

A 1090 Vienna, Sensengasse 3, Austria
T +43 1 3174010 F -150
E office@oefse.at | www.oefse.at

**AUSTRIAN FOUNDATION FOR
DEVELOPMENT RESEARCH**

Value Chain Analysis for Leather Products from Ethiopia

**Jan Grumiller, Werner Raza, Shamel Azmeh, Rachel Alexander and
Tewodros Yilma**

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ABBREVIATIONS

AAIT	Addis Ababa Institute of Technology
ADLI	Agricultural development led industrialization
ADPLAC	Agriculture Development Partners Linkage Advisory Council
ALLPI	African Leather and Leather Products Institute
ATA	Agricultural Transformation Agency
ATVET	Agricultural Technical and Vocational Education and Training
CAWEE	Center for Accelerated Women's Economic Empowerment
CBI	Center for the Promotion of Imports from Developing Countries
CITES	Convention on International Trade in Endangered Species of Wild Fauna and Flora
CMT	Cut-make-trim
COMESA	Common Market for Eastern and Southern Africa
CSR	Corporate social responsibility
DBE	Development Bank of Ethiopia
DFID	U.K. Department for International Development
DOT	Diocetyl tin
EBA	Everything But Arms Initiative
EC	European Commission
ECBP	Engineering Capacity Building Program
ECHA	European Chemicals Agency
ECO ₂ L	Energy Controlled Leather
EDDC	Ethiopian Domestic Distribution Corporation
EHL	Ethiopia Highland Leather
EIC	Ethiopian Investment Commission
EIFCOOS	Ethio-International Footwear Cluster Cooperative Society
EIIDE	Ethiopian Industrial Inputs Development Enterprise
ELIA	Ethiopian Leather Industries Association
EPA	Ethiopian Privatization Agency
ERCA	Ethiopian Revenue & Customs Authority
ERHSSA	Ethiopian Raw Hides and Skin Suppliers' Association
EU	European Union
EUR	Euro
FC	Farmer cooperative
FDI	Foreign direct investment

FeMSEDA	Federal Micro and Small Enterprises Development Agency
FeSMMIDA	Federal Small and Medium Manufacturing Industry Development Agency
FOC	Free of chrome
FTC	Farmer training center
GTI	Green Tanning Initiative
GTP	Growth and Transformation Plan
GVCs	Global Value Chains
IDS	Industrial Development Strategy
IPDC	Industrial Parks Development Corporation
ISO	International Organization for Standardization
ITPO	UNIDO's Investment and Technology Promotion Office
JICA	Japanese International Cooperation Agency
LICs	Low-income countries
LIDI	Leather Industry Development Institute
LISEC	Leather Initiative for Sustainable Employment Creation"
LLP	Leather and leather products
LLPTI	Leather and Leather Products Technology Institute
MOoEFCC	Ministry of Environment, Forest and Climate Change
MOI	Ministry of Industry (the former Ministry of Trade and Industry)
MOLSA	Ministry of Labor and Social Affairs
NACE	Nomenclature statistique des activités économiques dans la Communauté européenne
NARS	National Agricultural Research System
OBM	Original brand manufacturing
ODM	Original design manufacturing
OEM	Original equipment manufacturer
PAH	Polycyclic aromatic hydrocarbons compounds
PBB	Polybrominated biphenyls
PEPE	Private Enterprise Programme
PFOA	Perfluorooctanoic acid
PMO	Prime Ministers' Office
PoPs	Persistent organic pollutants
REACH	Registration, Evaluation, Authorization, and Restriction of Chemicals
ReMSEDA	Regional Micro and Small Enterprises Development Agency
RoOs	Rules of Origin

SMEs	Small and medium enterprises
TTF	Transformation Triggering Facility
UK	United Kingdom
UN	United Nations
UNIDO	United Nations Industrial Development Organization
USD	US Dollar
USP	Unique selling point
WEA	Women Entrepreneurs Association
WTO	World Trade Organization

EXECUTIVE SUMMARY

Structural transformation and export diversification into higher value-added products and away from primary commodities remain major development objectives for low-income countries (LICs). Sectors such as apparel or leather products have traditionally been gateways to export diversification for LICs and are generally regarded as first steps for developing countries embarking on an export-oriented industrialization process. Given their rather low entry barriers (low fixed costs and relatively simple technology) and labor-intensive nature, the sectors can absorb large numbers of unskilled workers and provide upgrading opportunities into higher value added activities within and across sectors. However, the defining characteristics of these sectors also mean that they are very competitive, leaving many suppliers with limited leverage and challenges in ensuring social and environmental compliance and longer term development benefits.

In Ethiopia, the objective to transform from the still dominant agricultural sector to the industrial sector is paramount in policies. Agricultural development led industrialization (ADLI) was promoted as the main guiding principle of Ethiopia's development process and the leather and leather products (LLP) sector was identified as one of the main priority sectors. Ethiopia has adopted an active, state driven industrial policy aimed at linking the LLP sector to global value chains (GVCs).

The LLP GVC represents a classic example of a buyer-driven value chain which is characterized by decentralized, globally dispersed production networks, coordinated by lead firms, which control activities that add "value" to products (e.g., design, branding), but often outsource all or most of the manufacturing process to a global network of suppliers. Similar to other industries, the LLP GVC has experienced important geographical and organizational shifts in the last few decades. These shifts entailed further participation of developing and emerging economies in the transformative stages of the industry, beyond the supply of hides and skins for manufacturing in the advanced economies, and are reflected in increasing global trade values over time. China, in particular, has emerged as a key location for the manufacturing of leather products.

In addition to the long-term trade growth due to geographical and organizational shifts in the LLP GVC, three further major trade trends can be identified in the last decade. First, LLP trade growth by value has slowed down since 2009, with the important exception of leather bags. Second, global trade of LLP by value has decreased since 2014 due to falling retail prices and a shift in consumption patterns in key markets, in particular a trend towards the use of synthetic materials. It remains to be seen whether or not this trend will continue in the near future. Third, China's market share in key consumption markets has been decreasing in the last few years.

The EU remains an important player in the global leather trade as both an importer and an exporter of LLP. The LLP industry has, however, experienced significant changes over the last few decades. Similar to apparel, a growing percentage of leather products consumption is now met through imports. The dynamics of EU imports were similar to global trends, with increasing imports in the last two decades, a slowdown since 2009 and – depending on the product – partially negative growth rates since 2014. China enjoys a dominant position in many market segments in the EU, but its share is decreasing. A number of EU countries maintain relatively large leather manufacturing sectors, in particular Italy, which managed to build a very strong position in the high-value added luxury segment of the market.

This report argues that the shifting LLP GVC dynamics and China's decreasing global supply of leather products opened a window of opportunity for low cost countries such as Ethiopia to link to GVCs and increase exports to key markets like the EU. Even though global and EU trade development have been sluggish, Ethiopia could increase its market share if the sector's competitiveness can be increased. Ethiopia has, in addition, not only market opportunities in key consumption markets, but also in regional markets in Africa with high growth potential and in the relatively large local market.

Exporting to the EU is highly demanding and buyer requirements as well as profitability differ across value chains. This report has identified seven value chains for leather products in the EU, differentiated by market segments (luxury, mid-high end, mass market branded and mass market unbranded) and the Ethiopian companies' specific integration and function in the value chain (cut make trim – CMT, original equipment manufacturer - OEM, original brand manufacturer – ODM, etc.). These value chains represent different pathways that – theoretically – could be taken by Ethiopian producers. Some of these value chains are characterized by low margins, but integrating in such chains can nonetheless have important learning effects and support manufacturers in exporting to markets with higher margins in the future.

In order to take advantage of the opportunities, the key bottlenecks in the LLP sector need to be mitigated. Some constraints are structural in nature and will take time to be fully resolved. Reducing key bottlenecks on a step-by-step basis will nonetheless suffice to link to GVCs and gradually increase exports. The key bottlenecks include the limited supply and quality of raw hides and skins; the limited supply of export-quality finished leather to local manufacturers in the necessary consistency; and the limited capacities and capabilities of locally-owned manufacturers to link to GVCs and fulfil buyers' requirements. Improving the horizontal and vertical cooperation in the sector and the development of a common export strategy will be crucial in order to fulfil the high requirements of EU buyers.

The lack of capacities and capabilities of locally-owned manufacturers to link to GVCs and fulfil buyers' requirements highlights the importance and potential of supporting measures as offered by CBI. This report has identified Ethiopian footwear, handbags and – potentially in the future – gloves as high potential leather products for increasing exports of locally-owned manufacturers to the EU. We argue that footwear and handbag manufacturers need to link to different value chains in the EU, given the different structure of the leather sub-sectors in Ethiopia and the varying buyers' requirements in specific value chains. The generally larger footwear manufacturers are more likely to succeed in the branded-mass market (CMT/OEM), and to a more limited extent, in the mid-high end market segments (OEM). Handbag manufacturers, on the other hand, are relatively smaller in size and are more likely to link to the mid-high end market segments (OEM).

If CBI implements a project in support of locally-owned leather manufacturers in Ethiopia, it is also important to ensure its sustainability and maximize its impact. Linking up to existing government policies and objectives, as well as to donor activities and coordination platforms will be a key factor to avoid redundancies, identify complementarities and maximize the impact of CBI's program. In addition, CBI should assess whether or not one of the proposed models for the institutionalisation of its program is feasible in order to make its intervention more sustainable.

1. INTRODUCTION

Structural transformation and export diversification into higher value-added products and away from primary commodities remain major development objectives for low-income countries (LICs). Sectors such as apparel or leather products have traditionally been gateways to export diversification for LICs and are generally regarded as first steps for developing countries embarking on an export-oriented industrialization process. Given their rather low entry barriers (low fixed costs and relatively simple technology) and labor-intensive nature, the sectors can absorb large numbers of unskilled workers and provide upgrading opportunities into higher value added activities within and across sectors. However, the defining characteristics of these sectors also mean that they are very competitive, leaving many suppliers with limited leverage and challenges in ensuring social and environmental compliance and longer term development benefits.

In Ethiopia, the objective to transform from the still dominant agricultural sector to the industrial sector is paramount in policies. Agricultural development led industrialization (ADLI) was developed as the main guiding principle of Ethiopia's development process. The underlying idea was that Ethiopia's manufacturing sector should complement the growth of the country's dominant agricultural economy, focusing on labor intensive and low-tech industries with linkages to the agricultural sector. One of the main priority sectors is the leather and leather product (LLP) sector given its direct links to agriculture through the livestock sector as well as its labor intensity, relatively simple technology and large export potential. Ethiopia has adopted an active, state driven industrial policy aimed at incentivizing exports, linking to global value chains (GVCs), attracting lead firms and foreign direct investment (FDI), supporting local firms, and creating local linkages to promote priority sectors. As a result, the Ethiopian LLP sector has experienced significant growth dynamics in production, employment and exports as well as upgrading processes in recent years. Despite many remaining constraints throughout the value chain that hamper growth in exports and the positioning of Ethiopia as a sustainable sourcing destination.

Given the high potential of the sector, the Center for the Promotion of Imports from Developing Countries (CBI) is currently assessing whether or not to support locally-owned leather manufacturing small and medium enterprises (SMEs) to increase exports to the EU. The CBI program could provide support in the following areas:

1. Strengthening the sector by capacity building of various stakeholders and strengthening collaboration between stakeholders.
2. Enlarging the export capacities of businesses with a product offer matching the needs of European buyers.
3. Enlarging the visibility of the variety of products Ethiopia has to offer in the international markets.

