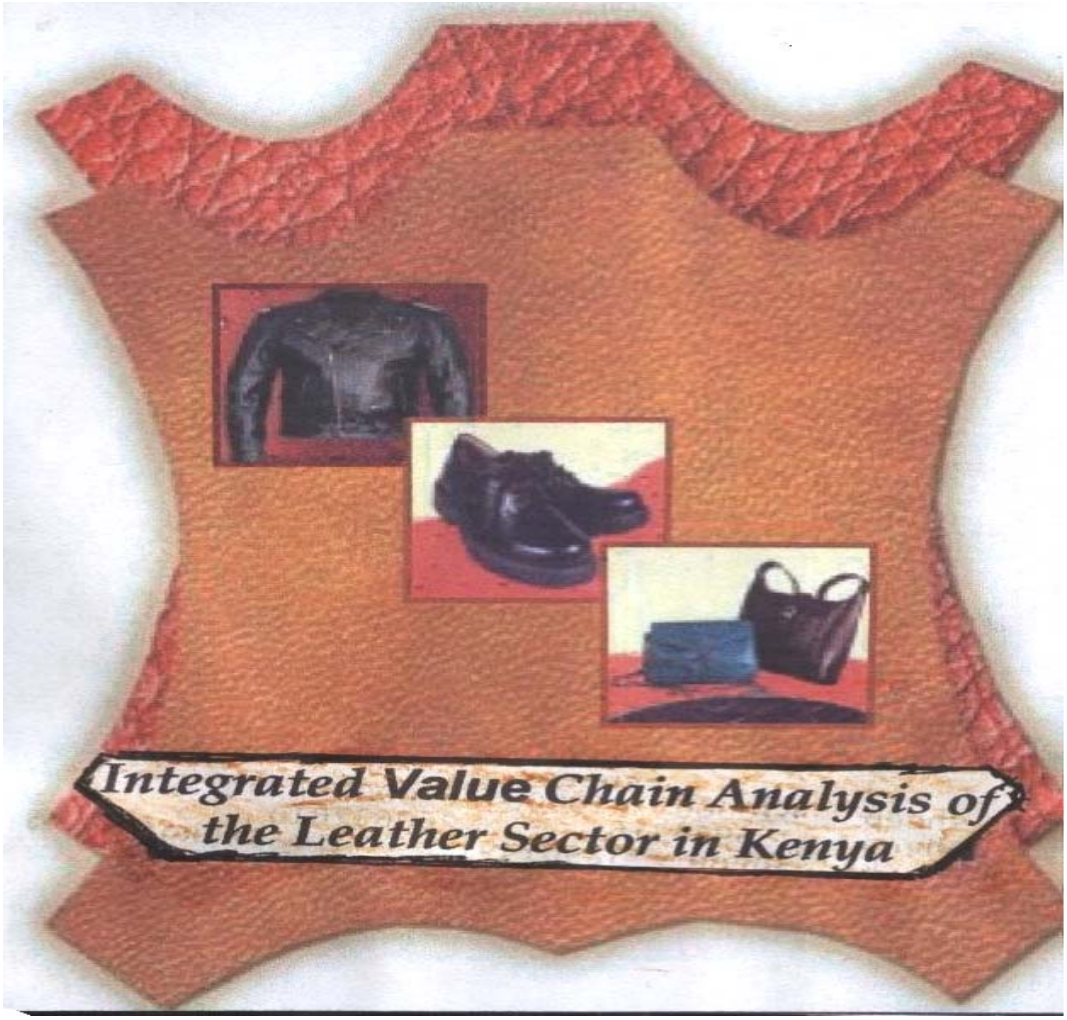
MSME COMPETITIVENESS PROJECT
MINISTRY OF TRADE AND INDUSTRY

INTEGRATED VALUE CHAIN ANALYSIS OF THE LEATHER SECTOR IN KENYA



STAKEHOLDERS' WORKSHOP VERSION

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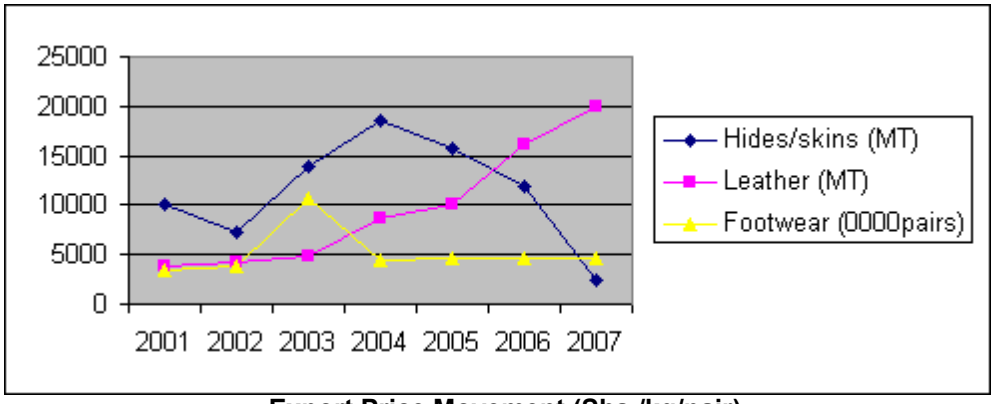
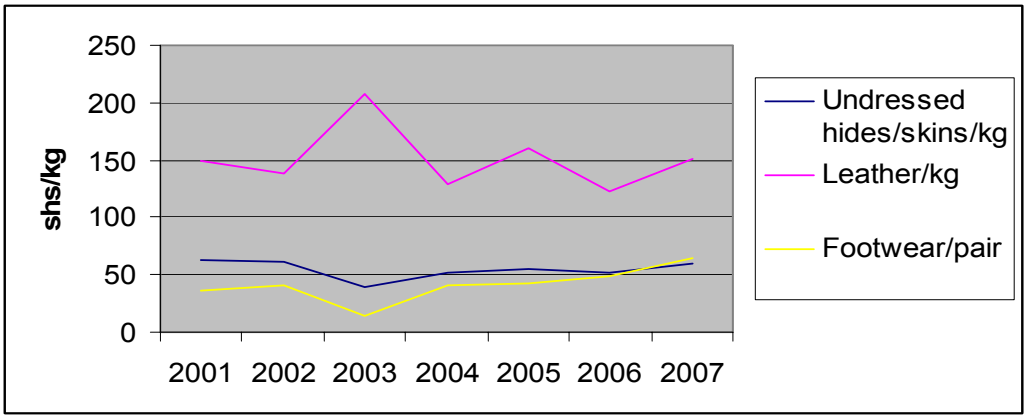
IS THE LEATHER INDUSTRY MOVING TOWARDS VALUE ADDITION?

EXPORT QUANTITY(MT)

	2001	2002	2003	2004	2005	2006	2007
Hides/skins (MT)	10000	7181	13910	18542	15683	11875	2416
Leather (MT)	3847	4334	4898	8646	10083	16062	20049
Footwear (0000pairs)	3357	3761.4	10684.5	4390.8	4628.8	4705.4	4723.9

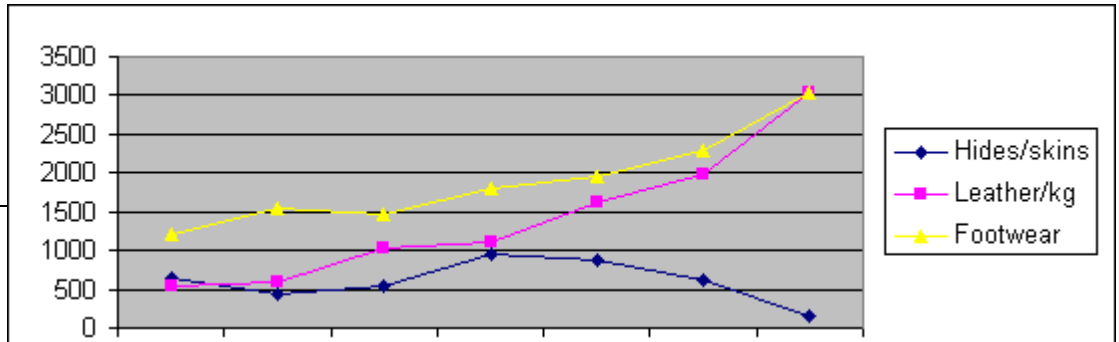


Export Price Movement (Shs./kg/pair)



EXPORT VALUE (Kshs.mi)

	2001	2002	2003	2004	2005	2006	2007
Hides/skins	635	445	551	956	866	622	143
Leather/kg	536	601	1018	1115	1611	1971	3036
Footwear	1204	1549	1457	1789	1952	2279	3029



1.0: INTRODUCTION

1.1: Value Chain Analysis (VCA) Concept

Basically, a value chain describes a whole range of activities from the producer to the consumer and is broken into networks of activities controlled by categories of stakeholders and identifies stages in supply process and support services to accomplish tasks. In the value chain analysis, the dimensions analyzed include:

- Input-output relationship in relation to value added and rents in the chain
- Institutional framework which identifies key players e.g. producers, assemblers, middlemen, traders, transporters, providers of services, processors and consumers
- Governance structures in relation to barriers to entry in terms of legislative judicial and executive. Analysis also looks into types of chain; producer or buyer driven chains in relation to barriers to entry.

