

## TIMES ARE HARD FOR THE LEATHER AND SHOE TRADES IN THAILAND. SO, WHAT ELSE IS NEW?

### Hanging in

Recent troubles have been placed at the door of the Asian Economic Crisis that kicked off in mid-1997. Then, just when it looked as though things were picking up along came SARS and 2003 was a lost year. 2004 opened with the E7H1 virus, more popularly known as Asian Bird Flu, in which Thailand, with its huge poultry industry, was more affected than most. The year ends with a prospect that, unless the government changes its approach, simmering discontent by the Muslim population (who are heavily concentrated in Thailand's southern provinces) could be fanned into full scale insurgency.

Yet, there is a risk that all these events could serve as an excuse when the real problems facing the industry are more deep-rooted. That is not to dismiss the impact of financial meltdown or deadly viruses—they are real enough—but other problems are present, and they lie more with the industry structure itself.

Too many of the tanneries remain relatively small, family-owned concerns. Wage rates are up to five times those in China. To compete openly with China there would need to be a far greater level of investment to improve quantity and/or quality. Most family businesses lack access to capital on this scale.

Understandably, there is a temptation to go for the easy solution.

It is noticeable that more tanneries are producing upholstery leather, and increasingly manufacturing the end product. For example, the Kuru Tannery in Samutprakan. Sakhon Kuruvelukom represents the fourth generation of this family business producing leather. Towards the end of 2003 Kuru moved into furniture and upholstery production. The tannery had manufactured this type of leather for some time but now they produce the whole thing—from frame to finished product.

The advantage of leather upholstery, Mr Kuruvelukom explains, is that it's easy. You don't have constant changes in fashion and you don't have to bring out seasonal collections four times a year. It has been a great success for the company because they're already exporting.

The obvious danger is that if it's easy and inexpensive then the bar to others entering is so low that it becomes only a matter of time before the field is flooded with overproduction.

When an easy source of income is to hand it is tempting not to bother overmuch in finding new business. A senior manager with a Taiwanese-owned shoe manufacturer based in Bangkok explains how his company has just one client of substance—a well-known US brand. The customer supplies everything, from design to material specification. Although the relationship has proved hugely beneficial for the company it has also, he says, left them extremely vulnerable. In fact, his colleagues have woken up to the threat and are beginning to seek new customers overseas—but it's not easy to find them!

There are success stories. Saha-Union comprises part of a group of some 50 companies with interests ranging from electronics, plastics, energy and textiles to footwear. On the footwear side they have been producing for OEM for some 20 years, working for most of the well-known brands; they have the experience, the reputation and,

significantly, access to capital.

About six years ago they decided to start their own brand—D-Maq—a range of sports and leisure shoes. The aim is to produce a global brand eventually, but they are taking it one step at a time: beginning in Thailand, then expanding into the ASEAN countries after three to five years, and after that... the world.

One advantage they have over the imported brands is that they can sell to the retailer in smaller quantities—no money is tied up in minimum size import orders—plus, they can respond much faster to 'just in time' demands for particular lines, colour, style or size. Basically, they can match supply to demand or, to put it another way, production is market led.

D-Maq is not just a 'me-too' brand either. Marketing manager Chana Vasuvat points out that many imported brands may not be that suitable for a hot and humid country like Thailand. D-Maq positions its shoes for three major market segments, which it defines as athletic shoes, shoes for streetwear, and what may be termed wellness and health. The last being defined as comfortable. "It has to be well cushioned, and it must be light," says Mr Vasuvat.

The Saha-Union factory has a ➤

#### Asian leather and footwear production

##### Leather - 2002

| m.sq.ft   | production |       | imports |       | exports |       |
|-----------|------------|-------|---------|-------|---------|-------|
|           | bovine     | sheep | bovine  | sheep | bovine  | sheep |
| Thailand  | 300.0      | 1.8   | 89.4    | 1.9   | 91.9    | 0.2   |
| Vietnam   | 8.0        | n.d.  | n.d.    | n.d.  | n.d.    | n.d.  |
| Indonesia | 82.0       | 35.0  | 12.4    | 5.1   | 29.5    | 3.9   |

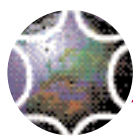
##### Bovine light leather - 1984-2001

| m.sq.ft   | 1984-86 | 1987-89 | 1990  | 1995  | 1999 | 2000 | 2001 |
|-----------|---------|---------|-------|-------|------|------|------|
| Thailand  | 73.5    | 162.4   | 194.3 | 267.4 | 290  | 280  | 300  |
| Vietnam   | 8.1     | 8.2     | 8.3   | 9.0   | 8.4  | 8.0  | 8.0  |
| Indonesia | 36.9    | 49.6    | 57.9  | 85.7  | 95.3 | 85.6 | 82.0 |

##### Footwear Production - 1984-2001

| m.pairs   | 1984-86 | 1987-89 | 1990 | 1995 | 1999 | 2000 | 2001 |
|-----------|---------|---------|------|------|------|------|------|
| Thailand  | 14.2    | 24.6    | 45   | 65   | 66   | 65   | 66   |
| Vietnam   | nd      | nd      | nd   | nd   | nd   | nd   | nd   |
| Indonesia | 13.7    | 21.7    | 43   | 131  | 140  | 145  | 150  |

Source for all: adapted from FAO



## Country Commentary: Thailand

capacity of some six million pairs a year and the company employs about 5,000 people. The factory carries certification for both ISO 9000 and 1400. Its own D-Maq brand makes up only a tiny part of this figure, but it's growing: last year it went up 40%, and it should be 80% in 2004, according to Mr Vasuvat.