This report provides a value chain analysis and presents the opportunities and challenges of the Ethiopian LLP sector in order to better assess whether or not such a program is suitable. The structure of the report is as follows: Chapter 2 gives a brief overview of the LLP GVC dynamics and recent developments. In chapter 3, we analyze the EU's LLP value chains by discussing different products, market segments and value chain dynamics as well as buyers' requirements. Chapter 4 discusses the Ethiopian LLP sector's recent development and structure. In Chapter 5, the opportunities and challenges of Ethiopia's LLP sector are presented and policy recommendations are developed thereafter, in Chapter 6. In Chapter 7, we present the key findings of our study.

2. THE LLP GVC

The LLP GVC represents a classic example of a buyer-driven value chain which is characterized by decentralized, globally dispersed production networks, coordinated by lead firms which control activities that add “value” to products (e.g., design, branding), but often outsource all or most of the manufacturing process to a global network of suppliers (Gereffi 1999). Although buyers are usually not directly involved in production, they yield significant control over manufacturers and stipulate often detailed product and production specifications. The strategies of lead firms/buyers, in particular their global sourcing policies related to costs, quality, lead times, market access, flexibility and compliance, importantly shape production and trade patterns as well as upgrading opportunities in the LLP sector.

Dimensions for producers to upgrade to higher value-added activities within GVCs include process, product, functional and end market upgrading. The steps in the functional upgrading trajectory¹ from cut-make-trim (CMT) to original equipment manufacturer (OEM) and further to original design manufacturing (ODM) and original brand manufacturing (OBM) can be used to define categories of leather product manufacturers (Gereffi/Frederick 2010; Staritz 2012).

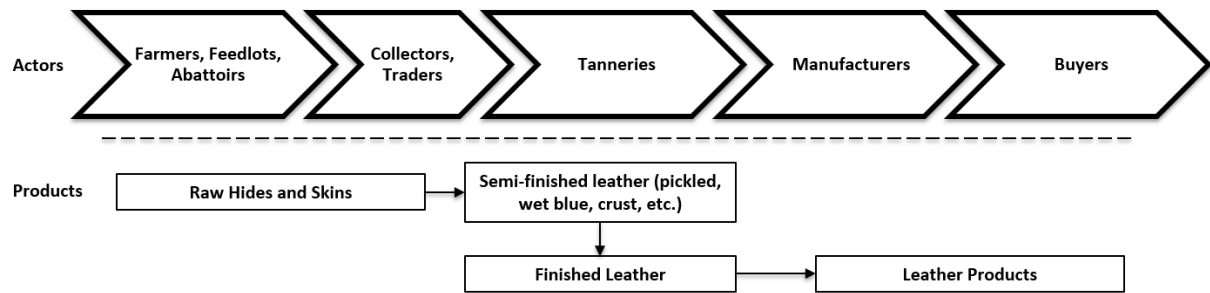
The LLP value chain can be roughly divided into five key segments (Figure 1): (i) the livestock sector and slaughterhouses, where hides and skins are collected; (ii) collectors and traders of raw skins and hides; (iii) tanneries, which transform raw hides and skins into semi-finished and finished leather; (iv) leather manufacturers, who produced various types of leather products; and (v) buyers (intermediaries, branders, retailers, etc.), responsible for distribution and sales channels at the wholesale and retail levels. Different leather items are traded locally and internationally at different points in the value chain.

In general, the raw hides and skins are a by-product of meat production and sold to tanneries by intermediaries. Tanning combines various processing steps from preparatory stages, tanning, crusting to finishing.² Many tanneries in the global (semi-)periphery are not able to perform all processing steps and only produce lower value and semi-processed leather (e.g. wet blue, wet white, crust, etc.). The finished leather is used to produce various leather products for a variety of end-use markets (footwear, apparel, bags, car-interiors, furniture, etc.). In contrast to the very labor-intensive manufacturing sector, leather processing in tanneries is more capital and scale intensive.

¹ An assembly or CMT manufacturer is responsible for manufacturing leather and may be responsible for cutting the leather and sourcing simple trim (buttons, zippers, etc.). The buyer provides product specifications and the leather. The leather factory is paid a processing fee rather than a price for the product. A FOB or OEM supplier purchases (or produces) the leather inputs and provides all production services, finishing, and packaging for delivery to the retail outlet. The customer provides the design and often specifies leather suppliers. An ODM is involved in the design and product development process, including the approval of samples and the selection, purchase and production of required materials. The last upgrading step in this trajectory is OBM, where suppliers develop their own brands and are thus also in charge of branding and marketing (Gereffi 1999).

² Leather products after tanning are termed wet blue or wet white. Leather products after crusting are termed crust. Leather products after finishing are termed finished leather. The processing stages in tanneries include the removal of the salt that farmers use to avoid bacterial action, swelling up (soaking), unhairing (liming), removal of flesh (fleshing), the cutting of the edges (trimming), splitting of the leather into a grain and flesh side (splitting), deliming/bating/pickling (treatment of the leather, e.g. to improve the effects of tanning) and tanning (chrome or vegetable tanning). At this stage, the leather is neutralized (removal of acids) and dried (wringing). After, the leather can be retanned, dyed (colored), fatliquored, dried, softened and – depending on the specifications of the buyer – finished (e.g. color effects, embossing, adjusting gloss level, etc.).

Figure 1: The LLP GVC



Source: Own elaboration.

Similar to other industries, the leather industry has experienced important geographical and organizational shifts in the last few decades. These shifts entailed further participation of developing and emerging economies in the transformative stages of the industry, beyond the supply of hides and skins for manufacturing in the advanced economies, and are reflected in increasing global trade values over time (Figure 2). China, in particular, has emerged as a key location for the manufacturing of leather products. This rise of China involved growing exports of semi-finished and finished leather from other parts of the world to China where these inputs are transformed and then exported to different markets including countries from where the leather was sourced. Similar to other industries, such shifts were reflected in the growth of imports of leather products in a number of key global markets.

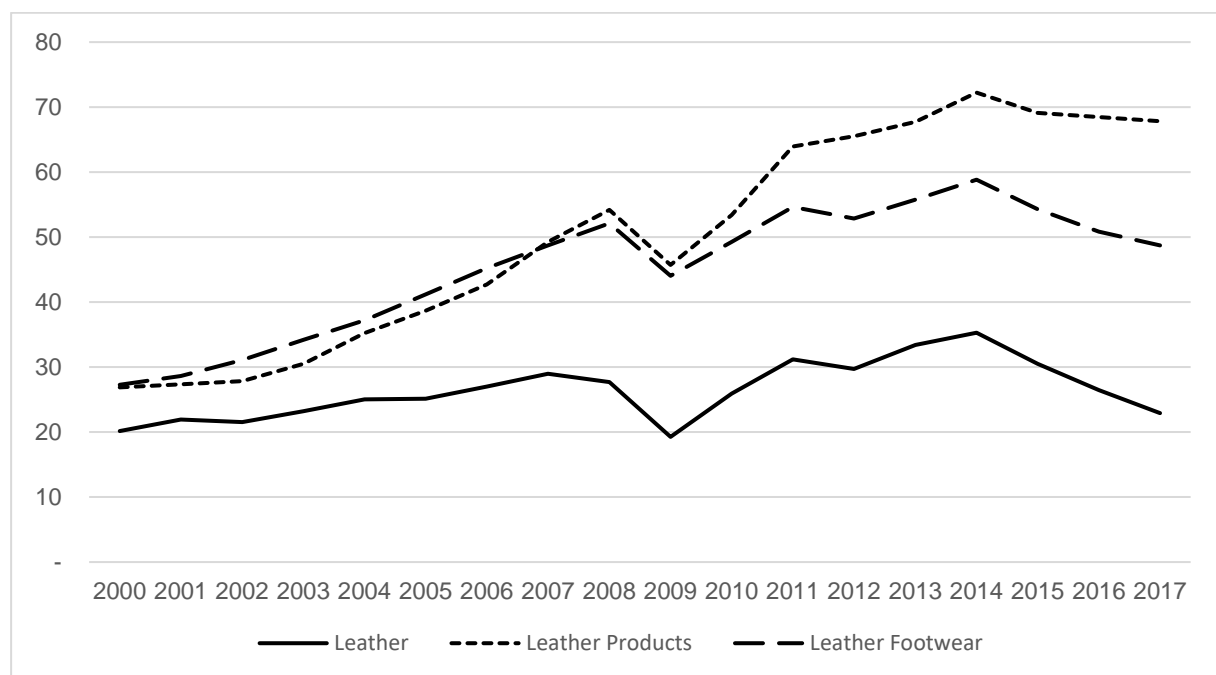
The majority of skins and hides are produced in developing countries. Tanning, on the other hand, is more dispersed globally with a relatively large number of countries maintaining tanning capacities and with a trend of tanneries to follow leather product manufactures geographically. Over the last two decades, tanneries in rising producers of leather products such as China expanded while tanneries in the advanced economies declined with remaining tanneries in the advanced economies focusing on niche segments (UNIDO 2010). A trend toward more globally consolidated tanneries has also been seen in the last few years as globalised tanneries set up production units in different parts of the world.

Manufacturing of leather products takes place with varying degrees of scale and labor/capital intensity. Leather products can be manufactured in small and more labor-intensive workshops or in large more capital-intensive factories (Memedovic/Mattila 2008). The two types of production exist in the global industry today and focus on different segments of the value chain. The rise of China in the manufacturing of leather over the last few decades has been largely driven by the ability of Chinese producers to dominate the lower to medium end segment of the industry through large-scale manufacturing. This model of production is highly sensitive to scale due to high fixed overhead costs. As such, this model is more sensitive to changes in market trends. Smaller scale production, on the other hand, is more flexible in terms of scale of production and has lower fixed overhead costs. Nonetheless, the lower economies of scale in this model makes it less competitive in price-sensitive segments. As we will highlight later in this report, the dominance of China in leather manufacturing based on large-scale and high fixed overhead costs is, thus, both an advantage, due to economies of scale, and a risk, due to the need to maintain large-scale production.

In addition to the long-term trade growth due to geographical and organizational shifts in the LLP GVC, three further major trade trends can be identified in the last decade. First, LLP trade growth by value has slowed down since 2009. However, leather products (excl. footwear), particularly bags, have been an exception to this trend. Growth rates for leather and leather footwear have been particularly weak. Second, global trade of LLP by value has decreased since 2014 due to falling retail prices and a shift in consumer demands in key consumption markets, in particular a trend towards the use of synthetic materials. It remains to be seen whether or not this trend will continue in the near future. Third, as we will show in more detail in the next chapter, China's market share in key consumption markets is decreasing in the last years due to rising wages, which opens a window of opportunity for low-cost suppliers such as Ethiopia.

The negative market trend thus does not necessarily imply shrinking opportunities for countries in the global periphery to link to the LLP GVC and increase exports. Global buyers continue to optimize their sourcing strategy and are likely to shift to countries like Vietnam, or potentially Ethiopia, in the context of rising wages in key supplier countries like China. In addition, countries with a unique selling point (USP), e.g. high quality of specific leather types, can use these advantages to successfully link to the LLP GVC and increase exports to key consumption markets.

