46^{th}

Leather Research Industry Get-Together (LERIG)

27 – 29 January 2012, CSIR-CLRI, Chennai

Prof B M Das Memorial Lecture

by

Dr. Dietrich Kebschull

Chairman of the IGEP Foundation, Gurgaon

Chennai, 27 January 2012

Introductory Remarks

Ladies and Gentlemen,

It gives me great pleasure to be here in this gathering. I would like to thank CLRI for giving me the opportunity to share a few thoughts with you regarding the situation of the Indian leather and leather manufacturing industry in the international markets. For 2012 many professional and less professional forecasters and analysts expect a further worsening of the international financial crisis.

For me as a German it is a special honor to deliver the Professor B M Das Memorial Lecture, because it underlines the fact that the relations between India and Germany which Prof Das helped to build up during his life are still strong and friendly. I have been in this great country now exactly for 25 years, during the course of which, I had the chance to see many changes for the better in India in general and in the leather sector in particular. I saw the industry changing from an exporter of leather and simple shoe uppers to a strong supplier of high quality and high fashion goods supplier with growing international reputation. I also saw how Indian entrepreneurs successfully dealt with the threats and difficulties resulting from

- the ban of Penta-Chloro Phenol (PCP),
- the rigorous stopping of the use of Azo-Dyes,
- the numerous attacks by NGOs, e.g. because of allegedly bad treatment of slaughtering animals and unethical slaughtering procedures,
- the threat to the environment and to workers and residents in connection with tanning processes and lack of proper affluent treatment,
- or time and again because of non compliance to social minimum standards in the production facilities.

This has been a sometimes depressing, but always challenging experience, pushing us into joint and quick action. Looking back I have to say that I more than highly appreciate the performance of the leather and leather manufacturing industry and especially the flexibility and innovativeness of the Indian entrepreneurs vis-à-vis all such dangers for their production and for their workers. They were not only able to adjust and to properly deal with sometimes false accusations, but they could even strengthen their position in the international markets against growing competition.

Today the Indian leather industry can be congratulated for having surpassed the export target of US $ 3.75 billion dollars during 2010-11, reaching a growth of more than 10 %

over its last year performance. This is really a remarkable achievement considering the mentioned developments during last year especially the volatility in the international markets.

It needs to be particularly emphasized that the leather sector was strong enough to achieve the turnaround after the crisis of 2008 and come back on the growth trajectory in a short period of time. In other countries it would be quite normal after such successes to lie back and rest on one's laurels. However, ladies and gentlemen, the Indian industry can and will not do this. We all know very well that it would be a dangerous illusion to believe that normal times are back.

Quite contrary! The international markets are fragile. It will need further hard and systematic work to maintain the position and to properly deal with the existing and expected difficulties.

The European Union Crisis – How it effects India

Coming from Germany I have to begin with the European Union. Because it seems to be in fashion today to criticize the EU, especially if one is not member of it or only half-heartedly joining it and trying to get as much out of it as possible, permit me to say that

The European Union has been a blessing for Europe and for the world. It is not only an economic success, but a unique demonstration of possible peaceful cooperation in many other fields between former arch enemies. There are many people who see this and love this. The successes are by and large so convincing and obvious that the vast majority of Europeans want to stick to this Union and further strengthen it.

In spite of all more or less well-based articles and statements you may have read or heard be assured that the German government will do everything to maintain the EU. We will pay for it because we are convinced that it is the best option for us, for Europe an for the whole world. The coming conferences and summits and especially the actions and programs will show this

For India, the European Union is traditionally the biggest market and trade partner. It has been for many years also the most important market for Indian leather and footwear exports. With the financial disaster in Greece and the following developments in other member counties the EU definitely faces its most serious challenge since the union was conceived, way back in the 1950s. The crisis is so deep and complex that pessimists and not- well wishers express serious doubts of the very survival of this union of 28 countries. This is aggravated by financial hazarders who – not always legally correct – try to take profits from using the possibilities of unrestricted “ugly” capitalism. The EU is fighting for survival. But given the different interests it will be a long fight. For the Indian leather exporters, this has to be a cause of concern because the EU market accounts for two third of the imports of Indian leather and footwear products (in 2009-10). The big question is: How can the sector maintain the growth trajectory with its main export market in a flux?

Challenges Facing Indian Leather Industry

I have clearly mentioned that I firmly believe that Europe will overcome the crisis. However, 2012 will be a difficult year. It will be more difficult because we have another crisis which is not so much in the headlines because everybody focuses on Europe. That is the United States.

We all know that this number one of the world is economically weaker than ever. It is totally over-indebted and still goes on spending much more than available and affordable. In principle this country is bankrupt and only survives by printing fresh money and getting loans from its major trade partners.