A big company can afford to take a long-term view which smaller concerns probably could not, no matter how go-ahead they might be. In doing market research for D-Maq, Saha-Union produced its own report on pronation—and discovered that 30% of Thai people suffered from over-pronation. So its shoes are designed to help counter the ill effects of over-pronation. In fact the firm has developed an on-the-spot test to establish whether someone does suffer from this.

Of course, you don't have to be big to cut it in today's marketplace. For SMEs (small and medium-sized business) the road to success often lies in specialising—quality, delivery or service, or maybe all three.

An example might be Q & Q Holding which manufactures resin rubber soling sheet. Right now, says Wirun Chivapuntusri, deputy managing director, the business is doing well. Mr Wirun tells

### Annual imports of hides by weight in kilograms

|       |            |
|-------|------------|
| 2003: | 61,256,344 |
| 2002: | 66,708,468 |
| 2001: | 67,111,363 |
| 2000: | 61,757,506 |

how his father had an established leather trading business before they started their own rubber sheet factory in 1981. There were a variety of reasons but prime among them was to ensure supply of the rubber sheeting. Previously these had come from Germany, the UK and the US, but the factories in these countries were steadily closing and, indeed, all now have.

They had production problems initially, he readily admits but eventually these were solved when they bought the formula from their erstwhile supplier in Germany, Carl Freudenberg, who was experiencing financial difficulty at the time. This was in 1989.

Thailand would never be more than a small market so from the outset they focused on export sales. These came initially from India, Pakistan and, importantly, Japan. This mattered because the high quality demanded by the Japanese

gave them (and other potential customers) increased confidence.

It is worthwhile noting that, with total expenditure to this stage running to some \$3 million, progress was far from cheap, even for a relatively small company. It didn't end there either. Q and Q started selling into China. "The Chinese came to us," says Mr Wirun. Initially, these were sales into southern China, to locally owned enterprises and a number of Taiwanese owned factories.

In 2001 they opened their own China factory, Taiyuanlomh (Sanshui) Rubber Products, in Sanshui City, Dongguan. It cost a further \$2.5 million.

These are investments that have paid off. The Thai factory has a capacity of 150,000 sheets per month. Mr Wirun says, "We're usually running at full capacity." Further expansion though will probably come from the China site, which currently produces 100,000 sheets per month. Plans are underway to increase production there "once some bottlenecks" have been overcome.

Generally, the China factory supplies the China market, with exports handled out of Thailand. Other export markets have grown to include Iran ("They've been big

### Coping with the China factor

In public, Asian politicians and business people will claim that China's rise is "an opportunity, not a threat". Maybe. The fact remains, however, that the Chinese market is so big and has such a wealth of human and material resources that it poses an all too real threat to other economies in the region. Governments are having to readjust their thinking and their policies to deal with the new economic order that China is creating.

The Thai government of Prime Minister Thaksin Shinawatra, in an experiment not widely reported outside of the country, is promoting a strategy that turns its back on head-to-head competition with China in mass export markets and focuses on its comparative advantage in smaller-scale production. The programme is winning support, despite initial scepticism.

Figures produced by merchant bank Morgan Stanley suggest the region's growth potential has been halved, from seven per cent to 3.5 per cent since 1997, chiefly as a result of the rise of China. Growth will continue to be cut by between two and four percentage points from its pre-1997 potential, the report suggests.

If these figures are correct, Southeast Asia has to find new drivers for growth. Among the options are domestically generated demand and the creation of manufacturing niches. Mr Thaksin has embraced a two-track strategy, one that achieves both ends. His government has applied fiscal stimulus to raise home-grown consumption, rationalised spending on traditional export industries and used indigenous resources to spur the creation of new exports and service industries. Thailand currently relies on exports for about two-thirds of its growth; Mr Thaksin wants to reduce that to about one-third.

Mr Thaksin campaigned for office promising to get his country moving forward. He pledged one million baht (\$ 23,000) for each village and a three-year debt moratorium for small farmers. While

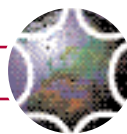
many viewed the promises as mere electioneering, domestic demand has been stimulated. Thailand achieved 5.2 per cent growth in 2003, making it one of the most robust economies in the region.

