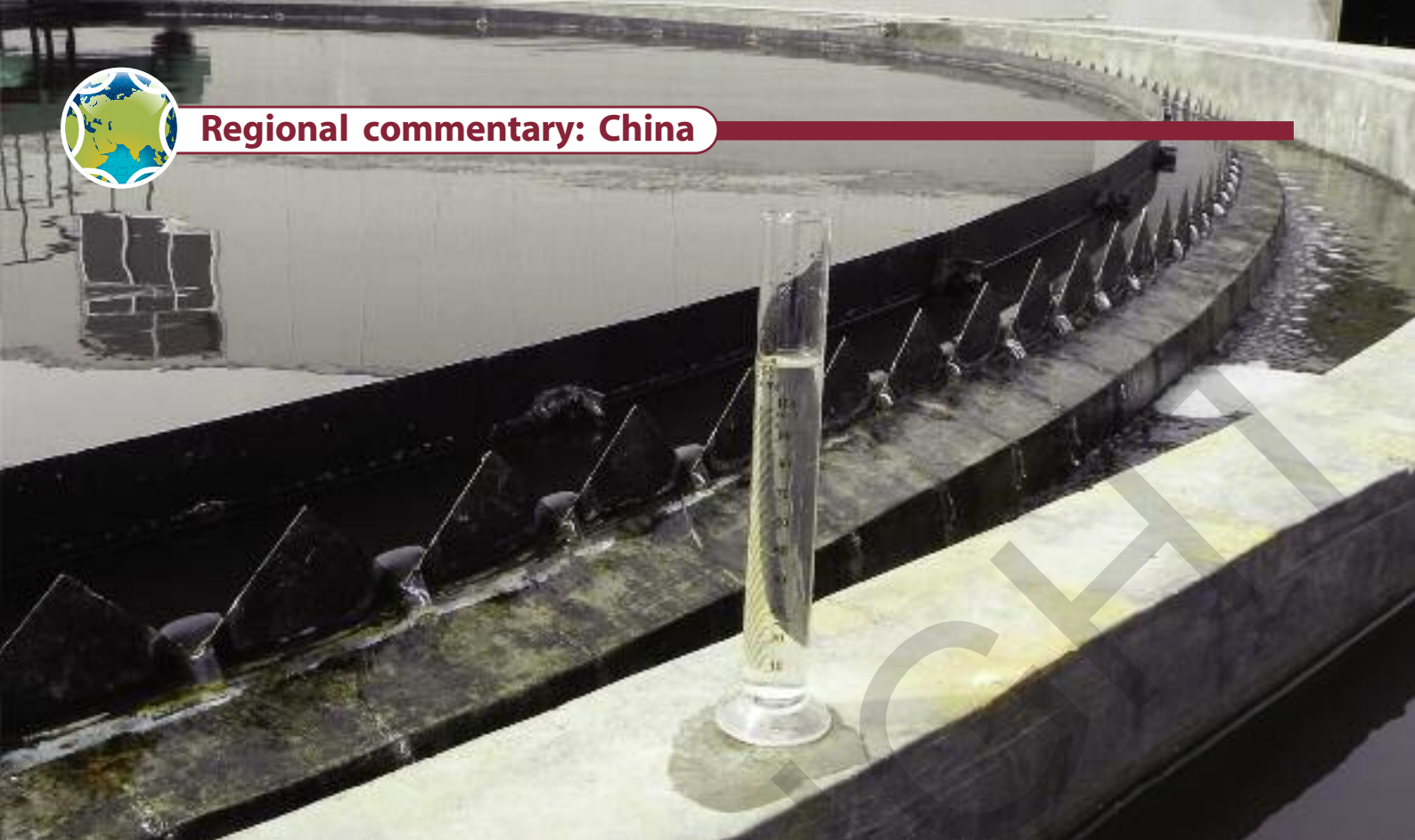




High-tech and clean: an advanced effluent treatment plant at one of China's leading tanneries.

China's roller coaster

World Leather's Market Intelligence reports over the last six months have described in detail "one of the most confusing periods for the global hides, skins and tanning industry" that we can remember. Record hide prices until March have been curbed by the elimination of tanning capacity in Hebei province, where the Chinese government has shut down a number of tanneries deemed too polluting. The knock-on effects are rumbling through the market.

The 2013 All China Leather Exhibition last September has been described by observers as a "hide seller's dream" – the aisles were packed and few could remember a time when a similar volume of sales had been booked on the first day of a show.