Indian exporters are aware of this. They realized the American difficulties already in 2008, 09 and 11. And there is no silver lining at the horizon. Exports to this part of the world will not become easier.

Put in perspective, however, these are not the only challenges facing the Indian leather sector. Apart from the continuing crisis in the Euro Zone and the disaster in USA the industry also faces challenges with a host of other issues such as:

- Shortage of essential raw materials as well as steep hike in prices,
- shortage and retention of skilled manpower,
- infrastructure deficiencies,
- technology and environmental issues,
- design innovation,
- the need for market diversification.

The Indian leather sector has set an ambitious target of US $ 14 billion by 2016-17 (by the end of the 12th Five Year Plan period 2012-17). Achieving this goal will depend on how will the industry raises itself to the challenge to deal with all these issues. What will also have a significant bearing is the need for product innovation, identification of niche segment opportunities and the always upcoming technical and non-tariff barriers to trade.

How will this go? What can be expected? Let us have a brief look at the present trends in the Indian leather and footwear industry – giving some emphasis to my country Germany which is the biggest economy in the EU and apparently the most robust one.

In total: All segments in the Indian leather sector with the sole exception of footwear components have shown a positive growth in 2010-11 in comparison to the previous year. Finished leather and footwear have grown by over 10 % over the previous year. Overall the leather sector has shown a sound and good growth of 8.4 %.

Performance of the Leather Industry in Terms of Exports

Product	**April-Jan 2006-07**	**April-Jan 2007-08**	**April-Jan 2008-09**	**April – Jan 2009-10**	**April – Jan 2010-11**
Finished Leather	36200	40360	31868	31397	40546
Footwear	61845	74467	76716	75380	86602
Leather Garments	15495	17267	21308	21430	20041
Leather Goods	35314	40023	43672	37851	40745
Saddlery & Harness	4116	5309	4607	4169	4307
Total ➔	152971	177425	179973	170228	192243

(Value in million Rupees)(1$ = 50 INR)

During the first seven months of 2011, Indian exports recorded a growth of 27.3 % for the period April – Oct, 2011, totaling US $ 2.741 billion. Despite the depreciation of the Rupee (Sept – Oct 2011), Indian exports did well both in Rupees and Dollar terms.

As per data available in 2009-10, *Germany is the largest net importer of Indian leather products* with a 14.5 % share followed by UK at 13.4 % and Italy at 11.7 %. These three countries therefore account for almost 40 % of India's total exports in this sector. *Will this go on? Can Germany continue buying from India?*

India's Export To Different countries (Value in million Rupees)

Category	2006-07	2007-08	2008-09	2009-10	2010-2011
Germany	20504	24667	25422	24564	29566
Italy	20667	24538	23078	19928	22137
UK	17992	20882	20662	22829	24616
USA	15879	15560	17961	14818	16755

Indian exporters to Germany (and also both governments) will be extremely happy to note a 21 % increase in German imports in 2010 over the previous year. And in spite of all crisis scenarios and doomsday prophecies there is hope that this trend continues. At least the pessimists are surprised that the German consumer apparently is not influenced by the everyday's bad news from the financial markets.

Contrary to the expected slowdown in the demand the average German consumer goes on spending. The investors and consumer confidence indexes have recently hit a 2 decade high in Germany. The Christmas business in December 11 was better than ever before. The big industry associations spread the optimism of their members. However, there is not only light, but also some shade. The events that unfolded during the year 2011 in the form of the Greek crisis have put the German economy in great strain. Germany supplies and will have to supply the bulk of the money that prevents the Greek economy to collapse. Other European economies have been affected from former uncontrolled overspending. It seems that some countries who received development assistance before becoming EU members, now thought to have the right to live on the costs of the richer member nations – without any bad feelings. This had consequences. They have been advised to reduce ambitious programs and expenditures and to save wherever this is possible. So they buy less from the world export champion Germany. A report in November 2011 indicated – not all surprisingly - that orders for German goods from its Eurozone partners fell by 12.1 %. The German economy is insofar not immune vis-a-vis the financial turmoil and economic slowdown in its Eurozone neighborhood. These events have led to a downgrade of economic growth projections for 2012 from 2 % to 0.8 % by a group of economic research institutes and government analysts in Germany. The possibility of a recession in the countries which have now to stick to budget discipline, will make it more difficult for the economic heavyweights of the EU, namely Germany and France, to help their struggling Eurozone partners. *However, there is no doubt that they will help to preserve the EU and to give what is needed to the so called PIIGS, Portugal, Italy, Ireland, Greece and Spain – even if USA and UK may not join the group of supporters!*

Future Strategy – What Needs to be Done Urgently

If we ask ourselves *how the European developments are going to affect the Indian leather exporters and what steps need to be taken by them in order to maintain a steady growth rate,* we should have this in mind.

