

## Leather & Footwear – Executive Summary

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The Leather & Footwear industry holds a prominent place in the Indian economy given its large social and economic contribution. It is an employment intensive sector, providing job to about 2.5 million people, mostly from the weaker sections of the society. Women employment is predominant in leather products sector with about 30% share.<sup>1</sup> The annual turnover of Indian leather & footwear sector was US\$7.5 billion in 2011-2012 and has been growing steadily at around 8% per year since last 5 years. Although, currently contribution of this sector to total GDP is less than 1%, this sector has all the basic attributes (like abundance of raw-material, basic skill sets etc.) to contribute highly in India's manufacturing output.

Leather sector consists of four segments viz. Footwear; finished leather; saddlery& harness; leather apparel; and leather goods; 'Leather footwear' and 'Leather apparel & goods' segments have been the engines of growth of the global leather & footwear industry. Leather footwear leads the pack with global exports of US\$ 91.37 billion in 2010 followed by leather apparel & goods with global exports of US\$ 20.61 billion in 2010. Finished leather stood third with global exports of US\$ 8.79 billion in 2010, while saddlery& harness had the least global exports within the leather & footwear sector of US\$ 1.09 billion in 2010. Same trend has been witnessed in Indian leather industry. India's total exports for the sector stood at US\$ 3.7 billion in 2010<sup>2</sup>, out of which footwear and leather apparel & goods segments contributed to more than 75% to the total exports (44% and 32% respectively). Given the current and expected future contribution of these segments, improvements in these two segments are expected to have far reaching and large impact on overall competitiveness of the Indian leather & footwear industry.

Leather footwear and Leather apparel & goods segments have three core manufacturing processes viz. Hide processing, Tanning & finishing, and production of finished product (Cutting, skiving, assembling, stitching, lasting, and pasting). India is relatively strong in hide processing and has ample raw material for subsequent steps of leather value chain, therefore it is imperative that focus should be given on tanning/finishing and final processing (cutting, skiving, assembling, stitching, lasting etc.) to increase the overall competitiveness of the Indian leather& footwear industry.

The world leather footwear market is dominated by China. Vietnam and Italy are the other competitive countries, serving some of the major import markets like Germany, France, Switzerland, and Austria. China contributed to 36% to the global footwear exports of US\$ 99 billion in 2010 and maintained exports CAGR of around 13% for the period 2005-10. Italy and Vietnam each contributed to around 9% to the global exports of leather footwear in 2010. However Vietnam has witnessed highest exports CAGR of 21% for the period 2005-10.

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The world leather apparel & goods market is also dominated by China. Italy, France and Pakistan are the other competitive countries, serving some of the major import markets like Germany, U.K. and

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<sup>1</sup>Council of Leather Exports

<sup>2</sup> International Trade Centre Trade Statistics, D&B Analysis

Australia. China is the largest exporter of leather goods and apparel globally contributing to around 40% to global leather apparel & goods exports of US\$ 47.8 billion in 2010. Italy was second with contribution of 10% to the global leather apparel & goods segment in 2010.

China's leather industry growth can be attributed to the first wave of economic reforms in 1978 with rapid development of Town and Village Owned Enterprises (TVEs) and second wave with foreign firms investing in China. Incentives for Foreign Invested Enterprises (FIE), which included subsidized land and power, reduction of import duties, tax holidays etc. has boosted Chinese exports manifold. Further, the cluster based approach has allowed Chinese companies to produce and deliver large volumes of footwear per order in most cost efficient manner. The close geographical location of similar manufacturers in the cluster enables efficient handling of production and delivery, sharing of investment cost of building facilities and other infrastructure like Common Effluent Treatment Plants, and reduction in shipping costs between suppliers and manufacturers. China has also been able to overcome technical barriers of trade in key international markets like Europe & the USA.

Pakistan's success lies in aggressive government schemes for enhancing exports of leather sector. Further, Pakistan has benefitted from better quality hides & skins which improve the overall quality of their leather. Environmental policy framework and focussed schemes for R&D and design have also boosted global competitiveness of its leather industry.