The leather and leather products value chain starts from the livestock producers (to produce quality animals), slaughter operations (to produce quality hides and skins), hides/skins trade (to properly cure the hides/skins), tanneries (to produce leather - wet blue, crust and finished), leather products producers (to produce footwear and leather products) to wholesalers/retailers who supply the consumers.

1.2: Kenya Leather Value Chain.

In 2006, the country produced 2.6 mi cattle hides, about 3.9mi goat skins, 2.5 mi sheep skins and 65,000 camel skins. The hides and skins are procured from on-farm slaughter and from 2,000 slaughter slabs and slaughterhouses. Procurement of hides and skins is undertaken by over 1000 hides and skins traders who operate about 1,000 stores and bandas in all provinces of Kenya.

In the tanning stage, 12 tanneries are in operation with an estimated capacity of about 1.5 million hides (down from 3.3mi in 1990) and 3.6 million skins (down from 6.3mi in 1990). The tanneries produce cattle leather (60% wet-blue, 14% crust and 25% finished leather) while skins from the small stock (shoats) is converted into wet blue (90%) , crust (6%) and 4% finished leather (4%). Leather is sold domestically to about 15 footwear manufacturers who have a capacity of eight million pairs of shoes per year. Leather goods manufacturers are estimated at 15 with a production of 300,000-500,000 pieces. Artisinal footwear and leather goods are also found in Nairobi and Thika and other urban and rural centres.

In the international value chain, Kenya is a very minor player. In exports of raw hides and skins, Kenya realized about 0.143bi in 2007 (down from Kshs.0.622bi in 2006) in the US$8bi hides/skins trade. In the case of leather, Kenya exports only Kshs.3.04 bi in 2007(an increase of 54% over 2006) in the global US$17bi market while exports of footwear (leather and plastic) it exported only Kshs.3.04 billion (an increase of 33% over 2006) in the US$50bi market. Leather goods exports are minimal, mostly as tourist curio items but the world trade is over US$3 billion. Recorded imports of footwear are about 6.3mi pairs valued at about Kshs.0.9billion. However, un-recorded and illegal imports may be far in excess of the recorded inputs.

Value addition in the leather sub-sector is well recognized in the national policies and it is estimated that an additional 20% value addition in raw hides, wet blue, crust and finished leather would earn an addition Kshs.0.9 billion. In the Industrial Transformation Strategy (SPN-2 of 1996), leather is placed in phase one of industries for immediate promotion while the Economic Recovery Strategy (ERS 2003-2007) puts strong emphasis on facilitating livestock-based industries. The Strategy for Revitalizing Agriculture (SRA 2004-2014) puts strong emphasis on value addition in the agricultural sector and argues for agro-industrial development to be prioritized in the investment code. Both the Private Sector Development Strategy (PSDS 2000-2010) and the Sessional Paper on Development of Micro and Small Enterprises for Wealth and Employment Creation for Poverty Reduction (SPN-2 of 2005) put emphasis on the private sector in macro, micro and small enterprises (MSMEs) as engines of growth, employment creation and poverty reduction. The newly released Vision 2030 (2007) emphasizes that value addition in the agricultural sector is capable of adding Kshs.80-90 billion to GDP and puts increased emphasis on crop and livestock products value addition as one of its flagship projects.

1.3: Study Objectives

Overall, the VCA of the leather sub-sector is to exhaustively study the sub-sector to come up with MSMEs and a program for public and private sector implementation. In undertaking the VCA, the following will be identified among others:

- the present supply chain organization and market destinies - what final market segments are served, for what qualities and at what prices;
- what technologies are used;
- what are the institutional arrangements used;
- what are the infrastructural facilities;
- policies and regulatory framework to indicate how access could be gained to make more profitable market segments through better quality management in the supply chains by ranchers, traders, processors and exporters with proper government support and adequate collective action;
- how to implement improvements throughout the supply chain to realize higher profitability (improve competitiveness) including;
    - handling (pre- and post-slaughter);
    - storage;
    - processing; and
    - testing etc.
- institutional aspects such as coordination in the supply chain;
- incentives through a proper standards and grading system;
- regulatory adjustments; and
- performance improvements of public and private testing facilities.

2: Global Leather Value Chain

2.1: Background to Value Chain Analysis

A value chain describes the full range of activities that are required to bring a product from production to marketing and consumption of the end products. It involves a series of components from raw materials procurement, intermediate inputs, processing, marketing and distribution. This perspective provides an integrated approach to the analysis of problems and constraints in the whole industry. From analysis of components of the policies, investments and interventions can be made for the improvement of the industry.

The process of globalization has promoted two types of chains through which global production networks manage the sectors. The first is the producer-driven chain based on capital intensive industries such as automobiles, aircraft and computers. The second type is the consumer driven chains which are organized around labour-intensive industries like textiles and footwear. Reasons why value chain analysis in the era of globalization is important include:

- Growing division of labour and global dispersion of production of components and competitiveness
- Efficiency is a necessary condition for penetrating global markets
- Entry into global markets allows for sustainable income growth.