The European Union has good chances to remain India's largest market. In the EU the Indian exporters have created a brand value for themselves. This will help them also in 2012 and it will support efforts to find a place in other markets of the world. The present crisis in Europe should be used by them to consolidate the position there and in addition to speed up their planning for bringing down the EU dependency from the nearly 70% share to – may be - a level of 45 – 50 %.

From my point of view as an export promoter for 25 years there are a few things which the Indian exporters along with the Leather Council and other experienced organizations have to plan and implement with priority in the short- and mid-term. The focus should be on strategic changes.

1. Other promising markets must be explored more vigorously. USA is weak at present, but there will always be a demand for leather shoes, garments and other goods. Especially now prices are playing a role. Here Indian exporters have to see how to use their possibilities to compete with China, Vietnam and Bangladesh. In a critical economic situation old established trade relations are often cut. The business is done by the fittest. And India has the strength to beat others. This is also possible in markets like Australia, Japan, Africa and Russia. India can offer today the best value for money. It also could follow the Chinese strategy of acquisition of distribution companies and brands, which paves them the way for an easier access to the market. This strategy has been followed by Indian IT, automotive and some textile companies. It could be recommendable for the leather sector, too.

2. Africa with its geographical proximity to India, offers immense possibilities. Africa on the whole is expected to record a growth of 5.8 % in 2012. This region is integrating more and more with the world and engaging more with emerging economies like China and India. India therefore should carefully and systematically look into cooperation possibilities with Africa to take advantages of its geographical proximity as well as other economic advantages. China is today the largest emerging trade partner with Africa at 38%. India follows behind with 14 %. And it has good chances to increase its share with the continent, which has a population of 1 billion and according to the African Development Bank a middle class population of 313 million. It is in spite of many negative assessments – which are in fashion – a promising market, which one should not neglect. Otherwise China will do the business there.

3. The Chinese leather industry, the dominant player for many years now, has reached an inflexion point. They are confronted with high cost of materials combined by labor shortages. This may have the consequence, that some of the main world trade partners of China are looking for other markets because they believe that these trends will go on. Already now a few – first - companies are reducing the shares imported from China. There is an opportunity here for Indian companies as there some of the orders can be diverted to other countries such as India. Apart from the problems with the "human rights" raising environmental concerns and treatment of workers (e.g. in the Apple manufacturing electronic companies) are some of the pressing concerns confronting the Chinese industry. In addition, the Chinese industry seems to come more and more under pressure to use their production capacities for meeting the increasing local demand which is growing at approximately 10 % per annum. Increasing per capita income is boosting consumption patterns in China, not only for luxury goods. This gives

chances for others – be it in the export markets or (in the longer run) also in China. India should not miss the opportunities here.

4. Despite their dominance in leather exports, a major drawback for Chinese exporters has been the lack of well know Chinese brands. The failure to build global brands was also made in the Chinese leather industry. Till today also the fashion and design development seems to be behind the Indian level. This should be exploited by our Indian exporters and planners. We in India still have an advantage here.

An alternative route would be to tie up with existing global players who are eying India as a sourcing base. These initiatives are needed if India desires to be counted as a major player in this sector.

5. Besides these points the Indian leather industry also needs to reflect other broader problems that make India a significant, but still only a small player in the international leather market.

The global leather trade is US $ 116 billion, of which India's share is US $ 3.75 billion. China on the other hand, has a share of 25 billion, or 22 % of the market.

One needs to ask why an Indian footwear unit normally can produce a maximum of *only 2000 pairs a day while it is common to find Chinese units manufacturing 40,000 pairs a* day. Out of the total global leather garment trade volume of 120 million pieces, China makes 70 million pieces, while India makes about 16 million pieces. The leather sector in both countries, ladies and gentlemen, was more or less of the same size about 20 years ago, about US $ 1 billion. India, like China too enjoys the availability of huge manpower and also a big raw material base.

China has managed to get a big slice because they have mastered the volumes game. India has apparently been a laggard here. To me it seems that it is not the ability to secure big orders, but the ability to execute it.

There are many reasons for it: from shortage of power over lack of credit facilities to logistical impediments, etc. The restriction of power usage makes it necessary to use expensive backup power. Loans are not very easy to secure as SMEs are treated as "risky" by banks. Inland transport is still slow and costly. Severe congestion in Indian ports and their inability to receive big container ships means that exporters have to pay extra to transship their goods via Colombo or Dubai or Singapore. Adding to these woes is an acute shortage of trained manpower.

Are there any readymade solutions for these serious problems?

We have the potential, but to convert it into the desired goals, calls for fresh thinking or as some people call it "Out of the Box" thinking.

A way can be found to handle big orders by what is known as the “Consortium” approach or is also referred to as the “Cluster” approach. Italy comes to mind immediately which has successfully demonstrated the benefits of such as approach. I myself had no good experiences with such approaches. However, this does not mean that they cannot work. They need tough management, clear guidelines and incentives.

