founder and chairman—a three-times gold medal winner in gymnastics at the 1984 Summer Olympics in Los Angeles—used his own name for the company. His reputation was strong enough to establish the brand, which also makes apparel, in China, but the firm has realised that it needs an extra push if it is to transform itself into a global player.

An expert on Chinese brands, John Cashman, has told *World Leather* that moves like the one Li Ning is making with Shaquille O'Neal to promote its footwear is an indication that the Chinese economy is entering a new phase of maturity, albeit with some way still to go on branding. Based in Shanghai, Mr Cashman runs the Chinese office of Washington DC marketing think-tank Social Technologies.

"Without question, Chinese firms have yet to reach the levels of sophistication of their counterparts in the west," he says, "but you have to remember that they've spent the last 15 or 20 years concentrating on improving in manufacturing and production. It's only recently that they've



realised that, if they want to go global, they have to become a bit savvier on the marketing side."

His information is that Li Ning is already spending between 17% and 20% of its budget (in 2006 it reported \$418 million in revenues and \$39 million in profits) on marketing, and he points out that this is a large sum for any Chinese company. He adds: "Li Ning are trailblazers; they've watched what Nike and adidas have done and decided that this how they need to go about things too."

Lenovo and Haier may be further along than the footwear manufacturer, in Mr Cashman's opinion, but he says Li Ning is catching up quickly. It will continue its programme of signing up western sports stars for sponsorship, he predicts. As well as the Miami Heat centre, Damon Jones of the Cleveland Cavaliers and Chuck Hayes of the Houston Rockets are also part of the company's branding initiative. Li Ning is also a supplier and sponsor to the Spanish national basketball team and the French gymnastics team.

It will attempt to promote itself widely

and lavishly at the Beijing 2008 Summer Olympics, including an initiative to kit out Chinese television presenters, viewing the event as an unprecedented opportunity to win brand-recognition for itself in the wider world. "You can't help but form the impression that the whole country is entirely focused on the Olympics," John Cashman observes. "So much so that I don't know what China will do after August."

The strategy for brands such as Li Ning, though, is clear. It has high aspirations to become a genuine rival to Nike, adidas and so on, not just in China, but all over the world. The battle to win hearts, minds and wallet-share in China is intense already. All the big global brands have made it clear that they see building up their presence in China as a fundamental element of their growth strategies. Mr Cashman says: "What's happening in China is amazing. It's a young population that's flat-out crazy for sports."

Li Ning, with its home advantage, is looking its rivals in the eye there, and if it is being more cautious in the way it seeks to expand internationally, he believes it's taking the right approach.

It already has an own-brand retail presence in Russia, for example, one of the fastest developing market economies on earth. "The company is probing to find what works there," the Social Technologies analyst suggests. "But if they can get themselves a toe-hold in Russia, that's 180 million potential users of the footwear." He believes that within two years, children in Russia will wear Li Ning athletic shoes just as enthusiastically as adidas or Nike.

Then, perhaps within five or eight years, if it invests its marketing money well, and signs up the right athletes to its bandwagon, there's every reason why people should stop referring to the company as 'the Chinese Nike' and just call it by its own name. If its efforts leading up to and during the Beijing Olympics bear fruit, it will take a big stride in the right direction. 🌐