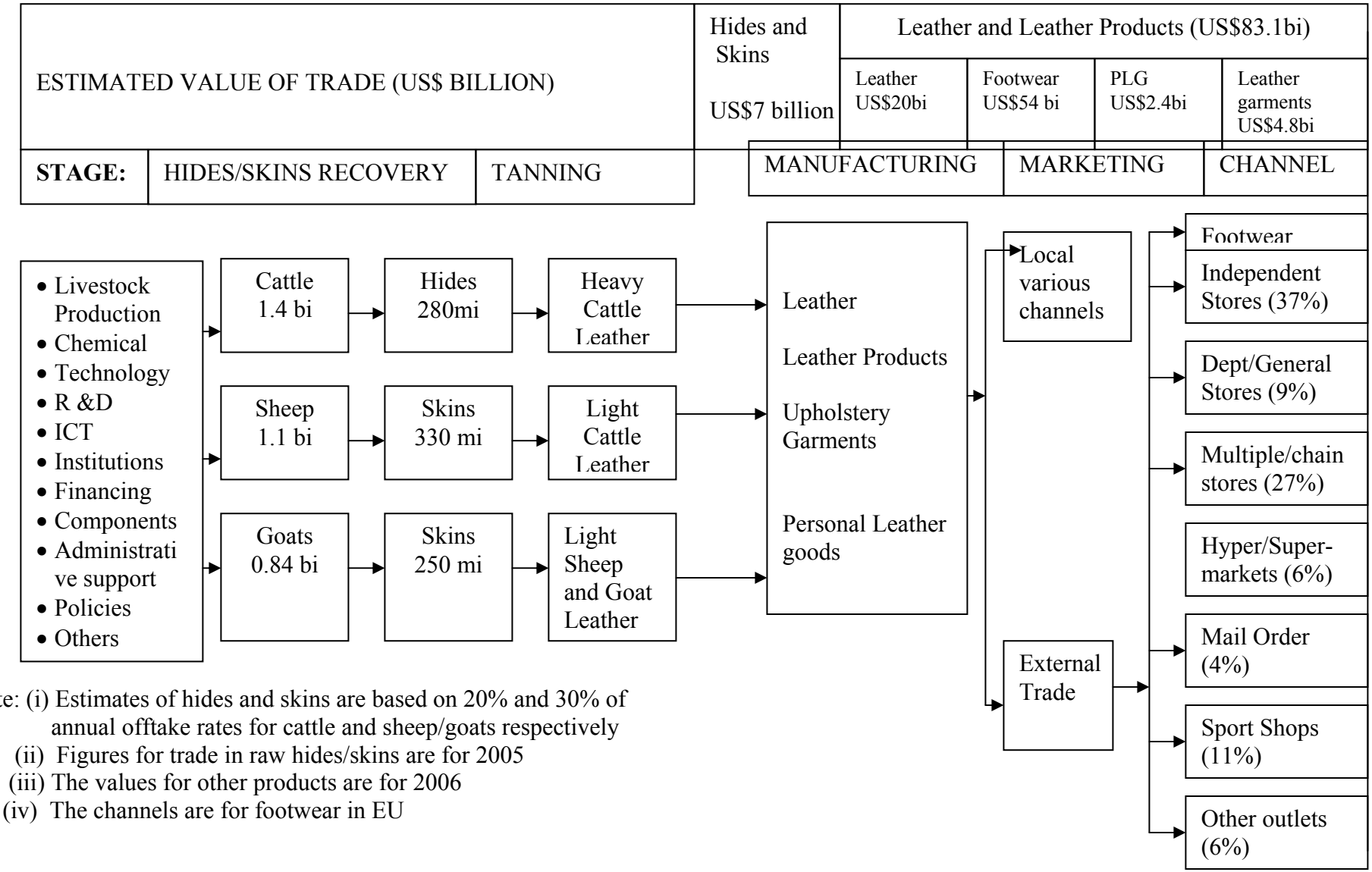
2.2: Global Leather Value Chain

The global leather value chain starts with the animal industry which produces its raw materials; hides and skins as by-products of slaughterhouses, which are transformed to various leather manufactured end-products. The chain has three processing stages each requiring different combinations of material inputs, labour and capital. In the first stage, hides and skins are recovered from dairy, beef, sheep, goats and other animals. The quality of hides and skins at this stage is linked to animal husbandry and breed of animals as well as proper slaughtering, flaying and post-slaughter handling. The second stage involves leather tanning and finishing to either pickled, wet-blue, crust or finished leather types. This stage is capital intensive and usually constrained by stringent environmental standards. The third processing stage is labour intensive and includes production of leather products (footwear, travel goods, personal leather goods, etc). These three processing stages are linked to commercial components of the chain including marketing of intermediate inputs, trade, consumption, design, chemicals supply, support institutions, research and development, training and adequate policies.

In a nutshell, the leather production – consumption value chain is described as follows. The raw materials; hides and skins are obtained from the world livestock resources estimated at 1.4 billion heads of cattle, 1.1 billion sheep and 0.8 billion goats. Other sources include camels, buffaloes, crocodiles, ostriches, among others, but only cattle hides and sheep/goat skins are considered for analysis. At an average offtake rate of 20% for cattle and 30% for sheep and goats. The annual production of hides would be 280 million hides and 580 million sheep/goat skins. These are used for domestic consumption and export trade.

The export trade involves raw hides and skins, leather and leather goods. The trade in raw hides and skins is estimated at US$7.8 billion while that of leather is estimated at US$20 billion. Global footwear trade is estimated at US$54 billion while that of leather garments is estimated at US$4.8 billion, personal leather goods at US$2.4 billion and that of leather components at US$2.2 billion. This gives a global leather and leather products (excluding hides and skins) trade of US$83.4 billion in 2008. A simplified value chain is shown in figure 2.1.

Fig. 2.1: Global Leather Value Chain



Note: (i) Estimates of hides and skins are based on 20% and 30% of annual offtake rates for cattle and sheep/goats respectively
(ii) Figures for trade in raw hides/skins are for 2005
(iii) The values for other products are for 2006
(iv) The channels are for footwear in EU

2.3: Analysis of the global leather value chain

2.3.1: Total Value

The global leather value chain is discussed in Chapter two. End-products in the global value chain are raw hides and skins valued at US$7.7bi, leather valued at US$20bi, footwear valued at US$54bi, personal leather goods valued at US$2.4bi and leather garments valued at US$4.8 billion.

2.3.2: Hides and Skins Value

Raw materials for the leather supply chain are from 1.4bi cattle, 1.1 bi sheep and 0.84 bi goats. Africa accounts for 18% of cattle, 24% of sheep and 29% of goats but its contribution to the trade is minimal. Ten countries account for 74% of the US$7.7bi trade in hides and skins. In Africa, only a few countries have significant exports; South Africa (US$99mi), Kenya (US$14mi), Zimbabwe (US$6mi) and Uganda (US$5mi). Some countries in Africa import hides and skins notably South Africa (US$25mi) and Tunisia (US$25mi).

2.3.3: Global Leather Value

Leather in world trade is valued at over US$20bi but ten countries account for 74% of exports with Italy, Hong Kong, China and Brazil accounting for 67% of exports. Similarly, ten countries account for 74% of imports with China, Hong Kong and Italy accounting for 66% of imports. Significant African players in the leather export trade include South Africa (US$93mi), Ethiopia (US$50mi), Egypt (US$27mi), Tunisia (US$16mi), Kenya (US$15mi), Morocco (US$14mi) and Algeria (US$11mi). In the import sector, the significant importers are South Africa (US$98mi) and Morocco (US$78mi).

2.3.4: Global Footwear Value

The footwear sub-component of the leather value chain is valued at US$54bi from an estimated 14.4bi pairs of shoes produced. Asia accounts for 45% of production, Americas for 25%, Europe for 20% and the rest of the world for 10% of production. In terms of exports of footwear, Asia accounts for 49% of exports, Latin America for 42%, North America for 1.86%, Africa for 0.71% and others for 1.3%. Importation is dominated by Europe which accounts for 50%, North America 34%, Asia 9.1%, Africa for 1.48% and the rest for 5.5% of imports. Average per capita consumption of shoes is 2.2 pairs per annum with an American average of 4 pairs, EU at 4 pairs, Asia at 1.7 pairs and the rest of the world at 1.1 pairs per annum.

2.3.5: Value of other Leather Goods

Other leather goods; garments, personal leather goods and leather components (mostly uppers) are valued at US$8.5bi with ten countries accounting for 76% of exports notably China (33%) and Italy (17%). In the import trade, ten countries account for 86% of imports with USA accounting for 31% of imports. Other countries include Germany (9%), Hong Kong (9%), UK (8%) and France (8%).

2.3.6: Global Leather Issues in Relation to Kenya

Demand side issues in relation to the Kenyan leather industry include: (i) supply of raw materials, (ii) dynamic nature of the global market, (iii) competitiveness, (iv) skills and expertise, (v) China and Asia factor in trade, and (vi) potential for MSMEs in the global value chain.

The global leather value chain depends on quality hides and skins. Kenyan hides and skins are considered of inferior quality. There is therefore a need to address issues of breeding, slaughtering and tanning. Although liberalization and the high demand in Asia have accelerated demand for raw hides and skins, many countries have put emphasis on value addition by restricting exports. To improve the quality, emphasis should be put on capacity building in slaughtering/flaying, hides/skins improvement programmes, support of institutions, among others. Other issues to be addressed include improvement in tanning equipment, capacity building in tanning, investments and favourable policy.

The global leather value chain is a consumer driven chain and it is a dynamic chain influenced by product related issues (short lifecycles, frequent change, diversification and consumer sophistication), technology issues (increase in complexity, multi-disciplinary skills, short lifecycles, substitution, among others) and market-related issues (globalization, high competition, large multinationals, emerging new markets, consumer concerns and issues of quality and durability). If Kenya aims to enter the global value chain, serious consideration and analysis of these issues is required.

End-products in the value chain are fashion driven and to participate and be recognized, there is a need for understanding of fashion forecasting, styling and design and proper manufacturing. Italy is recognized for styling and design as well as component design together with Spain, USA, UK, among others. In finished leather manufacturer, Italy, Brazil, USA and France are recognized leaders. When various leadership indicators are ranked, Italy emerges at the top followed by Spain, Brazil and China.

Competitiveness in the value chain is measured by such attributes as productivity (value added at factor cost). In EU, value added at factor cost is €28,000 for footwear and €16,000 per worker. Another attribute is wages per hour. In the EU, labour costs contribute 21% of costs in footwear and 16% in leather goods while in developing countries, it is 10-15%. Wage rates in China are as low as US$0.48/hr while those in India and Kenya are US$0.67/hour compared to US$19.76/hr in Italy. As discussed

above, other factors determine the location of manufacturing. Others include degree of modernization, design, branding new products and environmental considerations.