The key to Mr Thaksin's long-term economic strategy is shifting the focus of the Thai economy: rather than courting multinational corporations looking for cheap labour, the scheme develops small- and medium-sized businesses (SMEs) that exploit local skills to create new products and services or expand underdeveloped niches.

This makes sense. Thailand's comparative advantage does not lie in its abundant cheap labour, but rather in a business environment endowed with an aesthetic culture and tradition. By encouraging skill-driven enterprises, which organise workers who excel in their local skills, Thaksin's concept concentrates on local industries doing what they do well.

Specifically, it permits Thai business to concentrate on the value-added sections of their industries. This strategy gives Thailand pricing power without rejecting globalisation. However, success depends on the creation of a legal infrastructure for the SMEs. That means creating assets (such as intellectual property, land and other rights) that these new businesspeople can buy and sell (and use for collateral), and a legal system that protects them. There is still a fair way to go here.

The strategy has a number of important implications. First, it holds out some hope of insulating the Thai economy from external shocks. Second, it could check, to some degree, the spread of Chinese economic influence in the region. If fears of such an economic threat are correct, economic integration along the lines of the proposed free-trade agreement between China and the Association of Southeast Asian Nations (ASEAN) would leave other nations to fight over the crumbs.



### TTIA

The Thai Tanning Industry Association (TTIA), which now has 130 members, acts in the interests of its members to promote the tanning industry and to train members in new techniques, environmental control, waste management, and trade cooperation. Based in Samutprakarn, all 138 tanneries that make up the entire Thai leather industry are based on one industrial estate. This means that with the assistance of the TTIA, the industry is able to work closely to develop the industry and address issues that concern it such as the environment.

With a labour force of approximately 150,000 and a production capacity of some 15 million square feet of leather a month the industry is an important sector—which the TTIA has highlighted in government circles. This has led to 27 of the country's 138 tanneries receiving promotional privileges from the Thai Board of Investment (BOI).

The TTIA also manages two central water treatment plants to treat effluent from the tanneries. These facilities, which cost \$20 million to construct and \$50,000 a month to power, are an example of how the industry has united to address environmental issues.

Another project implemented by the TTIA is the Chemical Buying Scheme, which allows the tanneries to work as a cooperative for the purchase of chemicals—which can be costly when bought individually—thus reducing the industry's overheads and increasing competitiveness. While the TTIA aims to unite the tanneries in the world markets so as to become more competitive, it actually nurtures competition between the domestic companies to avoid a sense of complacency.

The Thai tanning industry's main production is in shoe upper; handbag and auxiliary leather products; upholstery; automotive upholstery; vegetable leather; and suede split. 97% of hides come from cows and buffaloes—36% of which is sourced locally and 61% imported. The majority of leather exports (80%) are in cow and buffalo wet blue, and the main export markets are Hong Kong, USA, Taiwan, Denmark, Australia, and Germany.

buyers recently"), Malaysia, Singapore, Egypt, Holland, the UK, Türkiye ("Potentially big"), and South Africa.

The investment has paid off because the company is not forced to sell on price alone. Price matters, of course, but as Mr Wirun puts it they succeed on the basis of quality, delivery and price. "We do not compete solely on price," he says.

In fact, looking across the industry generally confirms this. Thai leathersgoods manufacturers have been steadily building up a reputation for quality design and production. In the process they have developed a roster of regular customers.

Yiingkiat Laosrisakdakul, president of the Thai Leathergoods Manufacturers' Association admits that he is doing quite well. Interestingly, though, at the Bangkok Leather show at the start of 2004 his range of leisure bags on display included not one that was made of leather. However, other leathergoods manufacturers agreed that business was there to be had, especially those who have invested in building a brand of their own.

It was a sentiment echoed by Surasak Pongtawewirat, president of the Thai Shoe Manufacturers Association (TSMA). He mentioned that the range of ladies shoes developed under his own brand label, Taywin, was selling well. He has also developed his own retail outlets within Thailand. Even so the message coming out of TSMA is rather mixed. Ms Charoensri

Huadmai, manager of the Association, says that there is some pressure from members for the government to limit entry into the country of low end footwear from China—which certainly implies some among them entertain the idea of still trying to compete in this section of the market. At the same time, she says, members are looking towards greater involvement with government agencies in help with things like design, R&D and marketing.

The Thai government, especially through its Department of Export Promotion (DEP), have been banging the drum about how local Thai firms should build brands. Yet, at the same time, the DEP is involved in efforts to get more European brands to use Thailand as a manufacturing base for upper-end goods. That's not exactly a conflict but it does make it difficult to figure the main focus: is it to build Thai brands, or have Thai firms build the brands of others?

Thailand's leather industry, in all its sectors, faces challenges. By and large it cannot compete with the likes of China, Vietnam and India on price, yet it is only now that local manufacturers are trying to establish own-brand names (and even many of these sound more Italian than Thai). Those prepared to make the necessary investments appear well positioned. For others the future must seem rather daunting. ●