Vietnam's market access advantage to the Europe and USA on account of various bilateral trade agreements (BTA) has been one of the key reasons for building the export competitiveness. Further, Vietnamese government has given a priority to development of raw materials and accessories for the industry which has benefitted the productivity and efficiency of its leather industry.

Italy's competitiveness lies in its design & marketing capabilities. Italy has also benefitted from the successful cluster operations with each cluster specializing in its field of production (tannery, footwear, leather handicrafts etc.)

A comparative assessment of Indian leather & footwear industry vis-à-vis that of competing countries point out to the following key points:

**1. Unorganised industry structure lowers India's competitiveness vis-à-vis major exporting nations**

USA is the largest global import market for leather footwear, but it does not figure amongst the top markets for India as almost 85% of Indian footwear manufacturers are very small in size that cannot compete with huge factories of China in low-price mass production and hence lose out on huge orders placed by the US clients. The primary reason for the unorganised and small scale setup of Indian leather industry is the historical restrictions of licensing and SME reservation of the sector until 2001. Further, majority of companies in the Indian leather and footwear sector are proprietorship or partnership firms, which generally have a lower risk appetite and are usually unwilling to undertake major capacity expansions. Consequently, no significant capacity expansions have occurred in the industry over the last decade. On the other hand, industry reforms in China during eighties and nineties involving large scale privatisation and liberalisation attracted huge investments in the sector and contributed in establishing large scale businesses. Thus, while China boasts of hundreds of factories producing million pair of shoes annually, there are only handful companies of that scale in India.

**2. Foreign investments have played a major role in bolstering exports of competitors**

Indian leather sector has witnessed extremely low FDI, which generally brings in state-of-the art machinery, best practices in the industry and efficiencies in operations. Indian leather industry has

managed to attract a mere Rs.268 crore foreign direct investments since 2000. This constitutes a tiny 0.04 per cent of the total FDI inflows received by India. China on the other hand, has provided a favourable climate for Foreign Invested Enterprises (FIEs) in the form of flexible policies, reduced tax structure and other incentives. Consequently, several FIEs (especially from Hong Kong and Taiwan) have invested in the leather industry and currently account for majority share in the export of leather products. Some of the incentives provided by China include two years tax exemption for FIEs from the date they make profit and 50% tax exemption for the next 3 years; export tax refund of 15~17% for leather products till 2004 and 13% till 30-June-2007; and additional 10% tax exemption for firms which export more than 70% of its products. Further, China has taken business facilitation measures like delegation of the power to local authorities to approve foreign investment; and one - stop centre/single window for getting all approvals within a few days for foreign investment into China. Similarly, Vietnam's footwear industry has recorded unprecedented growth following the economic reforms and policies that encouraged FIEs to set up their factories in Vietnam. The Vietnamese government encourages foreign investors through various tax and non-tax incentives to invest in a variety of leather related projects such as supplying and production of footwear materials, components and accessories, setting up institutes for shoe technology, design development, training of human resources, service centres and waste treatment system for tannery and footwear enterprises.

### **3. Tax incentives and leather specific policies have provided a thrust to the sector's growth**

Almost all leather and footwear manufacturing countries have initiated various tax and non-tax incentives for the sector's growth and development. Pakistan, for instance, has earmarked special export investment fund for the leather sector that would enable sector firms to establish various facilities and hence improve their competitiveness; the fund would be used for providing grants to various sub-segments of leather for a variety of purposes including establishing design studios, setting up of effluent treatment plants, setting up labs in tanneries and installing flying machines. Vietnam had also put forth a master plan for development of its leather and footwear industry by 2010, which accorded priority to development of raw materials and accessories for the industry as the country had high import dependence for raw materials and semi-finished products (tanned leather, heels, accessories, chemicals, glues, etc.), which put it at a disadvantage in relation to countries like China in terms of production costs. The French government places high importance to research and development and thus various R&D related tax exemptions are available to enterprises. Some of the popular instruments include the Research Tax Credit (*CIR*), the 'innovative start-up scheme', funding by the Innovation Agency (*OSEO*) and support to 'Competitiveness clusters'. Such policies and tax incentives are lacking in Indian leather industry.