China has increasingly become a leading player in the global leather value chain. It is the largest importer of raw hides and skins (US$2.5bi) and third in export of leather (US$2.8bi). China produces 60% of world footwear and accounts for 30% of global exports (US$12.9bi), 73% of personal leather goods and 53% of leather garments. China's exports to EU have risen from €2.5bi in 2003 to €4.8bi in 2005 accounting for 39% of total EU imports. China has also penetrated the African market. In 2002, it was estimated that consumption in Africa was 506mi pairs of which 200 mi pairs were from China. In countries like Egypt and South Africa, with a comparatively well developed leather sector, the import penetration was 66% and 63% for the two countries respectively while for the whole of Africa, it was 73%. The implication to Kenya aiming at increased value addition is that it will face fierce competition from imports from China.

MSMEs have potential in entering the global value chain as the leather sector is labour intensive and MSMEs have advantages of flexibility and low cost of production. However, they face high transactions costs and limited production capacity unless they are organized in clusters. For them to enter the global value chain, there is a need to create a business friendly environment, strong inter-firm linkages (vertical and horizontal), opportunities for support and upgrading and dynamic supporting markets for products and services.

In conclusion, it can be stated that Kenya is a very minor player in the global leather value chain. When it is bench-marked against the world leader Italy in relation to raw materials availability, quality and cost, access to finances, sustained capital investment, vertical integration, technology, process skills, research and development, product development and tradition in leather industry, it scores very low except in raw materials availability and cost.

3: Kenya's Position in Regional Leather Production

3.1: Countries Reviewed

Kenya's position in the regional leather sector was undertaken in Chapter three and the Kenyan situation is compared to EAC countries (Uganda and Tanzania), COMESA countries (Ethiopia, Sudan, Eritrea, Botswana, Malawi and Zambia) and South Africa. The comparison was made in relation to population and demand, livestock resources, hides and skins availability, tanning, footwear and leather goods manufacture. A strategy for COMESA leather industry development is also highlighted.

The ten countries discussed had a population of 296mi. Considering an average consumption of 1.1 pairs per capita, the region's demand for footwear would be about

326mi pairs and even higher if the global average consumption of 2.2 pairs/capita is considered. However, population alone does not influence demand unless per capita income is high. The GDP for the eleven countries is about US$490bi but South Africa alone accounts for US$250bi. Per capita income ranges from US$167 in Malawi to over US$5,000 in South Africa.

3.2: Raw Materials Supply Situation

The Eastern African region has the highest population of livestock in Africa. Ethiopia has 41mi cattle, 25mi sheep and 23mi goats, Sudan (40mi, 48mi and 42mi respectively), Kenya (14mi, 10mi and 12mi respectively) and Tanzania (18mi, 3mi and 12.5mi respectively. This livestock resource base is capable of producing adequate hides and skins for a vibrant leather industry. However, due to poor animal husbandry, off-take rates which are low averaging at 14% for cattle and 27% for sheep and goats the potential output is not realized. The low off-take rates plus decentralized slaughtering and poor collection implies that a considerable number of hides and skins do not enter the market.

Hides and skins are generally of low quality due to defects caused in the field, in slaughtering and in preservation. Grading is hardly done and where it is done, they average at 20% (I), 33% (II), 20% (III), and 27% (IV). Over 80% of hides and skins are exported in raw form but in some countries like Ethiopia, South Africa and Sudan, there is considerable local utilization. Prices of hides range from US$0.80-1.3/kg while those of skins range from US$0.30-1.0/piece. Ethiopia has internationally recognized skins which fetch a high price of US$2.50/piece.

3.3: Regional Tanning Capacity

The region had 407 tanneries (2002) but currently, many are not operational except in South Africa and Ethiopia where all tanneries were operational. Kenya had 19 tanneries in 2002 but currently, only 12 are operational. Capacity utilization is generally low averaging at 30% but in Ethiopia and South Africa, it was over 60%. Tanning was dominated by wet-blue (60-70%), crust (15-20%) and finished leather (8-10%). South Africa however has 62% to the finished stages. The local market accounts for 10-15% while the rest is exported. Export values are highly influenced by the degree of value addition with South Africa's value at US$2.5bi, Ethiopia US$66mi, Sudan US$22mi and Kenya US$15mi.

3.4: Regional Footwear and Leather Goods Capacity

In 2002, it was estimated that the region had 689 footwear manufacturing enterprises but many have closed due to high importation of new and second-hand footwear. South Africa, Ethiopia, Sudan and Zimbabwe accounted for most of the enterprises. Installed capacity is high in South Africa (32mi pairs) and Ethiopia (25mi pairs).

Utilization of capacity is between 20% and 80% with high utilization in South Africa and Ethiopia.\

Leather goods manufacturing is not well developed except in South Africa and Ethiopia. In 2002, the number of enterprises was estimated at 554 units but currently, many are not operational. Utilization is from 20% to 60% and most goods are for local markets and tourist trade. There is also considerable artisinal and handicraft production.

3.5: COMESA's Strategic Plan for the Region

COMESA (2007) has prepared a comprehensive strategy for the leather sector in the region with four strategic objectives as follows:

* Improve raw and partially treated hides and skins quality, consistency and compliance with quality and environmental standards (low cost – 12 to 18 months).
* Reinforce support organizations and leather sector associations to provide market information and help enterprises apply it to improve quality and market attractive products (medium cost – 1½ to 3 years
* Improve technical and management skills and equipment in tanneries and leather fashion products manufacturers to produce consistently good quality products and make better investment decisions (high cost – 2 to 3 years)
* Develop sustainable national/regional clusters of products manufacturers to meet buyers volume/quality requirements and design attractive original products – sharing ideas, technical knowledge, skilled employees and prototyping equipment (high cost – 4 years).

The strategies are supposed to address the following beneficiaries:

* Abattoir and slaughter slab operators, their associated communities and unions
* Sector trade and business support organizations (associations, training institutions, laboratories, etc.)
* Tannery operators, actual and potential owners, investors, unions and employees
* Leather products manufacturing facility, actual and potential owners, investors, unions and employees.

4. Analysis of Kenya's Leather Value Chain

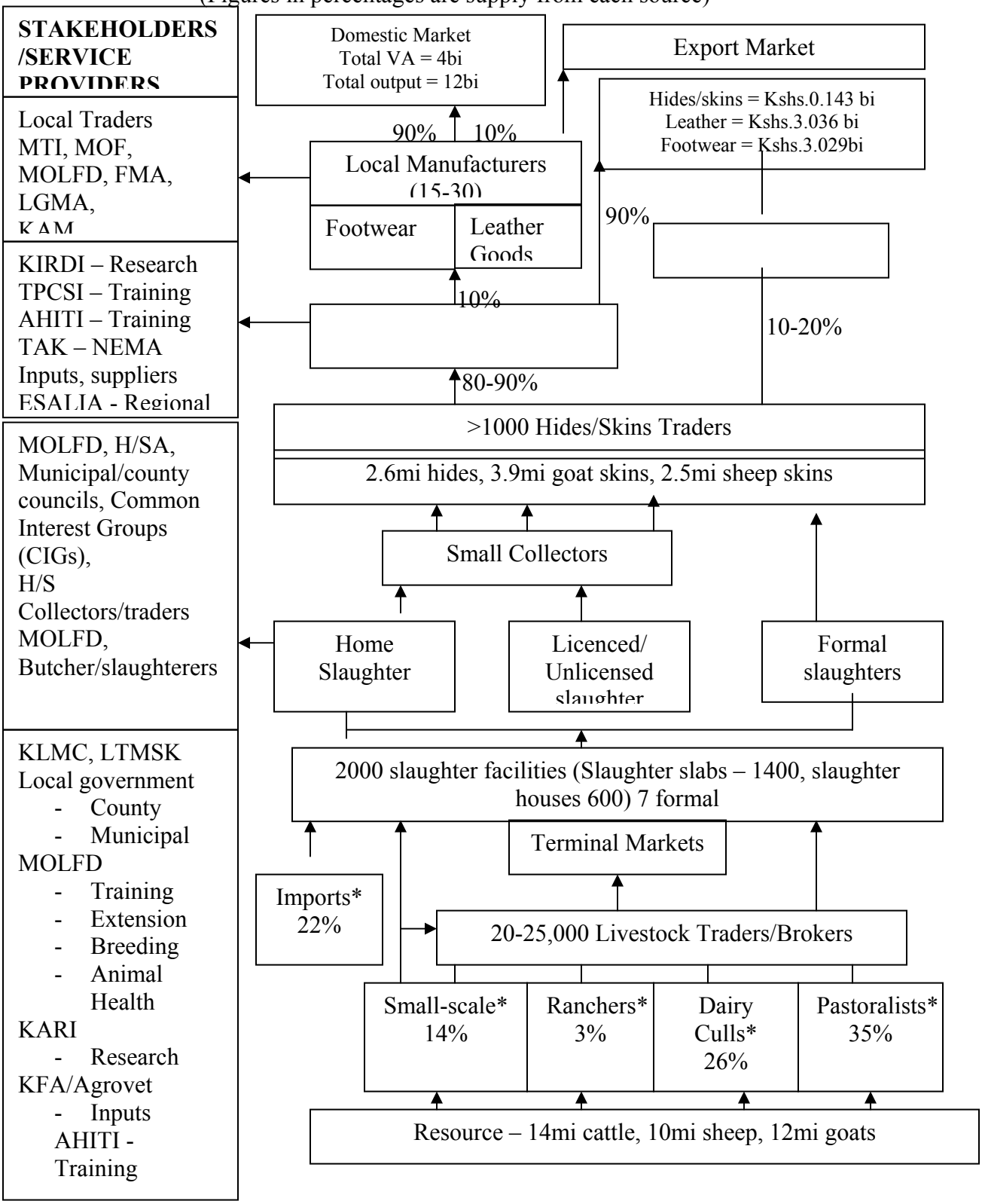
4.1: Overall Leather Supply Sub-sector Map and Value Chain