In hindsight, the reason for this seems clear: the wet-end production capacity in China's Hebei province grew significantly in 2013, with tanneries undercutting peers elsewhere in the country and offering their services at vastly cheaper rates. Some big tannery groups took advantage of the volume of business starting to be booked through the province, opening their own branches, while new businesses also emerged. Some leather buyers chose to source from Hebei as prices rose elsewhere. Business seemed to be booming.

But, as is often the case in the leather pipeline, things have a cause and effect. The boom negatively affected the industry

in a number of ways: by creating an overinflated need for hides, which caused prices to increase as people fought over a declining supply; by creating imbalance in the market, which took business away from tanneries that had previously secured contracts; and also by affecting the environment. It seems clear that one of the reasons the Hebei tanneries were able to offer cheaper wet-end processing was that many of them were circumnavigating pollution and effluent standards. Adhering to legislation, both provincial and national, and operating tanneries in an environmentally sound way is a large cost for most tanneries, but one which the best in the business undertake willingly to protect the environment. As more business flowed into Hebei, the negative effects escalated until it was brought to a sudden standstill: the pollution controls the Chinese government had been threatening all industries with for some time were

enforced and the plug pulled on those deemed too polluting. "China's leather-making industry tops the world in terms of scale of production, but there are prominent problems, for example, the large pollution load, mixed contents in wastewater, different pollution management levels and little effort in promoting cleaner production," said an official from the Ministry of Environmental Protection (MEP) at the start of 2014.

TANNERY INSPECTIONS

The MEP estimates that tanneries in China generate 160 million cubic-metres of wastewater every year, containing about 400,000 tonnes of COD, 16,000 tonnes of ammonia and 1,280 tonnes of chromium. From May to November last year, the MEP, the National Development and Reform Commission and other central government departments carried out



inspections as part of a larger campaign that includes steel and cement factories and power plants. Small “non-competitive companies which own outdated production facilities, low-level technologies and poor environmental pollution treatment facilities” were closed. By January, around 8,300 companies were shuttered, according to state media agency Xinhua. The number of tanneries in that statistic is unclear. The closures have continued in the first half of this year.

“The problem of shrinking profitability, which began to emerge in 2013 with a generally unbroken trend of firmer raw material prices and only small gains in leather prices, forced action in the industry,” say our Market Intelligence reports. “In particular, smaller companies in Asia had no choice other than to reduce production, because their position is continuously weakening. Investment in expensive effluent treatment facilities cannot be justified for small production volumes and, generally, the finance is not available anyway.”

China’s first anti-water-pollution standard aimed at the leather industry, standard GB30486-2013, came into force on March 1, 2014. The MEP acknowledges the standard may prove “impossible to attain” for perhaps as many as 45% the 3,000 tanneries in the country (including small operators), and those processing fewer than 50,000 hides a year might have to cease production. Many of the operations in Hebei were beamhouses, after the government had made a concerted effort to move these from coastal areas. This leaves a large gap in wet-end capacity. It is estimated that tanneries will collectively need to invest more than \$300 million to upgrade wastewater treatment plants and production processes nationwide.

The knock-on effects for some parts of the industry were felt almost immediately. The cow hide market has been devastated as it effectively took away a large production centre overnight – Hebei was one of the main destinations for European and Australian cow hides. Lamb and sheepskins for nappa production are also affected, although those markets had been in trouble for a while. Untanned skins sat in warehouses, on container ships or on suppliers’ books, unable to be tanned. This has added to costs in terms of demurrage [charges to the ship owner for its extra use], and the risk of deterioration of the product was high. Desperate for a way out, hides were often resold at much lower prices as people swooped in for a bargain, or contracts renegotiated to try to salvage some of the cost. Prices plummeted and many small tanneries, suppliers and exporters – who had already been operating on a knife edge in terms of cashflow – suffered. The results are still filtering through the market.

READJUSTMENTS

Elsewhere, the pipeline has coped surprisingly well. Hide prices, which had been climbing unrelentingly higher in the six months to April (up around 20% over the year before) suddenly started to decline. One estimation is that prices for several types of hide have declined by between 10% and 15% from the peaks seen in March 2014. This offers a semblance of relief for tanners who have been struggling to turn a profit after paying such high prices. But while prices have fallen, they are still high compared with recent years. The industry is breathing a collective sigh of relief as the vortex that was anticipated has failed to materialise.

“After a number of weeks, with tanneries closed and leather production stopped, we should have, under normal circumstances, noticed a shortage in the pipeline, but there has been no indication whatsoever that this is the case. This means that most of this capacity has never really been needed to supply the leather market; it only inflated raw material demand and



Only tanneries with advanced technology and extensive production capacities will be allowed to continue to make leather in China.