Figure 2: Global LLP trade (2000-2017, billion USD)



Note: Data represents global imports. Leather data includes raw hides and skins.
Source: UN Comtrade 2018 (WITS).

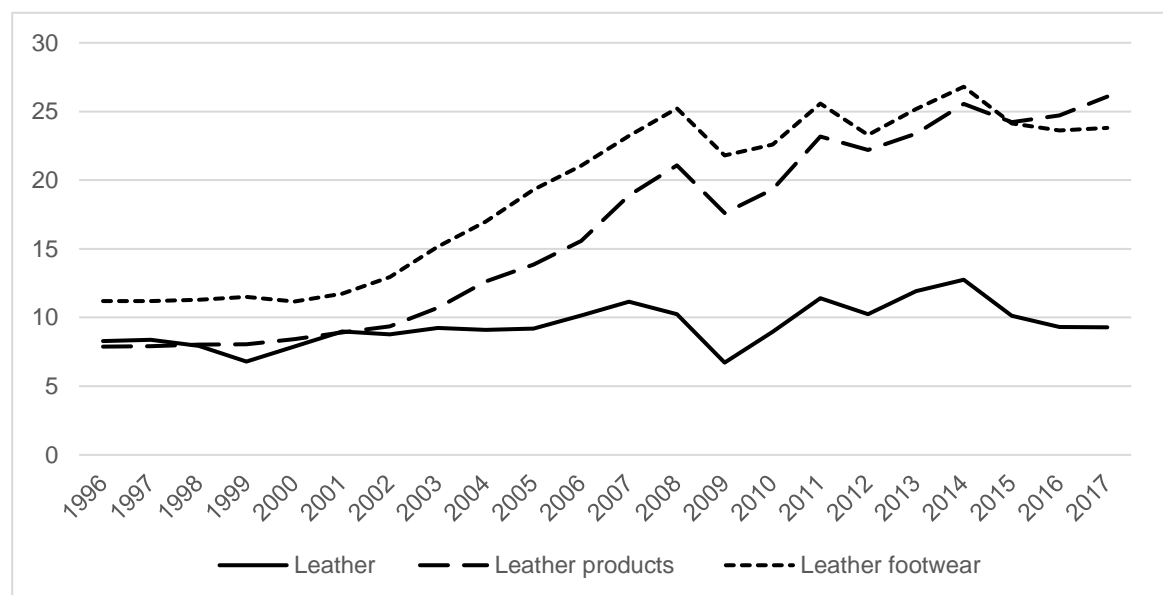
3. MAPPING THE EUROPEAN UNION'S LLP VALUE CHAIN

3.1. Introduction

The EU remains an important player in the global leather trade as both an importer and an exporter of leather and leather products. According to the EU Commission, the leather and related goods sector comprises about 36,000 enterprises and generates a turnover of EUR 48 billion employing around 435,000 people (European Commission 2018a). Europe remains an important player in the tanning stage with European tanneries active both in the EU and also through foreign direct investments (FDI) in different parts of the world. The European industry has, however, experienced significant changes over the last few decades. Similar to apparel, a growing percentage of EU's consumption of leather products is now met through imports. In addition to China, which enjoys a dominant position in many market segments in the EU, countries such as India, Pakistan, Vietnam and Indonesia, are important suppliers in addition to exports from countries within the Euro- Mediterranean zone such as Turkey, Morocco, and Tunisia. Nonetheless, a number of European countries maintain relatively large leather product manufacturing sectors. Those countries, in particular Italy, have managed to build a very strong position in the high value-added luxury segment of the market, thus, creating substantial branding barriers to entry for other suppliers. Other countries, such as Germany and the UK, maintain production in niche areas that are often connected to other domestic industries such as production of leather goods for the automotive sector.

Total EU imports of LLP have increased in the last two decades, particularly those of leather products and footwear (Figure 3). The dynamics of EU imports were similar to the global trends discussed in the previous chapter. Despite limited growth, EU imports of raw leather remained substantial for supporting European producers of different leather products in their quest to maintain a significant manufacturing sector.

Figure 3: EU's imports of leather and leather products (2000-2017, billion USD)



Note: Includes intra-EU trade. Leather data includes raw hides and skins.
Source: UN Comtrade 2018 (WITS)

3.2. EU's integration in the LLP GVC

In the following section, the integration of the EU in the LLP GVC is discussed. The EU LLP value chain can be roughly divided into five key segments: (i) the livestock sector, (ii) collectors and local traders that link farmers with tanneries; (iii) tanneries, which source hides and skins locally or globally and produce wet blue, crust and finally coated or finished leather. Tanneries export either directly with further manufacturing taking place abroad or supply (iv) leather manufacturers. Leather manufacturers may also import finished leather from abroad and (v) supply the EU market or export. Leather products are also often imported by branders, distributors, wholesalers or retailers.

3.2.1. Raw hides and skins and leather

Tanning involves the treatment of raw hide or skin to enable its use in the manufacture of consumer products. Europe produces its own leather used for manufacturing activities and also imports leather produced globally. Europe maintains its own leather industry with about 3,000 enterprises employing around 42,000 people and generating revenues of EUR 11 billion in 2015 (Eurostat 2018).³ European tanneries are a mixture of small and medium family businesses and larger tanneries and often produce very high value calf skins (European Commission 2018a). Outlets for European produced leather are footwear (41%), leather goods (19%), furniture (17%), the automotive industry (13%), clothes (8%) and other (2%) (European Commission 2018a).

In terms of leather imports, Italy remains the main destination in the EU accounting for almost a third of total EU imports (Table 1). This is due to the importance of Italy as a producer of leather products both in the European market and in the global market. Over the last few years, restrictions on exports of raw and semi-finished leather by a number of countries have provided a challenge in terms of access to raw materials for the EU industry, in particular with the decline in production of skins and hides in the EU (European Commission 2018a).

Table 1: EU imports of hides and skins as well as leather by country (% of total EU imports)

2007		2016	
Country	Share	Country	Share
Italy	38.4%	Italy	35%
Germany	9.3%	Germany	8.7%
Romania	7.6%	Spain	7.2%
Spain	6.95%	France	6.9%
Poland	5.6%	Romania	5.9%
France	5%	Portugal	5.7%

Source: UN Comtrade 2018 (WITS).

In terms of exporters, a relatively large number of countries supply hides and skins as well as leather to the EU (Table 2). In addition, there is a substantial intra-EU trade in leather with other EU countries often in the list of top five exporters of leather to other European countries. Italy, the largest importer of leather in Europe, imports substantial amounts from countries such as France, Spain, Germany, and the Netherlands.

³ These figures includes dressing and dyeing of fur.

Table 2: Hides and skins as well as leather exporters to the EU (% of total EU imports)

2007		2016	
Country	Share	Country	Share
Brazil	18%	Brazil	15.6%
United States	6.6%	United States	10.5%
India	6.6%	India	6.7%
Argentina	5.7%	Argentina	4.4%
China	5.1%	Nigeria	4.1%
Russia	5%	New Zealand	3.6%

Source: UN Comtrade 2018 (WITS)

It is important to note that the country of origin and EU importers differ significantly depending on the processing stage of leather. The EU imports leather at different stages (raw and semi-finished leather, crust/wet blue leather, and finished leather), but the majority of EU imports are finished leather as well as raw and semi-finished leather. Imports of crust/wet blue leather are relatively small.

For raw and semi-finished leather, Italy is by far the largest European importer accounting for around 60% of total European imports in 2017 (UN Comtrade 2018). Italy was followed by Germany, which imported 7.5% of all EU imports, followed by Spain (5.7%) and the Netherlands (5%) (UN Comtrade 2018). The main exporters of raw and semi-finished leather to the EU include Brazil (17.6%), the United States (13.1%), New Zealand (6.8%), and Argentina (6.5%) in addition to Ukraine, Paraguay, and South Africa (UN Comtrade 2018). Intra-EU trade is also substantial in this area with Italy importing large amounts of raw and semi-finished leather from France, Germany, the Netherlands, and Spain.

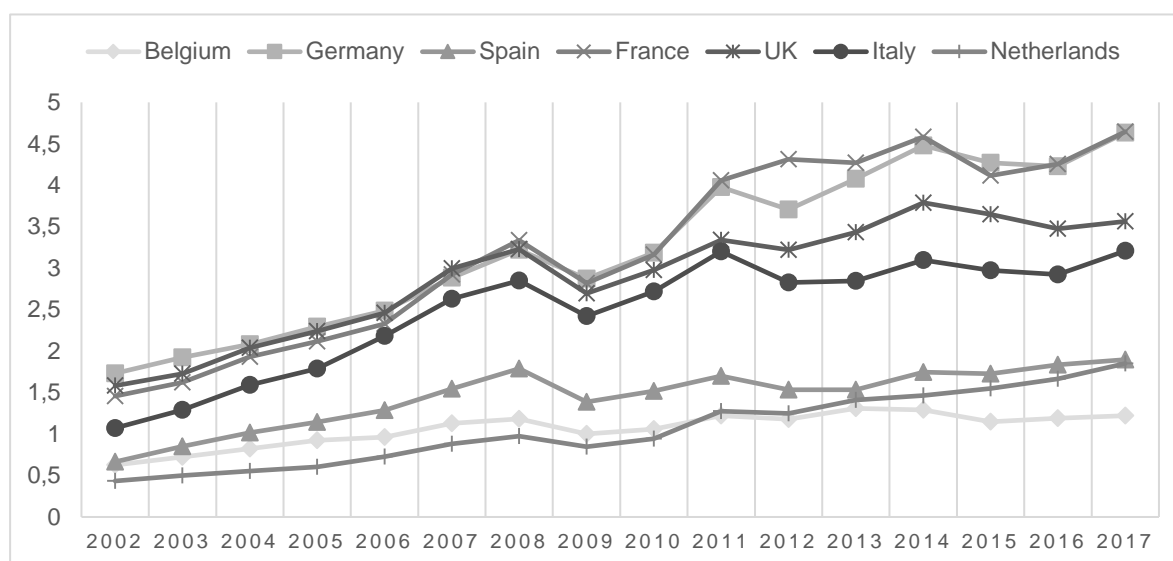
Italy is also the main EU importer of finished leather, but with a substantially lower market share (15%) compared to raw and semi-finished leather (UN Comtrade 2018). Germany (11.6%), Romania (11.4%), Poland (9.5%), France (8.2%), and Portugal (7%) are also important importers (UN Comtrade 2018). In terms of main exporters to the EU, Brazil had a market share of 25%, followed by India (18.2%), Pakistan (9.4%) and Turkey (6.3%), in addition to Russia and South Africa (UN Comtrade 2018).

EU imports of crust/wet blue leather are substantially lower. Italy is the main EU importer of crust/wet blue leather with an overall share of 76% of total EU imports (UN Comtrade 2018). Spain is the second importer with a share of 11.2% followed by France (4.3%) and Portugal (2.8%) (UN Comtrade 2018). With regards to exporters to the EU, Nigeria is the largest supplier with a 49% share of EU imports of crust/wet blue leather, followed by India (23.7%), Kenya (5.9%), Uganda (3.4%), and China (3.3%) (UN Comtrade 2018).