Kenya's livestock resource base is estimated at 14mi cattle, 12mi goats and 10mi sheep plus animals trekked across porous borders from neighbouring countries. Animals for slaughter are procured from smallholders (14%), ranches (3%), dairy culls (26%), pastoralists (35%) and neighbouring countries (22%). About 20,000 – 25,000 traders are involved in procuring animals to the 2,000 slaughter facilities of which 1,400 are slaughter slabs and 600 are slaughterhouses.

The value chain is as shown in figure 4.1

Fig. 4.1: KENYA'S LEATHER SUPPLY CHAIN MAP

(Figures in percentages are supply from each source)



* For cattle only

4.2: Raw Materials Supply and Issues

In 2006, Kenya produced about 2.6mi hides, 3.9mi goat skins, 2.5mi sheep skins and 63,000 camel skins. These are procured by 970 hides and skins traders who preserve them in 950 bandas. Preservation is mostly air-drying although wet-salting is one the increase. Hides and skins are not usually graded but the average grades are 34% (I), 25% (II), 11% (III), and 30% (IV)

Issues in hides and skins include:

* Low off-take rates, less than 10% for cattle and less than 28% for sheep and goats
* Small sizes due to poor breeds and livestock feeding. Kenyan hides are 20-25ft^2 compared to 40ft^2 in USA
* Non-recovery which is estimated at 14% for hides, 34% for sheep and 29% for goats.
* Very many defects of which 40% are pre-slaughter and 60% during slaughter and preservation
* It is estimated that if some of these problems (defects, recovery and preservation) are addressed, the country can realize over Kshs.650 mi in value addition at this level.

Slaughterhouses identified that there were problems with skins and they suggested interventions as follows:

Problems	**Interventions**
- Poor branding practice	- Training of farmers on branding
- Poor quality of animals/small hides and skins	- Improve breeding and husbandry
	- Purchase flaying machines
- Improper skinning of animals	- Supervise flayers
- Hurried flaying – paid by number	
- Lack of proper equipment	- Credit for purchase of equipment
- Slaughtering on the ground	- Purchase hoist equipment
- Transport/ bruises during transportation	- Improve on transport of animals
- Poorly trained flayers	- Train flayers
- Poor sanitation in slaughterhouses	- Improve hygiene in slaughterhouse
- Disorganized marketing /lack of market information on hides and skins	- Create awareness of value of hides and skins to farmers.

People involved in causing and removing defects are as summarized below:

Defect Type	**Causers**	**Influencers**
Pre-slaughter	Livestock owners, veterinarians, livestock traders, and drovers	Farmers' associations, agricultural colleges, veterinary organizations, traders' associations and government departments.
Peri-slaughter	Livestock buyers, slaughterhouse operators,	Livestock traders' associations, rural district (urban and municipal)

	meat inspectors, butchers, meat processors, and hides and skins merchants.	councils, technical colleges, public health authorities, meat processors' associations and tanners' associations.
Post-slaughter	Hides and skins merchants, transporters, and shipping agents.	Tanners' associations, trade promotion councils, public service media (newspapers, radio and so on), national statistics organization and national standards associations.

As noted above, both the private and the public sectors are involved and the following remedial measures are recommended

* Extension services towards improved animal breeding and nutrition (public/donors and to some extent private breeders)
* Training of pastoralists on the need for quality hides and skins (public/donor, NGOs and pastoralist associations)
* Promote provision of micro-finance for MSMEs engaged in hides and skins (Private sector and donors)
* Provide training on slaughtering, flaying and preservation
* Promote regional improved slaughterhouses with improved slaughtering facilities e.g. hoisting machines, flaying equipment, etc.
* Promote frame-drying and wet salting of hides and skins
* Promote grading of hides and skins and a differentiated price structure to act as an incentive for production of quality hides (See Annex 4.1a and b and 4.2a and b)

Analysis of the preservation sub-component shows that in preservation, salt accounts for 85% of costs and the rest for 15%. The margin is about 12%. In the export of hides and skins, cost of hides accounts for 63%, transport 1.3%, port charges 4.8% and taxes 29.2% (export duty 95% and veterinary levy 5%). The exporters' margins are below 2% due to the export duty of 40%. Value addition in preservation is 16.7% while in export it is 36.7%

Problems and potential interventions in selling hides and skins were identified as below:

Problems and Interventions identified by Hides/Skins Traders	
Problems	**Interventions**
- Branding and knife cuts	- Train owners/slaughterers on branding and flaying
- Poor pricing structure	- Pay differential prices by grade and set pricing mechanisms
- Market information - High competition among traders - Fluctuation in prices - Supply fluctuations	- Form trade association to give information
- Lack of training for flayers	- Train traders/flayers

- Credit - Unlicenced traders	- Provide credit - All traders to be licenced

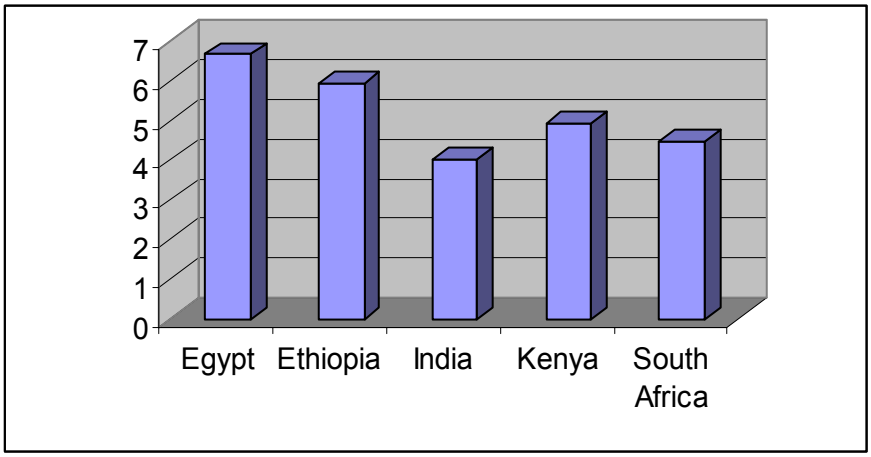
Problems and Interventions identified by Hides/Skins Exporters	
Problems	**Interventions**
- High export charges	- reduce duty
- Poor quality	- train flayers/ proper branding
- High transport charges - Marketing problems – no information - Low capacity in tanneries - High prices of preservation	- Form association to provide information and other services
- Lack training on grading and preservation	- train traders on grading/preservation
- Low capacity utilization in tanneries	- revive tanneries
- Prefer humpless animals	- increased animal breeding

4.3: Tanning Sub-sector and Issues

The tanning sub-sector peaked around the year 2000 with 21 tanneries with an installed capacity of 3.5mi hides and 11.6 mi skins. Currently, there are 12 operational tanneries with an installed capacity of 1.5mi hides and 3.6mi skins and they are located mainly in Nairobi and its environs. Problems in tanneries include high manufacturing costs, unfavourable trading environment, lack of tanning skills and out-dated regulatory, legal and policy framework.