An ultra-filtration unit with treated effluent going through final preparation for reverse osmosis.



As a result of more careful control and wider use of technology, the quality and value of finished leather from Chinese tanneries will increase.



Change is happening in China, but it's change for the better, the CLIA says

In an attempt to provide extra clarity on the current situation in the tanning industry in China, *World Leather* approached the chairman of the China Leather Industry Association (CLIA), Su Chaoying, in June 2014. In the comments he gave us, he has made it clear that not even his organisation is completely certain about the impact so far of the closures in this year of tanneries in places such as Hebei. "It is difficult to estimate how many tanneries are operating in Hebei province today and how many have closed; no such figure is available now," Mr Su says.

He points to the example of Xinji, one of the townships in Hebei in which tanning is most intense. Tanneries have closed in Xinji, he confirms, but he says the cessation of wet-end processing there is only temporary. "Tanneries in Xinji stopped operations to build up or improve their wastewater treatment facilities. A reconstruction plan is expected to be finished by the end of this year, and the operation of tanneries in this area will be back to normal after that," Mr Su tells us.

There have been reports of tannery closures in other parts of China, too, also for environmental reasons. Specifically, tanneries have been reported as having closed in Jiangsu province, with closures in Wuxi in particular leaving large numbers of people there out of work. Mr Su says the CLIA has no information on this. "No figures are available on how many small tanneries have been closed across China but I believe the percentage must be low," he says. "And local governments are committed to making proper arrangements for those who are unemployed."

He confirms that new environmental regulations have come into force for tanners in all parts of China this year. "The Chinese authorities have issued two documents," he explains. "The National Standard on Waste Water Discharge from the Tanning Industry came into effect on March 1, 2014." The second document, The Regulation of Operation in the Tanning Industry, outlines basic requirements for newly established tanneries including environmental requirements (which must be in accordance with new national standards). These also state that annual processing capacity must not be less than 300,000 hides and that new tanneries should set up production in established tanning clusters.

With so much change taking place, affecting, it seems, mostly the lower-quality, lower-volume producers, it looks certain that China will have fewer tanneries in the future. Mr Su says: "Small tanneries that have no ability to treat wastewater by themselves will be reformed to become part of medium- and large-sized tanneries through mergers and reorganisation. For those that produce lower quality products or have little or no treatment facilities and cannot be part of restructuring will have to be closed."

The CLIA president accepts that China's tanning industry is facing "big challenges" and that upgrades in technology and environmental management are becoming "more crucial". However, his belief is that the total volume of semi-finished and finished leather from Chinese tanneries in the coming few years will remain stable. At the same time, tanneries will become bigger and use more advanced technology. As a result, the quality and value of finished leather from Chinese tanneries will increase, he insists. ☺



deflated selling prices for leather," according to our annalists. As bad as the situation may sound, it is impressive how little it appears to have impacted the general global pipeline. The higher-end of the market, including hides and leather used for automotive and luxury leathers, appears almost unscathed. It looks as though many raw material suppliers were able to find solutions and price impacts have been limited.

"Regardless of the situation, leather will always be needed and produced and products with a market will be manufactured and sold," the reports continue. "The panic over bad news that we have seen in the past has been avoided and the situation is being managed professionally."

However, we have to be aware of the influence on leather manufacturing and costs. No matter when leather production finds new capacities it seems that for the

short term the cost of production is going to rise. The tanning costs in Hebei with cheap labour and little, if any, outlay for effluent treatment cannot be substituted at the same price. People have calculated a direct increase of beamhouse costs of a minimum 20% and a total cost rise, including transportation and other soft costs, that could amount to 30%.

It doesn't seem that the Chinese government is going to allow another production cluster polluting the environment at low cost. Retanning and finishing yes, but beamhouse operations will have a difficult time in China. So, production in China will be more expensive from now on and the time of 'cheap production' seems to be over. This applies not only for tanning, but also for leather manufacturing, in particular for shoes. Even before this situation many large factories closed and shifted production to other destinations in South East Asia or the

Middle East. China will remain a large, if not the largest, production centre of leather and goods produced from leather, but not just because of cost.

However, despite the negativity, all of this is good news for the future, because it is protecting the environment and moves tanning away from being thought of as a seriously polluting industry. It is also paving the way for fair competition for those tanneries in China that were already complying with international standards of wastewater treatment and working conditions for the labour force. It is also a good chance for strong and healthy leather manufacturers globally, because lower raw material prices will offer better margins. For others, a correction will give companies time to reorganise their businesses and to take some of the market risk away. For raw material sellers, however, falling markets are always a pain and generally create problems and losses. ☹