3.2.2. Leather manufacturing

While the EU has maintained an important presence in the leather manufacturing industry (mainly due to the position of Italy), the last two decades have witnessed a sharp increase in the imports of leather products by the EU, indicating that most growth in demand has been met by such imports. All of the major European markets experienced rapid growth in imports of leather products although rates varied (Figure 4). The main importers of leather products in the EU are France, Germany, the United Kingdom and Italy (Table 3).

Figure 4: Key EU importers of leather products (USD billion, 2002-2017)



Source: UN Comtrade 2018 (WITS).

Table 3: EU imports of leather products by country (% of total EU imports)

2007		2017	
Country	Share	Country	Share
United Kingdom	15.8%	France	17.8%
France	15.4%	Germany	17.8%
Germany	15.2%	United Kingdom	13.7%
Italy	14.1%	Italy	12.3%
Spain	8.1%	Spain	7.3%
Belgium	5.9%	Netherlands	7.1%

Source: UN Comtrade 2018

In terms of exporters, China is by far the largest supplier of leather products to the EU with a share of 55% of total European imports (UN Comtrade 2018). China is followed by India (11%), Switzerland (9.7%), Vietnam (7.2%), Pakistan (2.9%), and Turkey (1.6%). Intra-EU trade in leather products remains substantial with Italy in particular having a large market share in other European markets. While the main suppliers to different European markets tend to be similar, there are important differences in market shares. In France for instance, Italy is the main supplier with a market share of 35% compared to a share of 29.3% for China. In Germany, on the other hand, the share of China is 36.2% compared to only 12.3% for Italy (Table 4).

Table 4: Leading suppliers of key EU leather products markets (2017, % share)

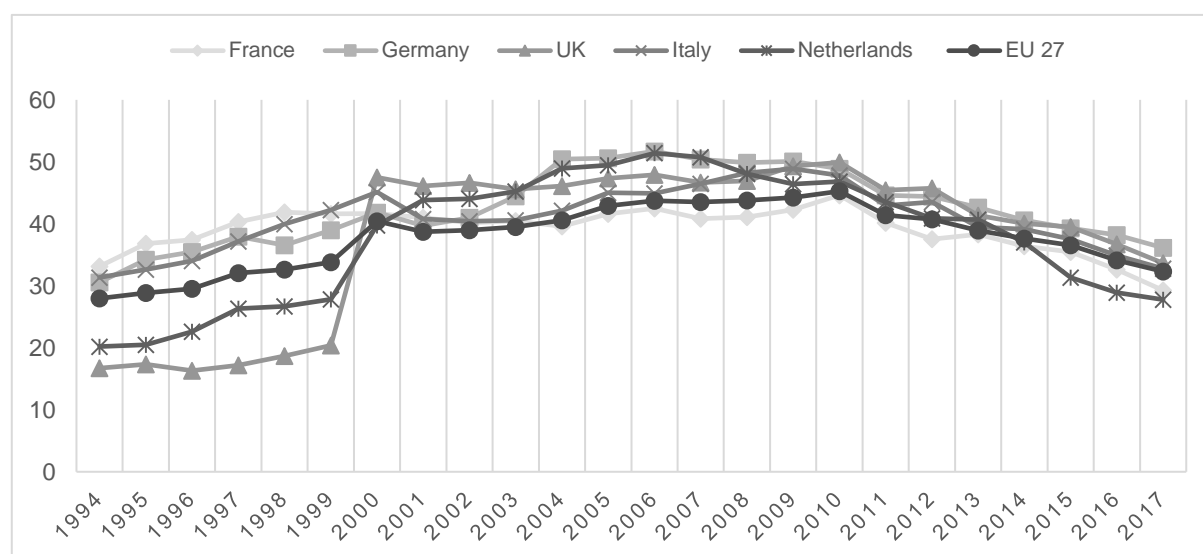
France		Germany		UK		Netherlands		Italy	
	%		%		%		%		%
Italy	35	China	36.2	China	33.6	China	27.8	China	33
China	29.3	Italy	12.3	France	17.4	Vietnam	12.3	France	21.4
Spain	7	India	9.5	Italy	14.8	Germany	10.8	Switzerl.	8.6
India	4.5	France	6.7	India	6.6	Italy	8.1	NL	6.6
Vietnam	3.8	Vietnam	6.4	Netherl.	5.2	Belgium	6.8	India	4.6

Source: UN Comtrade 2018 (WITS).

Despite the large share of China in EU's leather products imports, it is important to note that the share of China has been declining over the last decade following the rapid growth rates of previous years (Figure 5). This decline in China's market share was compensated by a number of other suppliers including a higher share of EU producers. Between 2006 and 2017, Italy, France, Germany, and Spain increased their share in EU imports of leather products, in addition to an increase in the market share of Vietnam.

The remaining production in the EU is often focused on niche products. The UK for instance has a sizeable automotive leather industry since the UK has a large car industry. Italy is to some degree an outlier as it has maintained its competitiveness in multiple product sectors, most notably in the luxury segment.

Figure 5: China's share in EU's total leather product imports (% , 1994-2017)



Source: UN Comtrade 2018 (WITS)

To examine trends in leather products more closely, we will now look in more detail at categories of leather products: footwear, apparel, apparel accessories and luggage and leather goods.

3.2.2.1 Footwear

3.2.2.1.1 Value chains and buyers-supplier relations

The EU is one of the key global consumption markets of (leather) footwear and is highly dependent on imports from low-cost manufacturing countries.

As discussed above, high levels of footwear are imported from low cost manufacturing countries. With many global suppliers competing individual suppliers have limited power in their relationships with buyers (MarketLine 2018a). In this industry it is difficult and consequently rare for manufacturers to forward integrate to incorporate retail functions (MarketLine 2018a).

European manufacturers offer highly differentiated products to compete with low cost imports (MarketLine 2018a). These can include products with specialised functions and high-end products.

Footwear producers are expected to move their production closer to European demand as labour costs have been rising in traditionally low-cost production areas, such as China and

Indonesia (MarketLine 2018a). Another issue is that retail prices are falling due to growing global manufacturing capacity based on technological developments (MarketLine 2018a). In this context many producers face challenges with rising labour and raw material costs (MarketLine 2018a).

3.2.2.1.2 Domestic production

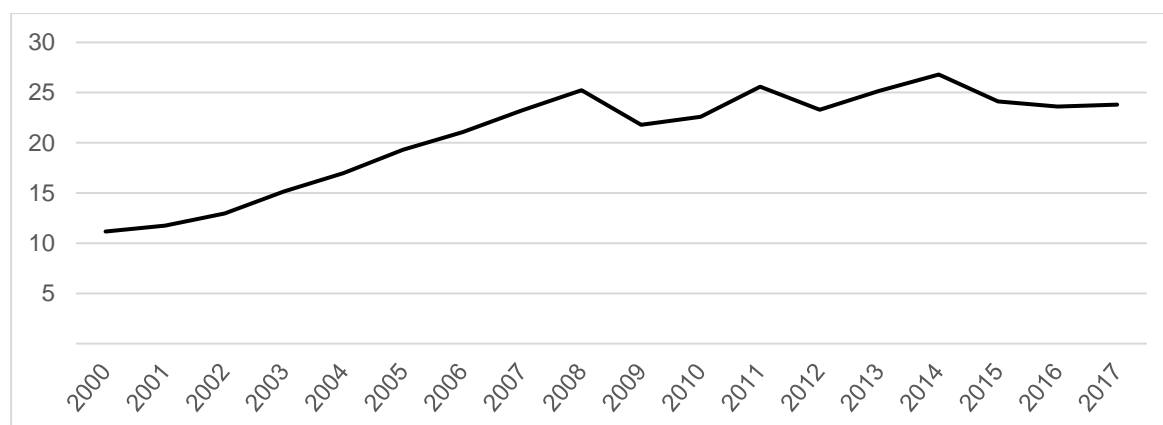
The EU's footwear sector (incl. non-leather production) had about 20,300 enterprises employing 287,000 people in 2016 with €27 billion in turnover (Eurostat 2018). Over two-thirds of this production is from Italy, Spain and Portugal with Italy alone contributing 50% (Eurostat 2018). In 2016, the top five producers were Italy (EUR 13.8 billion turnover), Spain (EUR 3.2 billion), Portugal (EUR 2.5 billion), Germany (EUR 1.9 billion) and Romania (EUR 1.0 billion) (Eurostat 2018). The high share of Italy particularly reflects the remaining leather footwear industry producing high-value shoes, with the most expensive global average price for shoe exports (MarketLine 2018a).

Most businesses in the EU are small with an average turnover of one million euros (European Commission 2018b). The number of firms has been declining as production moves abroad and most remaining are focusing on high-quality, high-added value or niche markets, such as high-end footwear, children's shoes, footwear for specific applications (protective, golf, skiing boots), and bespoke footwear (European Commission 2018b).

3.2.2.1.3 Imports

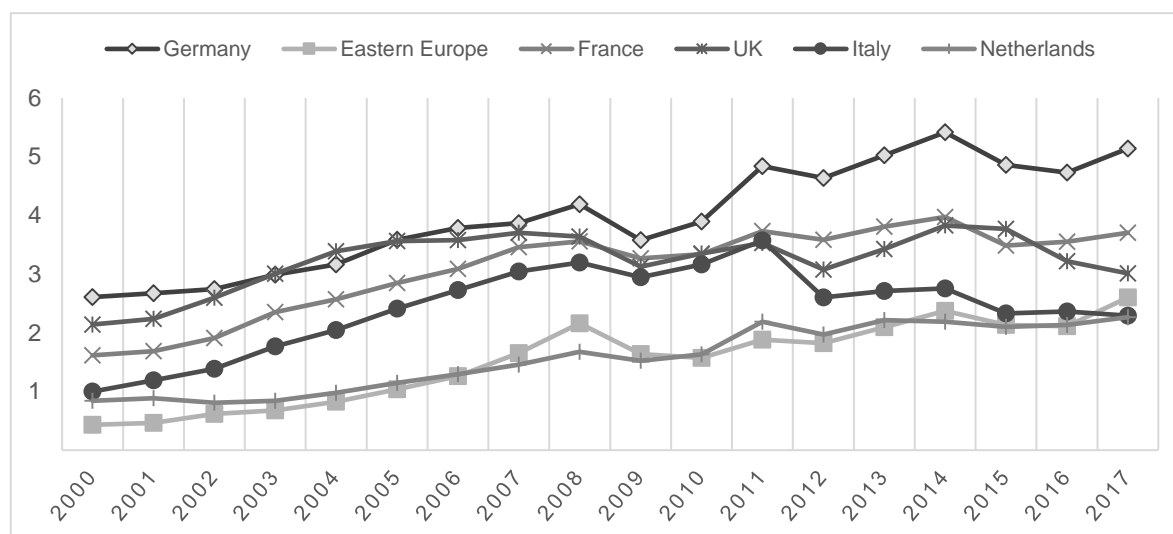
The EU's imports of leather shoes (HS6403/HS640510) increased rapidly in the first half of the last decade before stabilizing and fluctuating following the global economic crisis in 2008 (Figure 6). In 2017, Germany was the main importer of leather shoes in the EU with a market share of 21.6%, followed by France (15.6%), the UK (12.6%), Italy (9.6%), and the Netherlands (9.5%) (UN Comtrade 2018). The growth of the EU's imports over the last decade, however, varied between different markets with Germany, Netherlands, and Eastern European countries maintaining growth in their imports after the global crisis relative to Italy, France, and the UK where imports dropped (Figure 7).