### **4. Cluster development efforts have yielded high benefits in SME-intensive leather sector**

Cluster based approach has played an important role in building the competitiveness of leather footwear and leather goods manufacturers in China as well as Italy. Most of the SMEs in Italy operate through consortia, which support the small firms in areas where they are traditionally weak, such as finance or export. These consortia also receive government support at both national and local levels. In China too, both central and local governments provide support to the industrial clusters to build a favourable environment for improving competitiveness. Additionally, most units in China's leather clusters follow a collaborative approach for marketing, wherein huge export orders received by a unit are often collectively undertaken for timely completion and delivery. However in India, only a few clusters like Chennai and Kolkata leather clusters have largely benefited from developmental initiatives while several other clusters are yet to be developed in a similar fashion. Moreover, in contrast to China, there is a lack of collaboration and co-ordination among units within a cluster in India, which generally limits the capacity of units to produce large volumes per order and also results in high wastage across the supply chain, thereby affecting their international competitiveness.

#### **5. Most competitive nations provide huge export incentives**

All countries have introduced several incentives for their exporters to render them competitive in the global market. However, the types of incentives offered by competing countries are comparatively higher than that offered by India. China offers its exporters full rebate of excise duties, high rebate rates for VAT, exemption of import tariffs and refund of local income tax, amongst several other incentives. Vietnam provides several incentives to foreign and domestic enterprises such as tax holidays, lower income tax, refund of import duties, duty free import of machinery, etc. Pakistan too provides benefits like tax holidays, indefinite carry forward of losses, duty-free imports, and no import restrictions. Further, exporters in Pakistan are also assisted via general schemes such as freight subsidy, concessionary finance, tariff concessions on raw materials, intermediate inputs and equipment used in manufacturing products for export, tariff refunds, duty drawback scheme and duty and tax remission for exports (DTRE) scheme. Sector specific schemes have also been introduced such as R&D subsidy and freight subsidy for leather garments and footwear. In contrast, export incentives provided in India are mainly in the form of duty drawback, duty credit for exports to focused markets and duty free imports of inputs.

#### **6. Trade agreements provide easy market access to several competing countries**

The free trade agreements signed by various competing countries with the western and regional markets provide an easy market access for their exports of leather products. Vietnam's bilateral trade agreement with the US has helped Vietnam in gaining strategic access to the world's largest market for leather footwear. China does not have any FTA with the US or the Europe but it enjoys trade advantage in the Asian market partly due to its agreements with the ASEAN countries. Similarly, Pakistan has signed FTAs with China, Sri Lanka as well as other countries, which has enabled duty free or concessional duties access for various products including leather products to these markets. India too has actively engaged in various free trade agreements in the recent past. However, it does not enjoy preferential access to the major markets like the US and the EU.

#### **7. Meeting environmental standards enhances international competitiveness**

Leather industry raises environmental concerns due to high degree of pollution caused during the manufacturing activity. Consequently, the imports of leather products in major markets are subjected to stringent norms. Indian leather industry ranks low in terms of adhering to the strict environmental norms and thus is subjected to entry barriers in the major developed markets like EU and the US. A large number of tanneries in India are not modernized (due to small scale and lack of adequate funding) and thus in recent years, several tanneries have been closed on environmental considerations. In contrast, tanneries in China and other major competing countries have invested significant amounts of funds in large tanneries. Furthermore, China Leather Industry Association (CLIA) has developed and registered a certification trademark, 'Genuine leather mark', which is subject to implementation of strict standards equivalent of international standards and is thus internationally accepted. Adherence to strict environmental norms has thus increased the competitiveness of Chinese leather exporters in the international markets.