Qualitative bench-marking of crust production in Kenya, Ethiopia, India, Egypt and South Africa using attributes of business environment, materials availability, labour, logistics, permits and environment show Kenya at 3.9, Ethiopia at 3.7, Egypt at 3.6, India at 6.4 and South Africa at 6.8. Kenya, with some incentives, can become attractive to investors.

In terms of financial benchmarking, the profitability indices are shown as below:



Egypt and Ethiopia are the most attractive at PI's of 6.64 and 5.92 respectively due to tax holidays (10 yrs in Egypt and 5 years in Ethiopia). Kenya is the third most attractive country with a PI of 4.89 which is better than India and South Africa. Kenya's situation can improve to a PI of 6.74 with a 10 year tax holiday.

Value chain analysis to wet-blue bovine leather shows that raw hides account for 59% of costs, processing costs for 36% and processor's margin at 5% but is higher in skins. Of the processing costs, chemicals account for 43%, labour 24% and utilities for 33%. In crust leather processing, raw materials cost 75%, processing 21% and processor's margin at 4%. Chemical costs account for 40%, labour 26% and utilities 34% of processing costs. In finished leather, raw materials account for 78%, processing 12% and processor's margin for 10%. Value addition to wet blue averages at 21% (22% for hides and 20% for skins) to crust it averages at 32.5% (35% for hides and 30% for skins) and to finished leather at 39% (40% for hides and 38% for skins).

Constraints, Consequences and Solutions Identified by Tanners			
Area of Operation	**Constraints**	**Consequences**	**Suggested solutions**
Market Access	- The export orders are limited to wet blue - Low leather consumption locally - Leather and its products too expensive	- limited value added to the leather	- Promote the operation to finishing of leather
Input Supply	- Expensive processing chemicals - Low quality hides and skins - Electricity bills have been very high - High cost in treatment of effluent	- Tannery limiting their operation to wet blue - Operational cost becomes expensive - Environmental problems	- Duties on imported chemicals be removed - Strengthen the hides/skins improvement services - Lower the cost of electricity - Lower the cost of water, chemicals.
Technology/Product Development	- There is no leather training institute - Limited knowledge on leather finishing - High load of tannery effluent	- Lack trained manpower - Few tanneries do finishing - Environmental problems	- Centre to be started for leather technology training - Training on leather finishing procedure - New method of

			leather processing
Access to Finance	- High interest rate - Unavailability of loans - Lack of long-term credit facility	- Limited growth of leather industry - Not able to modernize the tannery - No new tanneries have been started	- Create a revolving fund for tannery modernization
Infrastructure	- Poor roads - Telephone - Internet connection	- High cost of production	- Improve and maintenance of road network.
Policy/Regulation	- Ban of hides and skins exports - Enforcing of hides and skins Act - Few small size tanneries	- Promote smuggling across borders - Improving of quality of hides and skins - Sometimes there is surplus of hides and skins	- Incentive payment of post tanning export - Strengthen or privatization of hides and skins improvement services - Financing of association

Overall, the SWOT analysis of the tannery sector identifies the strengths, weaknesses, opportunities and threats as tabulated below:

Strengths	**Weaknesses**
- Abundant supply of hides and skins - Demand of wet blue in world market - High installed capacity of wet blue - Basic chemicals available locally (chrome)	- Poor quality of hides and skins - Few well trained personnel in the industry - Tanneries owned by foreigners - Weak leather tanners association
Opportunities	**Threats**
- Economical growth in sector - Opportunities to finances from banks - Can expand their production in crust and finished leather - The tanneries that have been closed down can be re-opened which is much easier than building new ones	- Smuggling out of raw hides and skins to other countries - Dumping of leather goods from developed countries – mitumba - High demand of cleaner effluent - Major jobs are held by foreigners - Tannery machines expensive

4.4: Footwear and Leather Goods Manufacturing and Costs

The footwear and leather goods sector consists of 10-15 footwear manufacturers and 18 leather goods manufacturers plus over 60 MSMEs. Problems experienced include; high production costs, diminishing manufacturing skills, low quality products, competition from imports, lack of market information and export promotion. Value chain analysis for men footwear, plain leather belt, computer bag, ladies bags and leather wholesaler were undertaken.

A value chain for a size seven men shoe which retails at Kshs.1,600/pair showed that leather accounted for 25.9%, other inputs 13.4%, overheads 19.7%, producer margin 9.7%, retailing costs 3.1% and retailers margin at 28.1%. In the informal manufacturing sector where shoes are sold directly to customers, the value chain for a shoe retailing at Kshs.360/pair showed that uppers accounted for 48.9%, sole for 16.8%, labour for 12.6%, other materials for 4.9% and the producer margin for 17.9%. In the informal sector manufacturing, there are materials suppliers who obtain leather from tanneries and supply to shoemakers. In this value chain, materials account for 76.5%, trading and transport for 5.4% and the wholesaler realizes a margin for 18.1%

Value addition in the informal sector manufacturing was calculated at 25% for men's shoes, 18% for leather supplier and 63% for a plain leather belt. In medium scale manufacturing, value addition for sandals was calculated at 32% for kids shoes at 36%, for moccasins at 38% and for men's Derby shoes at 30%. In leather goods manufacture, value addition for a laptop computer bag was calculated at 32% and for a ladies' bag at 45%.

In the footwear and leather goods manufacturing, the identified constraints and suggested solutions are as summarized below:

Constraints, Consequences and Solutions identified by Footwear/Leather goods manufacturers (MSMEs)			
Area of operation	**Constraints**	**Consequences**	**Suggested Solutions**
Market access	- limited to low income earners - lack of awareness of these type of shoes	- Limited sale figures - Limited sale	- Marketing centre in town - Need to advertise
Input supply	- Lack of quality leather - Expensive leather - Lack of good equipment - Lack of expertise in shoe making	- Unable to compete with other suppliers - Limited to types of shoes - Sub-standard quality - Less competitive in market	- Fund to finance operations - Fund to acquire machinery - Training in design and shoe making

Technology/Product Development/Design	- No formal training on shoe making - Limited designs	- Poor and sub-standard products - Low sale figures	- Training institute for shoe making – polytechnic
Access to Finance	- Lack of security for funding	- Limited or no growth of business	- Availability of unsecured loans
Policy/Regulation	- Importation of 'Mitumba' shoes	- Lower profit margin	- Ban importation of these shoes.

A strengths, weaknesses, opportunities and threats (SWOT) analysis of the footwear and leather goods component is as summarized below:

Strengths	**Weaknesses**
- Easily available inputs - Low production costs due to minimal production overheads	- Many people regard their products as sub-standard - They have limited designs of shoes - Lack of enough capital base - Lack of machines - Lack of trained manpower
Opportunities	**Threats**
- The market for their products is huge	- Imported second hand shoes - Inputs like leather are expensive - Relatively well mechanized small units coming up

As a summary, the leather sector contribution to the economy is small but can be improved. It accounts for 2.5% of export earnings from hides and skins (Kshs.622mi), leather exports (Kshs.1.974bi) and footwear export (Kshs.2.279bi). Value added by all firms is estimated at Kshs.2.66bi while gross output of all firms is estimated at Kshs.10bi. The sub-sector offers formal employment to 1,700 employees with wage earnings estimated at Kshs.443mi in 2005.

5: Supply-side and Cross-cutting Issues

Supply-side and cross-cutting issues affecting the leather sector are discussed in Chapter five. These include: (i) policies in support of the sector, (ii) need for a comprehensive sector strategy, (iii) need to promote private and public sector partnerships, (iv) review of legal and regulatory framework, (v) strengthening institutions, (vi) capacity building, (vii) credit availability, (viii) quality and standards, (ix) market information and export promotion, and (x) development of clusters. Some of these are briefly discussed.