Figure 6: EU's imports of leather footwear (2000-2017, USD billion)



Note: Data includes intra-EU trade.
Source: UN Comtrade 2018 (WITS).

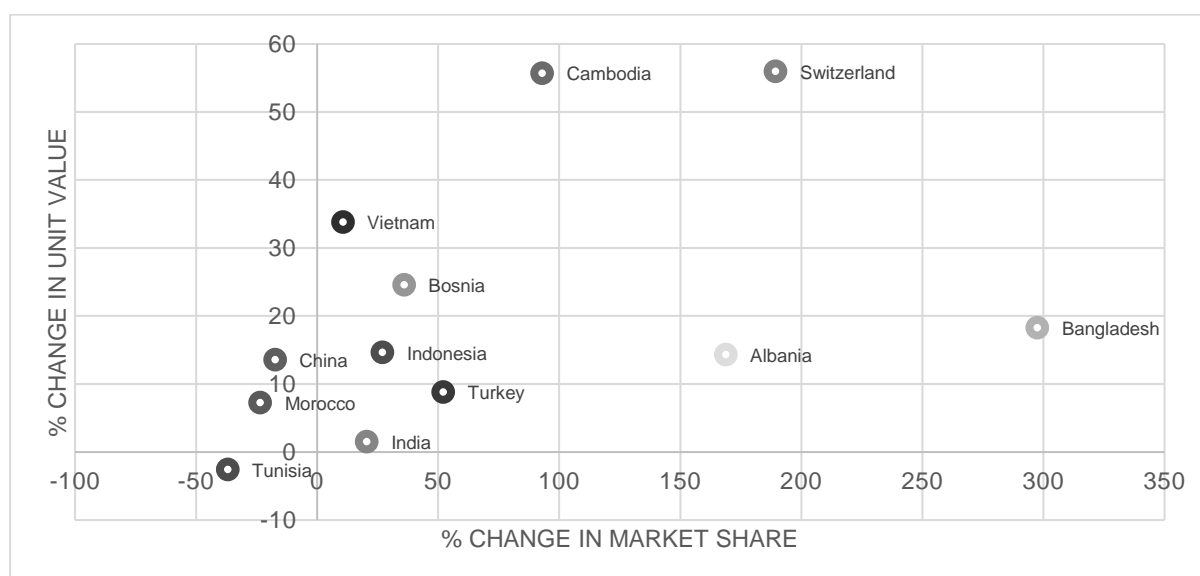
Figure 7: EU's imports of leather footwear by country (2000-2017, USD billion)



Note: Data includes intra-EU trade.
Source: UN Comtrade 2018 (WITS).

In terms of exporters to the EU, China was the main supplier of leather shoes to the EU in 2017 with a market share of 25%. Vietnam was the second largest supplier with an 18% market share, followed by India (13.9%), Indonesia (10.1%), Switzerland (6.4%), Bangladesh (3.1%), Tunisia (3%), Albania (2.9%), Cambodia (2.7%), Bosnia (2.3%), Morocco (1.9%), and Turkey (1.6%) (UN Comtrade 2018). This represented a decline in China's market share from 30% in 2007, compared to 16% for Vietnam, 11.5% for India, and 7.9% for Indonesia (UN Comtrade 2018). Overall, a degree of consolidation in the supply base took place over this period with the share of the top 12 exporters increasing from 81% in 2007 to 90% in 2017 (UN Comtrade 2018). These changes in market share were associated with shifts in unit value, with some countries such as Bangladesh, Cambodia, and Switzerland achieving a substantial increase in both their market share and unit value (Figure 8).

Figure 8: Change in market share/unit value of top suppliers of leather shoes to the EU (2007-2017)



Source: UN Comtrade 2018 (WITS).

3.2.2.1.4 Retail market

Footwear revenue in the EU amounted to USD 104.9 billion in 2017, with leather footwear accounting for almost half of total revenue (49% or USD 51.7 billion) and 28.7% by volume as leather footwear is more expensive (Statista 2018a).

In Western Europe, the footwear market is heavily fragmented with more than 40% of sales split across smaller manufacturers and brands that each account for under 1% of the retail market value (Euromonitor 2015). In most countries, local brands play an important role and the large number of companies creates high price competition. Price competition is intensifying as foreign retailers and footwear specialists are entering EU markets, improving options for styles and brands. (MarketLine 2018a).

There is also so process of consolidation with the top 10 sellers making up 28% of the Western European retail value in 2014, which was an increase of 11% over 2005 (Euromonitor 2015). By 2017, the leading five footwear players in Western Europe made up 25% of the region's sales (Table 5; Euromonitor 2018a). Consolidation can be seen as a result of consumers downgrading to more affordable fashion brands offered by large apparel chains and large footwear specialist retailers expanding their offerings in the lower end of the market (Euromonitor 2015). These companies have the advantage of economies of scale.

Table 5: Top Western European Footwear Companies in 2017

Rank	Company	Rank	Company
1	Nike Inc	6	Kering SA
2	Adidas Group	7	Inditex
3	Private Label	8	Geox SpA
4	Deichmann SA	9	Vivarte SAS
5	C & J Clark Int. Ltd.	10	Asics Corp

Source: Euromonitor 2018a

As a result, the footwear market in Western Europe is becoming increasingly polarised. Private labels have lost in competition with low priced global fashion giants (Euromonitor 2018a). Fast fashion retailers, such as H&M, Zara (Inditex) and Primark, have increased their market share, putting pressure on specialist shoemakers and multi-brand footwear specialist retailers (Euromonitor 2015). Sports footwear brands such as Nike and Adidas have also experienced high growth rates, benefitting from strong brand recognition, continued innovation and marketing campaigns (Euromonitor 2018a). In the five years from 2012 to 2017, the fastest growing companies in terms of revenue were all sports footwear players. Online retail has also experienced high growth rates: E-commerce rose from 5% of footwear sales in Western Europe in 2009 to over 12% in 2014 (Euromonitor 2015).

The European footwear market is rather evenly split between the top four markets, Germany (14.0% market share), Italy (13.5%), UK (12.2%) and France (11.3%) (MarketLine 2018a). Some large companies are focused on individual countries within the EU (Euromonitor 2018a). Mass market retailer Deichmann, for example, is popular in its home market of Germany and also in Austria, the Netherlands and Turkey. Vivarte focuses entirely on its domestic market, France. C&J Clark International, similarly, has 94% of its regional sales in its home market, the UK. Nike Inc, Adidas Group, and Asics, on the other hand, have broad regional coverage.

3.2.2.2 Apparel

The category of 'Apparel' refers to items of clothing. The EU's NACE Rev 2 classification system considers leather clothes to include "wearing apparel made of leather or composition leather including leather industrial work accessories as welder's leather aprons" (Eurostat 2008: 128). The category excludes fur wearing apparel, leather sports gloves and sports headgear, fire-resistant and protective safety clothing.

3.2.2.2.1 Value chains and buyer-supplier relationships

EU's apparel retailers acting as buyers are often very large companies. Also a large portion of the retail sector in Europe is made out of retailers' own brands. For example, for ASOS, a large and rapidly growing online retailer with 2017 sales surpassing USD 2.5 billion, two-fifths of products sold were own brand (MarketLine 2018b). However, numerous smaller buyers also have a place in the market.

Large apparel retailers and supermarkets have the ability to buy in bulk and save money on economies of scale. This puts downward pressure on prices of suppliers. Apparel suppliers are often small and medium enterprises, which face low bargaining power. There are high levels of cost competition globally. Wage differentials between EU-producers and low-cost regions remain very high.

Buyers have traditionally had a relatively low cost of switching. However, this is changing. There are some factors driving the development of longer relationships. For some buyers, working conditions in the factories they source from have become part of the supplier selection criteria. Large buyers are developing more sophisticated on-boarding processes and they increasingly use approved supplier lists. Also, with fast fashion, buyers can benefit from having suppliers they can trust to work quickly to meet expectations. Nonetheless, the low levels of differentiation between products mean that it is not difficult for new players to supply EU buyers.

Clothing manufacturing remains a highly labour-intensive activity. Being located in areas with low labour costs can be an advantage for suppliers. While most suppliers remain small, some large multinational suppliers have emerged in recent years. Clothing suppliers for EU markets have been developing their own domestic and global fashion brands, particularly in Asia.

3.2.2.2.2 Domestic production

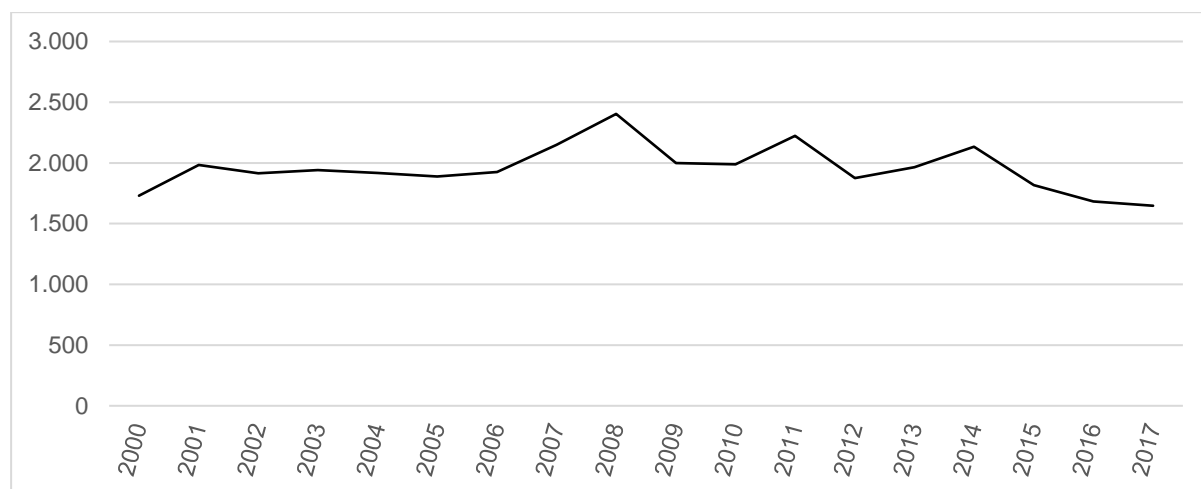
EU clothing production has declined in the context of rising imports. However, the EU still housed approximately 120,000 apparel enterprises employing almost a million people with a turnover of EUR 71 billion in 2015 (Eurostat 2018). Top producers in 2016 were Italy (EUR 28 billion), Germany (EUR 9 billion), France (EUR 7 billion), UK (EUR 5 billion), Spain (EUR 5 billion) and Portugal (4 billion) (Eurostat 2018). Leather apparel is a small portion of this industry. In 2014, Europe had about 2,400 leather apparel businesses, employing 11,000 with a total turnover of 900 million EUR. Specifically considering leather apparel, Italy was by far Europe's largest producer with a manufacturing turnover of EUR 554.5 million, followed by France (EUR 70.3 million), Germany (EUR 53.4 million), Poland (EUR 45.2 million) and Romania (EUR 16.8 million) in 2016 (Eurostat 2018).