#### **8. Costs and availability of critical input material- raw material, manpower and technology**

While India has the highest buffalo population in the world and exports leather to various countries including China, still it doesn't have competency in raw material cost. The primary reason is lack of availability of high quality raw material (leather) from Indian abattoirs. Indian manufacturers of leather products have reported frequent issues of cuts, marks on the skins etc. Due to this, India needs to rely on imports of high quality raw material. Further, there are reported issues of price regulations of hides & skins provided by abattoirs which further put cost pressures on manufacturers of finished

leather & leather products. Apart from these issues, limited availability of cow leather in India because of ban of cow slaughtering in various regions renders Indian firms with no choice but to rely on import of cow leather. Other inputs like synthetic leather, laces, PU soles, insole board, steel toe caps, metal fittings and accessories etc. have very limited indigenous production, due to which most of the manufacturers have to rely on imports which leads to increase in overall raw material cost. However, no government scheme has taken care of these concerns of Indian leather & footwear sector. On the other hand, Vietnam had forth a master plan for development of its leather and footwear industry, which accorded priority to development of raw materials and accessories for the industry as the country had high import dependence for raw materials and semi-finished products (tanned leather, heels, accessories, chemicals, glues, etc.), which put it at a disadvantage in relation to countries like China in terms of production costs.

### **9. Technological processes and innovation**

On comparing India's performance in R&D and technology and innovation as well, it has been observed that Chinese and Vietnamese firms are very active in developing & incorporating new product line while Indian firms have been most active in upgrading the existing production line. This is primarily because most of the firms in this sector are either small or medium enterprises having very little risk appetite and not inclined towards investing in newer technologies. There is very limited collaboration with industry and hence the research & development is not reaching the masses. Further, MSME's which constitute majority of leather & footwear industries in India have not been able to utilize the benefits of R&D efforts of Central Leather Research Institute (CLRI). On the other hand, competing countries have done a lot of work in the area of system improvement and R&D for leather sector. For instance, Conciaricerca Italia, the Italian organization promoted by UNIC, is active in research in Italy and supports projects concerning technological innovation, training and research in the chemical field with the aim of modernizing tanning processes. Further, to foster R&D, tax credit policy was established for research in December 2010 and subsequently replaced and strengthened, in May 2011, by a tax credit for companies financing research projects in universities or public research bodies'. Pakistan has also undertaken several steps in this area like establishment of Research & Development centres in Karachi and Sialkot by Pakistan Leather Garments Manufacturers and Exporters Associations for providing R&D support to Leather Garments & Leather Goods Exporters, sharing 25% financial cost of setting up labs in the individual tanneries, providing matching grant for setting up of effluent treatment plants in individual tanneries etc.

### **10. Transport & Logistics costs**

According to the World Bank Logistics Report, the logistics costs in China are very less as compared to India; China's infrastructure is ranked higher than India's infrastructure in all the sub-sectors (Electricity, Water, Roads and Ports) which helps in its development of trade. Furthermore, since most of the big leather clusters in India like Kanpur, Agra, and Delhi etc. are land-locked regions, transportation & logistics cost is higher in these areas especially for exports. Dearth of any schemes for subsidization of transportation has rendered these locations less cost competitive. However, no present scheme in India addresses these issues. Pakistan, on the other hand realizing that extra cost on inland transportation erodes export competitiveness of a range of its products has launched a scheme to compensate inland freight cost to exporters of cement, light engineering, leather garments, furniture, soda ash, hydrogen peroxide, sanitary wares including tiles, finished marble/ granite/ onyx products.

Based on analysis of the current status and international norms & standards, the gaps & issues in the Indian leather & footwear industry can be summarised as following:

S.No.	Areas	Issues
1	Scalability	Unorganized industry structure, being a major hindrance for low-price mass production and hence Indian Leather & Footwear manufacturers lose out on huge orders placed by the US, EU clients.
		Lack of backward Linkages with limited availability of key components and machinery leading impacting scales of production
		Inability to able to attract large FDI in part due to the erstwhile restrictions and reservations and partly due to operating constraints such as rigid labor market and relatively poor infrastructure. Lack of FDI backed with fragmented nature of sector is an impediment for large scale production
		Decline in animal husbandry leading to availability issues for high grade leather for leather footwear, apparel & goods industry. Further, availability of cow leather is an issue because of religious sentiments, therefore impacting production.
		Decline in new labor force(unskilled or semi-skilled) entering the industry
2	Cost Efficiency	Increasing demand supply gap between leather because of decline in animal husbandry, leading to increase in prices of raw-material.
		Dependence on imports for critical non-leather components like PU sole, insole board, steel toe caps, metal fittings etc. This leads to increase in raw-material cost
		Cost pressures on tanneries due to mandatory effluent treatment plant. This results in increasing cost of finished leather
3	Productivity Optimization	Issues in adhering to the external legislative requirements in EU & US markets like Minimum specified chemical limits (REACH standard), testing and certification req. etc. therefore making Indian firms less competitive in quality conscious markets
		Inadequate testing & certifying agencies in India is an impediment for Indian firms to conform to global quality norms
		Non-acceptance of goods by the buyer because of quality issues, or unfair trade practices leading to blocking of working capital of Indian firms
4	Quality Excellence	Hand cutting & knife de-skinning being employed in most of the abattoirs leading to quality issues with leather
		Lack of skilled people in the areas of dyeing , tailors, cutters & skilled master
		Inadequate testing & certifying agencies in India.
		Lack of investments in Research & design development
		Lack of awareness of quality norms and standards
5	Sustainability	Lack of awareness and knowledge about REACH standards
		Inadequate industry for recycling of solid effluent
		Inadequate Common Effluent Treatment Plants for tanneries
		Inadequacy in the primary treatment done at the tanneries and no monitoring system to measure the TDS level in the affluent

The analysis of various facets of the global and the Indian leather & footwear industry clearly shows that India needs to look at multiple interventions including in the areas of Regulatory framework, Investment policies, Trade policies, Fiscal policies, Infrastructure, R&D, Skill, Financing, Process, Collaboration and Technology. These interventions have been detailed in the main report.

However, recommendations only related to technology and research & development have been detailed which could form part of several schemes undertaken by Department of Science & Industrial Research in this section.

<b>Intervention 1 : Mechanization &amp; Quality Management in Abattoirs</b>	
<b>S.No.</b>	<b>Tasks</b>
1	Based on the base-line information of slaughterhouses and slaughter practices, a blue print for modernizing the existing slaughter houses and/or establishing modern slaughterhouses need to be prepared. Then according to the blue-print, the existing slaughterhouses across the country may be modernized / established. The scheme aims to enable access to knowledge for technology development and dissemination for modernization of abattoirs
<b>Intervention 2 : Support programs for R&amp;D in emerging technologies</b>	
<b>S.No.</b>	<b>Tasks</b>
2	<ul style="list-style-type: none"> <li>• Strengthen industry academia linkage for conducting joint R&amp;D. For the same, incorporate a research cell with equal participation of all the industry segments (Tanning, Leather Footwear, Leather Apparel &amp; Goods etc.) &amp; academia. There need to be different sub-cells within the body (One to take care of market issues &amp; identify areas for R&amp;D and another one to conduct the research assignments).</li> <li>• Announce fully sponsored projects for Industry for conducting research in emerging technologies. Some of them can be :                             <ul style="list-style-type: none"> <li>• R&amp;D to make buffalo leather as good as Cow leather.</li> <li>• R&amp;D in the area of ultra-thin leather.</li> <li>• R&amp;D to enhance the quality of finished leather etc.</li> </ul> </li> </ul>
<b>Intervention 3 : Increase competitiveness of Leather Tanning Sector</b>	
<b>S.No.</b>	<b>Tasks</b>
3	<p>Launch a scheme for: Planning, implementing and monitoring the program for increasing the competitiveness of the leather tanning industry which is based in key clusters like Chennai and Kanpur. The tasks that may be performed are:</p> <ul style="list-style-type: none"> <li>• Prepare a list of technologies pertaining to cleaner technologies, wastewater treatment, odour abatement, solid waste management etc.</li> <li>• Demonstration at Pilot scale on selected technologies at different training clusters.</li> <li>• Set up a committee also incorporating experts from countries like Germany, Italy etc. to organize training programs to comply with necessary standards like REACH.</li> </ul>
<b>Intervention 4 : Support for establishing common facilities to enhance collaboration among SMEs</b>	
<b>S.No.</b>	<b>Tasks</b>
4	<p>Launch a scheme to support common facilities in the key clusters to enhance collaboration among Indian SMEs. The cost can be shared between government and the industry. Some of the facilities that need to be provided are:</p> <ul style="list-style-type: none"> <li>• Shared Marketing &amp; Business Development agency to take large export orders which can be undertaken by number of SMEs.</li> <li>• Shared testing &amp; certification centre for accurate and relevant evaluation of leather products in India to satisfy the stringent and critical requirements of performance related products parameters in the global market etc.</li> </ul>
<b>Intervention 5 : Scheme for encouraging setting up modern Waste Recycling Plants to Produce Products such as Bio-Diesel, Soap and Cosmetics</b>	
<b>S.No.</b>	<b>Tasks</b>
5	<p>The technology development &amp; demonstration scheme needs to undertake following activities:</p> <ul style="list-style-type: none"> <li>• Research on proven technologies of solid waste recycling. Detailed project reports on those technologies may also be prepared.</li> </ul>