Indian exporters should not give up, but try to find ways how to work together and to combine their manufacturing capacities. Raw material sourcing can be combined thereby bringing down the costs. Backup energy can also be shared amongst the users. A unified approach can also increase the confidence of international buyers in the capability of Indians to execute large orders. Agra, Chennai, Kanpur, Ranipet and Ambur are centers where this strategy can be tried and tested.

The Era of Globalization and What it Means to India

Globalization has changed the dynamics of international trade in more ways than one imagined even a few years ago. It is no longer important to find the cheapest supplier but also to find a supplier who is ethical as well as socially compliant. What this means is that it is no longer sufficient only to build good infrastructure and production techniques, but the working environment and working conditions of the workers also need to be given adequate attention by the management. To be part of a reputed international supply chain, these social requirements can no longer be ignored today. We have great experience with social compliance and partnership between socially oriented buyers and manufacturers. Compared with China and Bangladesh India has here clear advantages. If today most of the foreign buyers look for “sustainable business’, it should be made known to them that they can realize it in partnership with Indian entrepreneurs. The Indian and the western culture and concepts offer an ideal basis for long term cooperation which is not for maximizing profits and increasing shareholder value.

Government’s role

So far we have looked mainly at issues on company level. The Indian exporters have worked very hard to sustain India’s growth momentum in the leather sector despite serious challenges confronting them. They need to be applauded for whatever they have achieved so far overcoming enormous challenges and difficulties.

But there is also the government which has to look for a conducive framework for growth in the industry.

Ladies and Gentlemen, as all of you know, India is entering the 12^{th} Five Year Plan period, 2012 – 17. The government has announced that 1 trillion US-Dollars would be spent to expand and improve India’s infrastructure during this plan period. Roads, electricity generation, ports are some of the thrust areas and this is to be welcomed. If India plans to double or triple its merchandise exports, this definitely cannot be done with the present state of infrastructure.

Another milestone which can have far reaching and significant implications on India's economy is the successful conclusion of the Free Trade Agreement between India and the EU.

The India EU Free Trade Agreement (FTA) negotiations were launched in 2007. So far 11 negotiating rounds have been held with the last one taking place in Brussels on 10th December, 2010. Negotiations are expected to be concluded this year, i.e. in 2012.

However, as can be expected, major differences remain. The points of contention are many. For India, the services component of the agreement is of very high importance. Tariffs for Indian agricultural commodities in Europe remain very high. From the EU point of view, India still maintains substantial tariff and non-tariff barriers that hinder trade relations with the EU.

The successful conclusion of the talks can help in increasing trade in both goods and services between the two.

Trade between India & EU – Key Figures

Let us have a look at the trade statistics between India and the EU taking 2010 figures.

Trade in Goods

- EU goods exports to India 2010: Euros 34.7 billion
- EU goods imports from India 2010: Euros 33.2 billion

Trade in Services

- EU services exports to India 2010: Euros 9.8 billion
- EU services imports from India 2010: Euros 8.1. billion

Foreign Direct Investment

- EU outward investment to India 2010: Euros 3 billion
- Indian inward investment to EU 2010: Euros 0.6 billion

I believe that the speedy conclusion of the EU-India Free Trade Agreement will be an important step towards further strengthening the trade relations between the two regions.

The Growing Importance of Social Compliance Today

Before concluding I would like to draw your attention to the various non-commercial issues that have come to dominate global trade. Environmental and social compliances have become a pre requisite for doing export, especially to established and well recognized brands and retailers in Europe and the USA. SA 8000, BSCI etc. are some initiatives to help the exporters conform to these requirements. I am sure that the exporting community is well aware of these challenges and has taken steps to meet these. I am fully aware of the tremendous efforts made by the Indian leather industry to meet the social and environmental requirements in different parts of the country. Let me just say that this should not be allowed to become a bottleneck to India's export efforts.

From my point of view two aspects are very important here:

- The EU should not try to bring social working conditions into the trade regime of the two partners;
- the Indian side – i.e. entrepreneurs, their associations and government – should try to avoid that some NGOs and self-styled world improvers are time and again spoiling the Indian image with horror stories. The unholy alliance between these people and protectionist elements in the importing countries must be broken. India is losing millions of exports and jobs because of this. But although this is well known, there is nobody saying it loudly and fighting it.

Concluding Remarks

Friends, I am convinced that the Indian leather sector has a great potential for growth. Somehow, the industry has not yet realized it. The fact that the industry has braved the current global economic crisis well is indicative of its strengths and resilience. I hope that this new found confidence will help the industry to make full use of its possibilities and become a leading player during the 12th plan period.

Thank you.