3.2.2.2.3 Imports

EU imports of leather apparel by value experienced a declining trend over the last two decades, particularly following the economic crisis of 2008 (Figure 9). In 2017, Germany was the main importer of leather apparel with a market share of 22% followed by France (16.9%). Italy (12.3%), Spain (11.2%), the UK (11.1%), and the Netherlands (8.2%) (UN

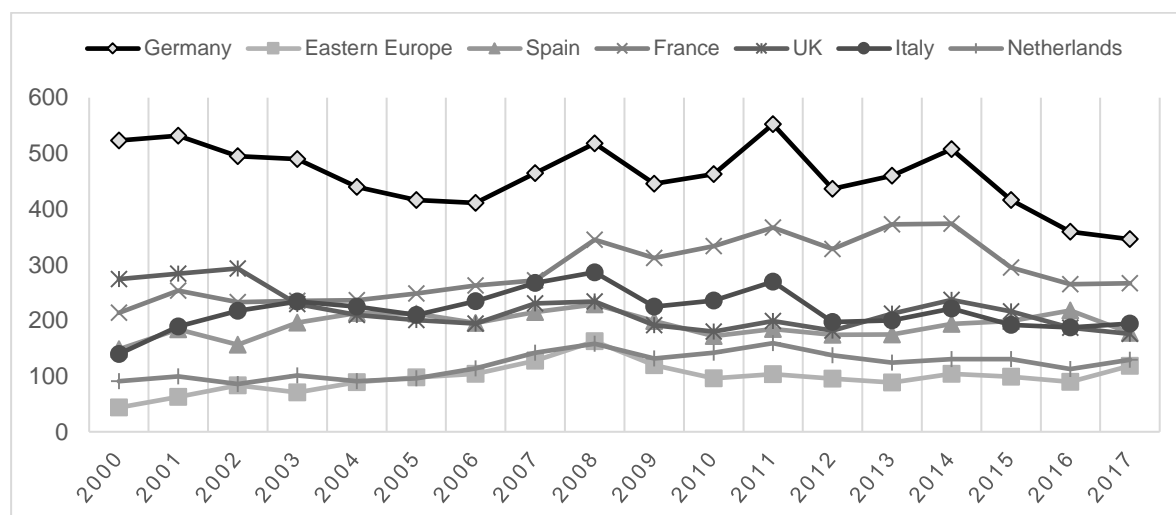
Comtrade 2018). Over the last two decades, most of the main EU markets experienced a stagnation or a decline in their imports of leather apparel (Figure 10).

Figure 9: EU's leather apparel imports (2000-2017, USD million)



Source: UN Comtrade 2018 (WITS).

Figure 10: EU's leather apparel imports by country (2000-2017, USD million)



Source: UN Comtrade 2018 (WITS).

India is the main supplier of leather apparel to the EU accounting for 40.1% of total imports in 2017 (UN Comtrade 2018). India is followed by Pakistan (22.6%), Turkey (11.6%), China (7.4%), Switzerland (5.2%), Vietnam (3.3%), Ukraine (1.7%), Sri Lanka (1.4%), the United States (1.2%), and Tunisia (1%). This represented a dramatic shift in top suppliers compared to 2007 when China was the main supplier with a share of 35.9% followed by India (23.7%), Turkey (15.1%), and Pakistan (15%) (UN Comtrade 2018). These changes in market share were associated with changes in unit prices. Countries such as China and Turkey experienced an increase in their unit price and a decline in their market share compared to countries such as India, Pakistan, Vietnam, Sri Lanka, Switzerland, and the United States, where gains in market share were associated with an increase in unit prices. Tunisia, on the other hand, expanded its market share but with a lower unit price, indicating a shift to lower cost segments of the market (Figure 11).

Figure 11: Change in market share/unit value of top suppliers of leather apparel to the EU (2007-2017)



Source: UN Comtrade 2018 (WITS).

3.2.2.2.4 Retail market

In the EU, leather clothing sales accounted for only 1% of the European textile and clothing turnover in 2016 (Statista 2018b). Womenswear, in comparison, accounts for the bulk of sales at 57.5% of the EU's apparel retail industry's total sales value (MarketLine 2018b). Germany is the largest market accounting for 16.8% of total value of sales (ibid.).

In 2017, apparel in the EU was mostly sold through clothing, footwear and accessories specialists (61.4%), followed by department stores (9.8%), online pure play (7.5%), hypermarkets, supermarkets and hard discounters (6.0%), and others 15.3% (ibid.). Fast fashion retailers, specializing in rapidly updated product offerings, are key outlets. In this category, two global apparel retail giants are based in the EU (H&M and Inditex), making it difficult for new entrants. Supermarkets and online retailers have seen growing levels of apparel sales as they are now considered as a place to buy clothes, not just food (ibid.). This trend is particularly prominent in the UK with supermarket brands Asda (George), Tesco (F&F) and Sainsbury's (Tu). France and Germany are also following this shift (ibid.).

3.2.2.3 Apparel Accessories

Apparel accessories is a category that includes items that people wear other than clothing, such as belts, gloves and hats.

3.2.2.3.1 Value chains and buyer-supplier relationships

Similar to apparel, accessory buyers have a lot of relatively undifferentiated options for suppliers. This creates a situation in which suppliers have limited power.

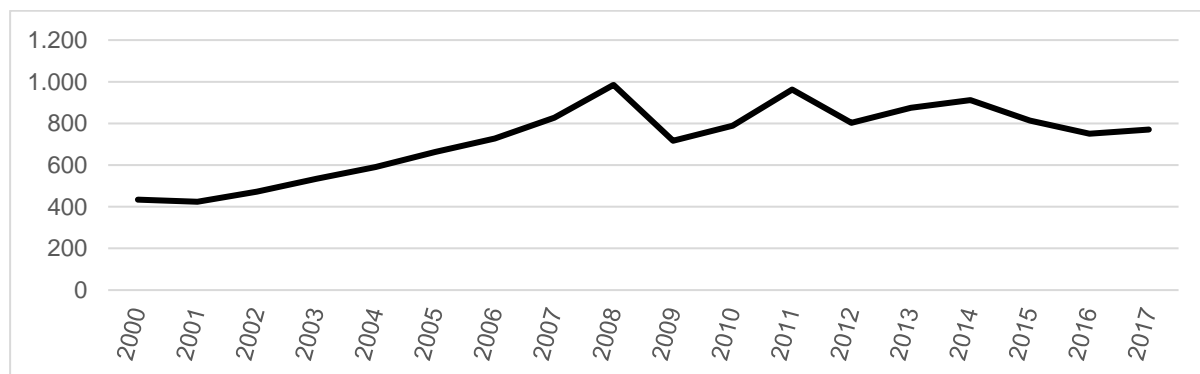
3.2.2.3.2 Domestic production

The EU's apparel accessories production can be partly measured within NACE Rev 2 in a category called 14.19 Manufacture of other wearing apparel and accessories (Eurostat 2018). This category includes some items that would not be considered as apparel accessories within this report and excludes other items that would be counted. Italy is the largest producer for this category with a turnover of EUR 4 billion, followed by the UK (EUR 1.3 billion), Germany (EUR 1 billion), Spain (EUR 0.8 billion) and France (EUR 0.7 billion). Following the top five, turnover values significantly drop with Poland, the 6th largest producer having a turnover of less than EUR 0.2 billion.

3.2.2.3.3 Imports

Within the category of leather apparel accessories imports to the EU, key products are leather gloves and belts. The EU's imports of leather gloves increased rapidly in the first half of the 2000s before an overall decline from 2008 onwards (Figure 12). Following strong growth in EU's imports of gloves in the first few years of the 2000s, imports to a number of EU markets declined with the exception of Eastern Europe (Figure 13). In terms of the main markets for leather gloves in 2017, Germany was the leading importer, accounting for 19.2% of EU's imports, followed by France (13.3%), Sweden (9%), the UK (8.8%), and Belgium (6.8%) (UN Comtrade 2018).

Figure 12: EU's leather gloves imports (2000-2017, USD million)

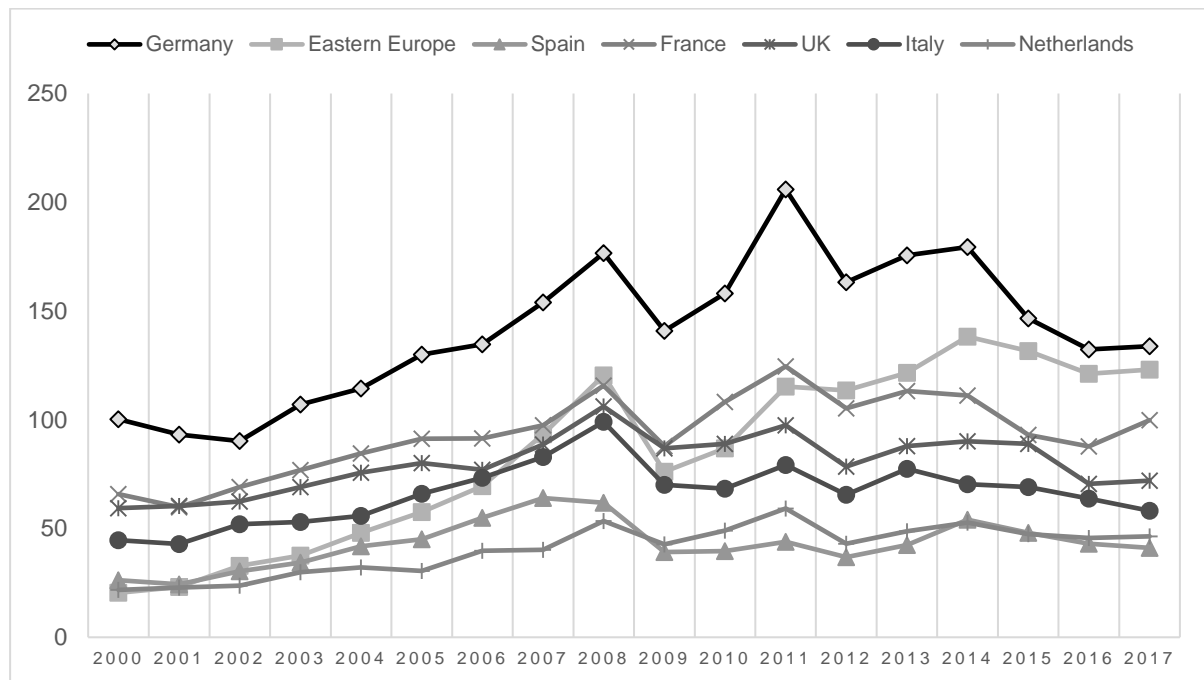


Source: UN Comtrade 2018 (WITS).

In terms of non-EU suppliers, China, India, and Pakistan dominate the EU's imports of leather gloves with a combined share of more than 85% in 2017. In the same year, China was the leading exporter of leather gloves to the EU with a market share of 34.5% followed by Pakistan (26.6%) and India (25.7%) with substantially smaller imports from Indonesia (3.5%), the Philippines (1.2%) and Vietnam (2.8%). This represented a sizeable decline of China's market share in comparison to 2007, when China supplied 52% of the EU's imports of leather gloves. This decline was reversed in the case of India which increased its share from 21.9% in 2007 and Pakistan which increased its share from 17.8% in 2007.