5.1: National Policy Issues

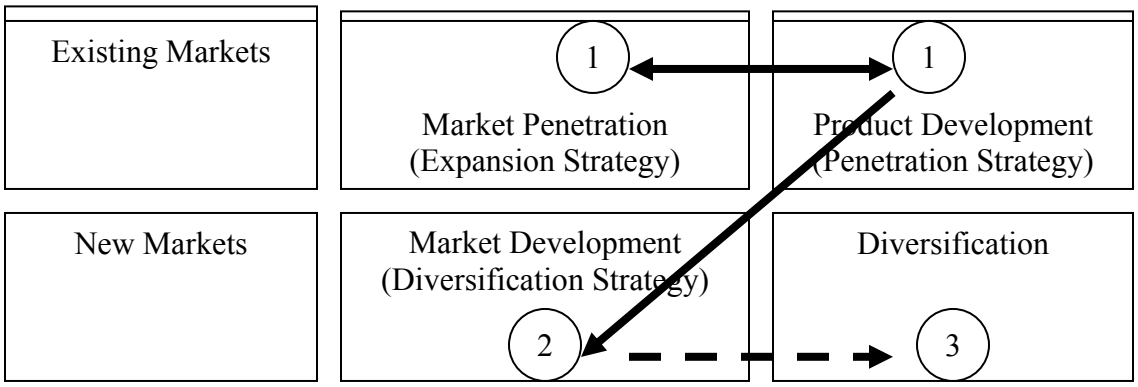
Various policy documents have been published and are all in favour of value addition in the agricultural sector. The Industrial Transformation Strategy to 2015 (SPN-2 of 1996) identifies leather processing as an industry in the first phase of industrialization. In relation to value addition, the Strategy for Revitalization of Agriculture (SRA-2004), the

Economic Recovery Strategy (ERS-2003) and Vision 2030 (2007) all emphasize value addition. In relation to private sector-led development, the Private Sector Development Strategy 2000-2010 and Development of Micro and Small Enterprises (MSMEs) for Wealth and Employment Creation for Poverty Eradication (SPN-2 2005) emphasize private sector and MSEs as essentials for development.

5.2: Need for a Long-Term Leather Industry Development Strategy

There is a need for an overall strategy for the leather sector. UNIDO (2004) and COMESA (2007) have developed strategies for Kenya and for the region covering all aspects of the sector. The proposed Apex organization with assistance from ESALIA and the concerned ministries should consolidate these documents to come up with a top-down (pull) approach (TDA) to revitalize the sector as shown below:

Kenya's Ansoff's Matrix for TDA



Policy Mix for Implementing TDA in the Kenyan Leather Sector

Price Policy	**Product Policy**
• Keeping prices right for raw material • Making the market transparent and fair • Support infrastructure for companies • Technology and technological capability • Enhancing the productivity of labour • Enhancing the effectiveness of processes	• Creating the capacity to develop new products • Quality • Making available information about the market • Support structures for production and design • Support structures for marketing • Clustering
Communication Policy	
• Making the consumer aware of issues such as quality, safety and health • Image promotion: image building (made in Kenya compliant with the a.m. standards) • Distribution: contacting big distributors	

- Product promotion: trade fairs and export consortia
- Image promotion: image building (out of Africa)
- PR: inviting testimonials of Kenyan production and organizing events

Source : UNIDO Strategy Paper 2004

5.3: Legal and Regulatory Framework

The legal and regulatory framework also needs considerable review. There is a need to review CAP 359 and legal notices for the sector to reflect the private sector-led development in a liberalized economy. The regulatory framework should also be positive in promoting value addition by addressing duties, taxes and levies.

5.4: Institutional arrangements

Institutions in the sector are inactive; i.e. Hides and Skins Association, Tanners Association of Kenya, Footwear and Leather Manufacturers Associations. These should be activated and facilitated to form an Apex association to lobby and formulate strategies for the sector.

5.5: Skills Development and Capacity Building

The sector lacks skills and technical expertise as the only training is the certificate at AHITI and short courses at KIRDI-LDC and TPCSI. To meet the challenges of a dynamic sector, there is need to up-grade skills. The proposed up-grading programme by the University of Nairobi to higher levels needs support to create a critical mass for future development of the sector.

5.6: Credit and Finance Issues

Availability of investment finance is critical for growth of the sector. Currently, financial institutions only lend 8.4% to the agricultural sector which is not adequate for improving production of quality raw materials. In the industrial sector, the existing lending enterprises have inadequate funds. For example in 2005, they only lent Kshs.912mi to 137 projects. MSEs lack finances as the many micro-finance institutions and SACCOs have not been geared to lending to MSEs.

5.7: MSMEs Requirements in the Leather Industry

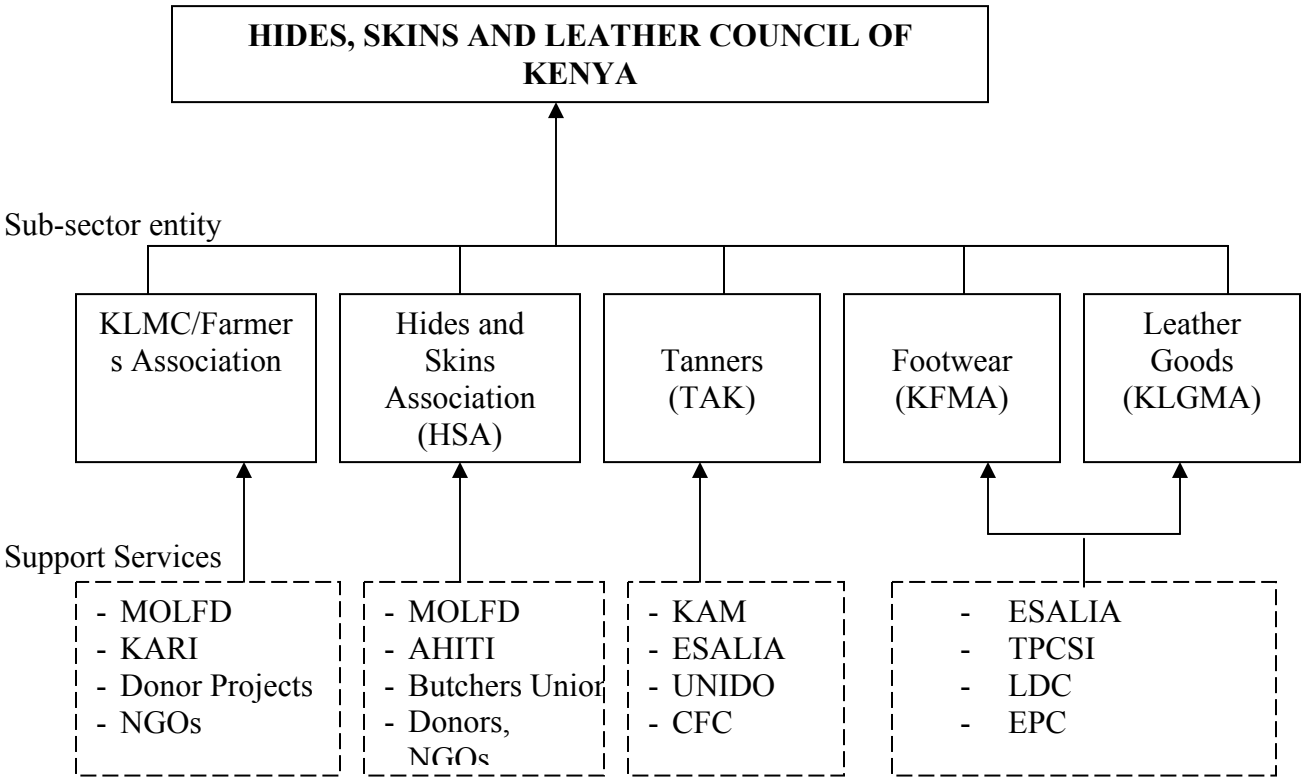
The leather sector is mostly dominated by MSEs. These lack market information, marketing infrastructure and openings to export markets. There is a critical need to promote horizontal integration and clusters for creating the volume and quantity to attract traders. A wholesale leather market is also required to expose products from MSEs to clients. The concerned organization like the Export Promotion Council (EPC) should accelerate export promotion efforts in specialized leather products fairs and shows as well as giving manufacturers the requirements on quality and standards.