	<ul style="list-style-type: none"> <li>Set up a model factory layout for the recycling plant having facility to perform thermo and mechanical processing on fatty meat pieces, scraped from leather in the factories so as to extract water (to be sent back to factories), fat (to be sent for manufacturing of cosmetics, soap &amp; bio-diesel) and protein (to be sent to cattle breeding farms for feeding of cattle) and other possible by-products.</li> <li>Invite proposals from individual innovators/incubates and support shall be extended to approved projects</li> <li>Financial Assistance for firms setting up recycling units</li> </ul>
<b>Intervention 6 : Database &amp; technology support to SMEs</b>	
<b>S.No.</b>	<b>Tasks</b>
6	<p>Provide database &amp; technology support to domestic firms in the following areas:</p> <ul style="list-style-type: none"> <li>Quality standards followed globally for various products.</li> <li>Technology- and innovation-related international journals from major publishers.</li> <li>Country wise SOPs for certifying/testing the products.</li> <li>Details of testing infrastructure available in India and globally. The details need to include testing labs availability and tests conducted by them, machinery employed for testing, fees for conducting the tests etc.</li> <li>Database of industry experts (either retired or from the industry) who can be contacted by domestic firms for any kind of technical support required. For the same, profiles of the experts need to be invited and kept in a repository.</li> </ul>
<b>Intervention 7 : Focused scheme to improve certification of Indian products</b>	
<b>S.No.</b>	<b>Tasks</b>
7	<p>Various tasks that need to be performed are:</p> <ul style="list-style-type: none"> <li>Focused scheme to create an 'Indian Leather Mark' that will standardize Indian Products making them Competitive in the Domestic as well as Global Markets.</li> <li>Development of a "quality manual and accreditation scheme" which defines the quality standards which applicants will be required to meet in order to be accepted in the program and for use of the 'Indian Leather Mark'.</li> <li>Development of an agency need to undertake training programs so that technological know-how and awareness is provided to enterprises willing to go for the 'Indian Leather Mark' certification</li> </ul>

The interventions mentioned above are further prioritized on the basis of their role in fulfilling various objectives\* of the Government of India for the growth of the manufacturing sector. Each intervention is tagged with the objective that it may help achieve. The intervention impacting maximum number of objectives has been prioritized for implementation.

\*These objectives have been picked up from "PM's Group Report on Measures for Ensuring Sustained Growth of The Manufacturing Sector", "National Manufacturing Policy 2006" and "National Manufacturing Policy 2011".



Intervention	Government Objectives				
	Employment	Technology Adoption	Skill development	Building Strong Capacity & Scale	Local Value Addition
Mechanization & Quality Management in Abattoirs		✓	✓	✓	✓
Database & technology support to SMEs		✓	✓		✓
Scheme for encouraging setting up modern Waste Recycling Plants to Produce Products such as Bio-Diesel, Soap and Cosmetics	✓	✓			✓
Support programs for R&D in emerging technologies		✓	✓		✓
Support for establishing common facilities to enhance collaboration among SMEs		✓	✓	✓	
Increase competitiveness of leather tanning sector		✓	✓		
Focused scheme to improve certification of Indian products		✓	✓		

## Leather & Footwear: Innovative Framework