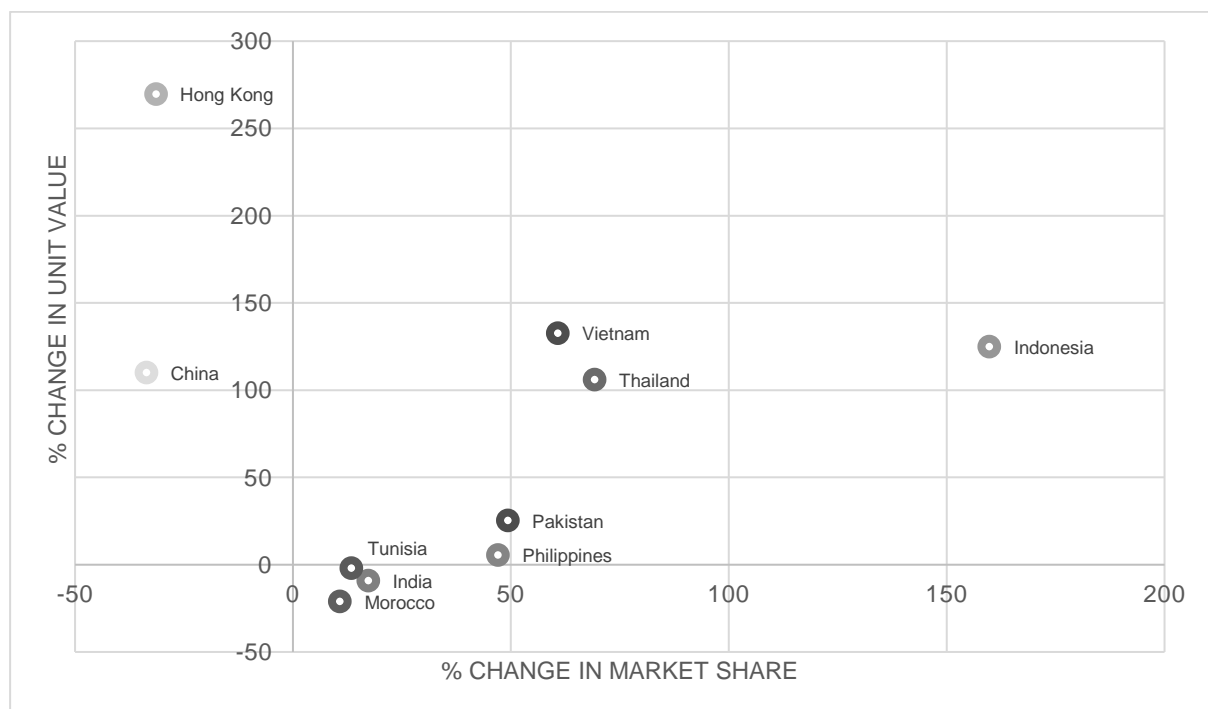
These shifts mirrored substantial changes in the unit value of EU imports of leather gloves. In addition to a substantial decline in its market share, the unit price of Chinese imports of leather gloves to the EU increased substantially, indicating China losing competitiveness in low cost segments of the market. India, on the other hand, expanded its market with a small decline in unit value indicating more competitiveness in lower cost segments of the market. Pakistan managed to achieve a substantial increase in both its market share and its unit value, indicating an ability to supply larger amounts to higher-end segments of the market (Figure 14).

Figure 13: European imports of leather gloves by market (2000-2017, USD million)



Source: UN Comtrade 2018

Figure 14: Change in market share/unit value of top suppliers of leather gloves to the EU (2007-2017)

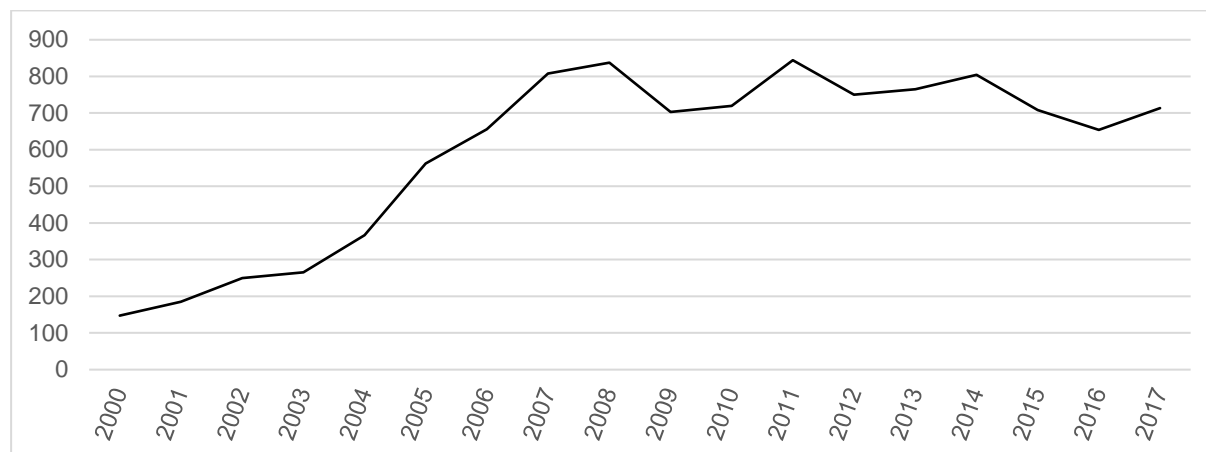


Source: UN Comtrade 2018 (WITS).

Similar to leather gloves, EU imports of leather belts grew rapidly in the first part of the 2000s before a substantial decline following the economic crisis of 2008 (Figure 15). In terms of main markets, France was the main importer of leather belts in the EU in 2017 with a market share of 24.6%, followed by Germany (22.6%), the UK (13.4%), and Italy

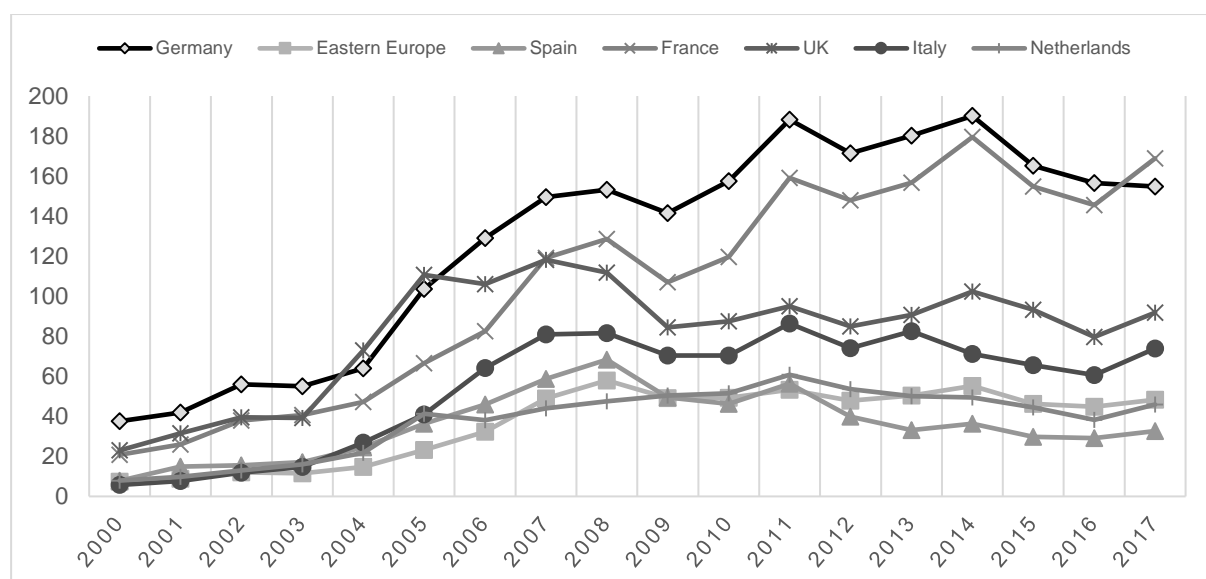
(10.8%) (UN Comtrade 2018). Most EU countries experienced import growth of leather belts over the last decade, with France and Germany witnessing a particularly sharp increase (Figure 16).

Figure 15: European imports of leather belts (2000-2017, USD million)



Source: UN Comtrade 2018 (WITS).

Figure 16: European imports of leather belts by market (2000-2017, USD million)



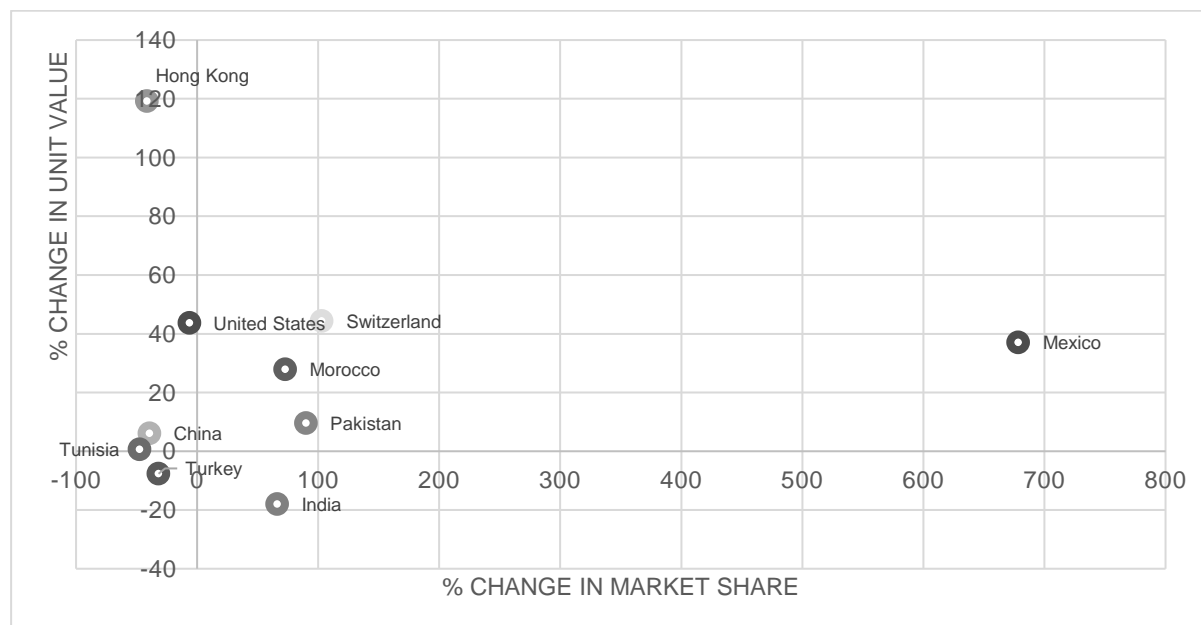
Source: UN Comtrade 2018 (WITS).

In terms of exporters of belts to the EU, Switzerland was the main supplier in 2017 with a share of 31.9%, followed by China (29.8%), India (15.7%), Turkey (7.7%), Morocco (3.1%), Tunisia (2.4%), the United States (1.6%), Hong Kong (1.3%), Pakistan (1.1%), and Mexico (0.98%) (UN Comtrade 2018). Similar to leather gloves, this marked a substantial drop in the share of China over the last decade. In 2007, China was the main exporter of leather belts to the EU with a share of 49% compared to 15.7% for Switzerland, followed by Turkey (11.3%), India (9.4%), and Tunisia (4.6%).