6. Potential Skills Development Pilot Projects and Strategy for Implementation

6.1: APEX Organization and its Roles

The leather value chain is disjointed and there is need to facilitate the institutions to form the Apex Organization. The MSME project can work with ESALIA to form the Apex organization. The envisaged structure is as shown in figure below:

Proposed Organizational Structure of Hides, Skins and Leather Council of Kenya (HSLCK)



The functions of the organization would include the following among others:

* Lobbying for the sector through joint development of a joint strategic plan for the sector
* Promote skills development and training at all levels

* Lobbying to the government to improve funding for public goods projects in the leather value chain
* Form focal point for market information
* Price monitoring
* Address working environment
* Promote stakeholders access to finances, among others.

6.2: Potential Skills Development under MSME Matching Grant Component

Potential skills development pilot projects are discussed in Chapter six. These are analyzed for each link in the chain. Assuming a private-public sector development strategy, the projects for the public sector are also identified. Although the matching grant component deals with skills transfer, there is also a need for investments using funds from other components of the MSME project.

The potential links for pilot project development are identified as follows:

* Grass-roots links to involve farmers/pastoralists
  - Farmer/Pastoralist – Livestock/hides and skins trader
  - Water users association – livestock trader
  - Ranchers – Traders – Slaughterhouse
  - Farmer – Slaughterhouse - Trader
* Livestock trader – slaughterhouse. To capture the fact that the livestock trader is the final owner of the hides and skins and should be concerned about quality.
* Hides/skins trader – Slaughterhouse – Tannery
  - The three stakeholders should be concerned about the quality of hides and skins
* Hides/skins Trader – Tannery
  - The tanneries can influence the traders to procure and preserve quality hides and skins
* Hides/Skins Trader – Exporter
  - The exporter is aware of the requirements in trade and this information should be passed to traders.
* Tannery – Footwear/Leather goods manufacturer
  - To deal with issues of quality leather for quality end-products
* Tannery – Leather merchant – Footwear/Leather goods manufacturers

6.3: Private Sector Investments

Private sector investments are required and are discussed as below: These can be funded from other components of the MSME project.

Stakeholders in the Chain	Type of Investment
1. Livestock Trader(s)	• Transport vehicles as a group from a specified area
2. Hides and Skins trader	• Transport (pick-up) for collection of raw hides/skins • Credit for building improved bandas and curing facilities
3. Hides and skins exporters	• Credit for storage facilities
4. Tanners	• Credit for up-dating/renovation of tannery equipment • Credit for effluent treatment to meet NEMA standards.
5. Footwear/Leather goods manufacturers	• Credit for renovation of manufacturing equipment and purchase of additional equipment to meet the needs of a changing industry.
6. Jua Kali manufacturers	• Credit for centralized equipment in a manufacturing cluster • Credit for setting up a footwear/leather products wholesale market.

6.4: Strategic Objectives in Skills and Knowledge Transfer

In relation to the MSME project, the strategic objective of skills and knowledge transfer is as summarized in strategic matrix 1.

The public sector investments include provision of extension, capacity building and quality improvement for hides and skins and other investments is as analyzed in strategic matrix 2.

Strategic Matrix 1: 1: PROMOTE SKILLS AND KNOWLEDGE TRANSFER TO STAKEHOLDERS

Strategic Objectives	Constraints to be addressed	Programme Activities	Estimated Resources Requirements (US$)	Implementing Agencies
SO#1: Promote formation of Apex organization and revitalization of stakeholder associations	• Lack of linkages in the value chain • Inactive stakeholder associations at all levels	• Undertake seminars and workshops to create awareness • Create Secretariat for Apex organization • Provide seed money for Apex and associated organizations	US$50,000	MOLD (DVS), MTI, MSME Stakeholders, ESALIA
SO#2: Promote skills development at all links of the chain	• Many existing constraints at all links in the value chain	• Undertake specific studies to identify pilot projects and BDS at each link	To be determined after link specific studies	Proposed Apex Association/Stakeholders, MSME/PPMT, MOLD/MTI
SO#3: Access to finance by stakeholders in the leather value chain	• Inadequate finance for working capital, new equipment and renovation	• Create awareness of MSME financial products (FSD, SME risk capital) and organizations involved (BPI and participating banks)	As per stakeholders requirements and capability to repay	MSME, MTI

Strategic Matrix 2: PUBLIC SECTOR INVESTMENTS IN THE LEATHER SUPPLY CHAIN

Overall objective: Promote Production of Quality Hides and Skins and Increased Value Addition up the Value Chain

Strategic objective	Constraints	Programme Activities	Estimated Resources Requirements (US$)	Implementing Agencies
SO#1: Promote improved production and handling of hides and skins at farm slaughter, curing and storage levels	**1. Farm Level** - Poor husbandry producing smaller hides and skins - Poor ectoparasite control - Poor farm slaughter operation **2. Slaughter Level** - Improper skinning/flaying - Inadequate preservation - Inadequate supervision **3.Procurement Level** Limited information on grades and prices Poor storage of hides and skins in bandas Monopolistic buying due to licencing procedure	- Launch a training/extension programme at community/producer level - Launch a training/extension programme for slaughter men and slaughterhouse operators at 2000 slaughter slabs - Training of 970 licenced traders and improvement of 1,000 sheds	US$7.5mi/five years	VSD/MOLFD/Donors (UNIDO-ESALIA, CFC, FAO, EU) VSD/MOLFD VSD/MOLFD

SO#2: Improve Utilization of tanning existing capacity, renovation and acquire new technology for finished leather	- Low duties on imports - High duties on tanning chemicals and inputs - Old technology	- Impose duty on leather imports and exports of raw hides/skins (40%) - Zero-rate duties on tanning chemicals and inputs - Acquire modern tanning technology (Create a soft credit fund)	US$2mi	MOF, MOLFD, MTI, Donors, ESALIA, MSME
SO#3: Promote increased production of leather goods for domestic consumption and exports	- Diminishing number of technical skills in design and manufacturing - High production costs - Competition by imported new and second-hand leather goods	- Training programme at AHITI and Leather Development Centre – TPCSI -Thika - Government policy on electricity and fuel - Zero rate duties on input - Impose 40% duty on imported leather items	US$3mi	MOLFD, ESALIA-UNIDO, Donors, MOLD, EPC, MTI MOF MOF MOF
SO#4: UP-grade skills for technology transfer	- Inadequate number of skilled personnel in all aspects of leather technology	- Undertake a training programme to develop Diploma, BSc, MSc and PhD either locally or internationally	Kshs.4.77mi (US$80,000) per year to train various categories of personnel	MOLD,UON, MSME/Donors

Annex 1: Summary of each country's situation before the project

Country	Situation
Botswana	85 percent of skins did not enter the formal market mainly because of poor price incentives.
	Lower prices were offered to smallholder farmers compared to established commercial holdings
	Lack of standardized quality grading systems
Malawi	Poor preservation methods and facilities – High prevalence of ground-drying of hides and skin.
	Lack of organized market system – Thriving, illegal hides and skins trade.
	Lack of organized collection system
	Inadequate slaughterhouse equipment e.g. lack of hoisting equipment, flaying knives, poor flaying techniques
	Lack of price incentives
	Non-functioning Leather Association of Malawi (LAM)
Zambia	Poor preservation methods and facilities
	Lack of an organized market
	Lack of organized collection system – uncollected/wasted: 40% hides, 80% skins
	Inadequate slaughterhouse equipment e.g. lack of hoisting equipment, flaying knives, poor flaying techniques
	Lack of price incentives
	Lack of standardized quality systems
	200 – 2003: Utilization of installed tannery capacity was between 45% - 50%
	Poor flaying techniques, inadequate flaying tools and lifting devices
Zimbabwe	Poor preservation methods and facilities
	Lack of an organized market system
	Lack of organized collection system
	Inadequate slaughterhouse equipment e.g. lack of hoisting equipment, flaying knives, poor flaying techniques
	Lack of standardized quality grading systems: buyers/collectors of hides used grading criteria known only to themselves which they keep secret from the sellers/producers of the hides offering low/poor prices.
	Existing hides and skins storage facilities operated below capacity due to under-utilization by the stakeholders.
	Sharp increase in the price of salt witnessed a reduction in wet salting.

Source: Commercialization of Hides and Skins Project (CFC, FAO, ESALIA 2007)

Yours Sincerely,

For: **Matching Grant Management Team**

Anthony Getambu (PhD)

Team Leader