These shifts in market shares were linked to shifts in unit prices (Figure 17). The decline in the share of China was associated with an increase in the unit price of Chinese exports although this increase was substantially smaller than the corresponding increase seen

earlier in leather gloves. Switzerland achieved a rapid increase in both its market share and its unit value showing ability to expand into premium segments. Morocco achieved a substantial increase in unit price although with a limited change of its market share. India increased its market share with a decline in unit price, indicating growing exports to large-scale cost-sensitive segments.

Figure 17: Change in market share/unit value of top suppliers of leather belts to the EU (2007-2017)



Source: UN Comtrade 2018

3.2.2.3.4 Retail market

As with apparel, most apparel accessories are sold at apparel and footwear specialists. Also, concentration among the largest companies is growing. In Western Europe, the leading five companies accounted for 11% of the market in 2007, but by 2016 it increased to 16% (Euromonitor 2017). The largest market in Western Europe is Germany (20%) followed by Italy (17%) and the UK (14%). Across most of Western Europe, scarves are the largest category, with belts topping Spain and Italy and hats/caps the largest in Portugal (ibid.).

3.2.2.4 Luggage and other leather goods

A final category of leather products considered here is 'luggage and leather goods'. This category includes bags, wallets & purses, and luggage. Bags, wallets and purses include briefcases, handbags, wallets and purses. Luggage includes suitcases and travel bags.

3.2.2.4.1 Value chains and buyer-supplier relationships

Retailers can source luggage and leather products from manufacturers or wholesalers.

Both types of suppliers are very fragmented with global competition for manufacturing in low wage regions decreasing suppliers' power (MarketLine 2015). High labour intensity prevents suppliers from being able to benefit greatly from economies of scale. It is easy for buyers to switch suppliers as the industry has relatively low differentiation. Some suppliers have brands that retailers sell but these products can be in competition with retailers' own brands. In some cases manufacturers have more power when they have their own retail shops (ibid.).

Department stores hold substantial market power in this category. They benefit from economies of scale, as do other large buyers. Department stores are however not as dependent on customers buying luggage and leather goods as more specialised retailers (ibid.).

3.2.2.4.2 Domestic production

In 2016, the EU's production categorized as 'manufacture of luggage, handbags and the like, saddlery and harness' was concentrated in Italy (EUR 7.0 billion in turnover) and France (EUR 5.1 billion) (Eurostat 2018). The remaining countries comprising the top five producers have much lower turnover with Spain at EUR 0.6 billion, United Kingdom at EUR 0.5 billion and Hungary with EUR 0.5 billion.

3.2.2.4.3 Imports

The EU's imports of leather bags (HS 420221, HS 420222, and HS 420229) increased substantially over the last two decades (Figure 18). In 2017, France was the main importer of leather bags in the EU, accounting for 24%, followed by the UK and Italy (17% each), Germany (12%), Spain (8.5%), and the Netherlands (6.1%) (UN Comtrade 2018). This reflected the rapid increase in imports of leather bags to some EU markets over the last two decades (Figure 19).

Figure 18: European imports of leather bags (2000-2017, USD billion)

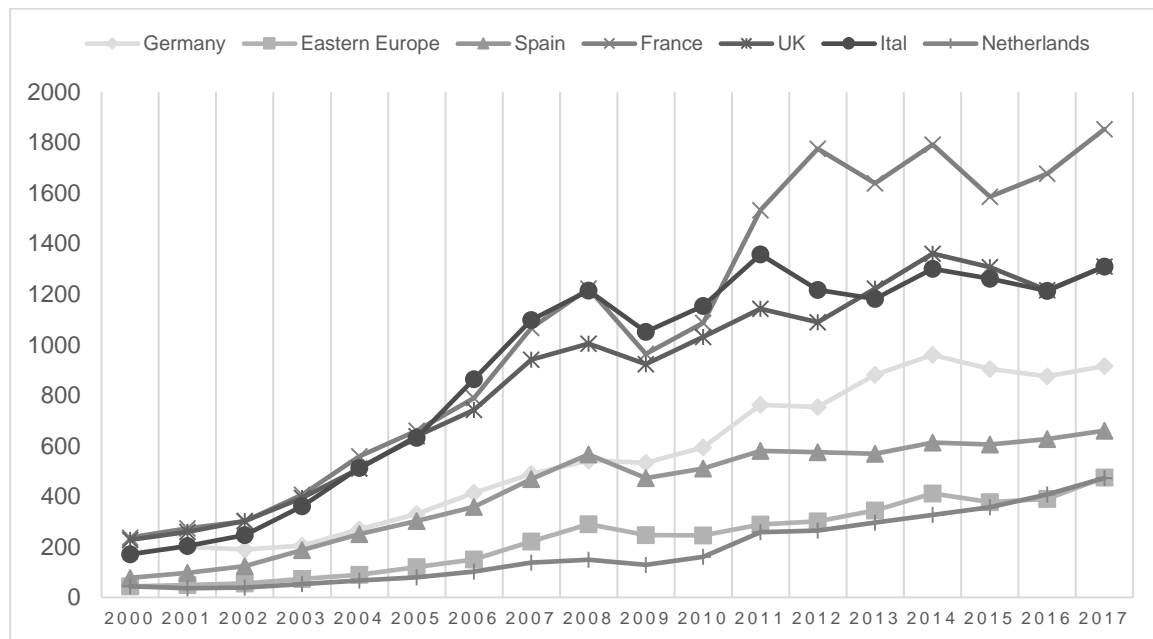


Source: UN Comtrade 2018 (WITS).

In terms of exporters to the EU, China, Switzerland, and India dominated the supply of leather bags to the EU in 2017. China accounted for 52.3% of total EU-imports followed by Switzerland (22.6%), India (9.9%), Vietnam (2.6%), Turkey (1.5%), Hong Kong (1.5%), Tunisia (1.1%), Cambodia (1.1%), Indonesia (1%), and the United States (0.87%) (UN Comtrade 2018). This represented a decline from China's market share in 2007, which stood at 69% compared to 11% for Switzerland, 8.1% for India, 3.7% for Hong Kong, and 1.8% for Turkey.

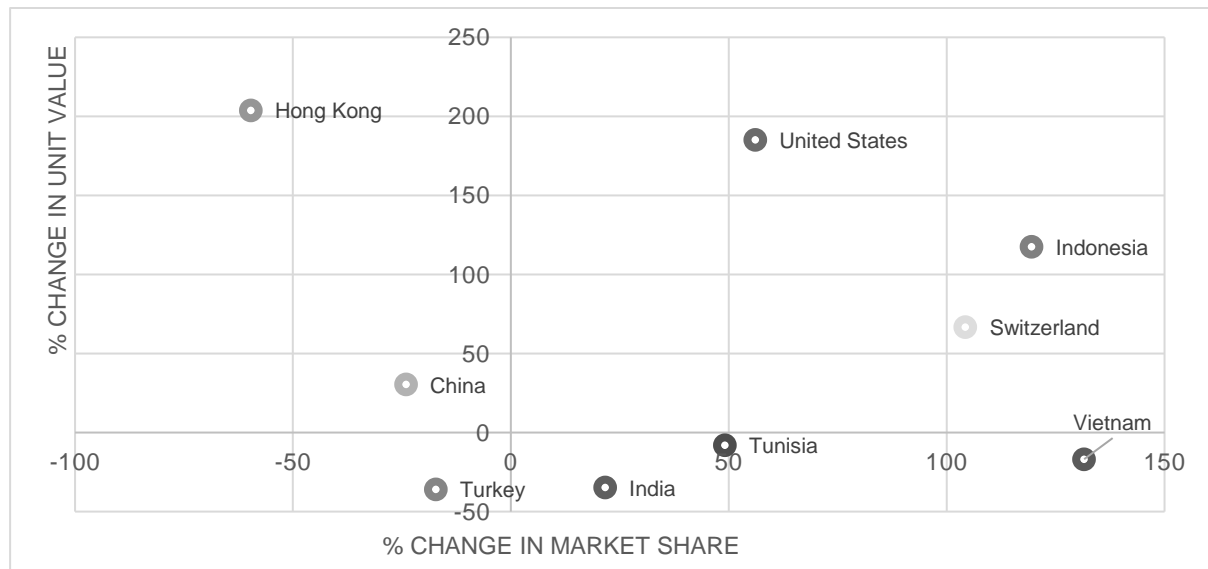
Similar to belts and gloves, the decline in China's market share was associated with an increase in the unit value of Chinese exports indicating a loss of competitiveness due to high costs (Figure 20). Switzerland increased both its market share and unit price substantially. Vietnam achieved an increase in its market share with a decline in unit price while Turkey experienced a drop in both unit price and market share. India achieved an increase in market share with a decline in unit value. This was in the wider context of a 51% increase of the unit prices of EU's imports of this product category, the latter indicating a general shift of market demand to higher value products.

Figure 19: European imports of leather bags by market (2000-2017, USD million)



Source: UN Comtrade 2018

Figure 20: Change in market share/unit value of top suppliers of leather bags to the EU (2007-2017)



Source: UN Comtrade 2018 (WITS).

3.2.2.4.4 Retail market

The biggest retail segment in this category is bags, wallets and purses. In 2013, this set of products amounted to a total revenue of USD 10.8 billion, making up 61.9% of the EU's market value (MarketLine 2014). The luggage segment's revenues made up another large portion with USD 6.6 billion, contributing 38.1% to the market's value (MarketLine 2014).

Specialized clothing, footwear, sportswear and accessories retailers had the biggest market share in 2013, contributing 30.2% of the market's overall revenues (MarketLine

2014). The remaining market share was divided between department stores (16.8%); discount, variety store and general retailers (16.8%); hypermarket, supermarket and discounter (8.2%); and other retail (28.1%) (MarketLine 2014). The industry has relatively high levels of consolidation, with 40% of sales of bags and luggage in Western Europe going to the top 10 retailers (Euromonitor 2018b). The top 10 retailers are listed in Table 6. These companies have benefited from strategic acquisitions of other brands.

Table 6: Top Western European Bag and Luggage Companies in 2011-2016

Rank	Company	Rank	Company
1	LVMH Moët Hennessy Louis Vuitton	6	Hermès International SCA
2	Kerring SA	7	Burberry Group Plc
3	Samsonite International SA	8	Michael Kors Holdings Ltd
4	Prada SpA	9	Private Label
5	VF Corp	10	H&M Hennes & Mauritz AB

Source: Euromonitor 2018b

In 2013, Germany was the biggest EU market with a 22.1% market share, followed by France (12.4%), UK (11.8), Italy (11.3), Spain (7.8) and rest of Europe (34.6) (MarketLine 2015). While France, Switzerland and the Netherlands saw declines from 2012 to 2017, Germany and the UK maintained strong growth (Euromonitor 2018b). Solely considering bags and luggage, Western Europe is the third largest region in terms of sales in 2017 and accounts for about 15% of the worlds' total, at USD 20.2 billion with the UK, France and Italy accounting for over half of the region's sales revenue. Handbags were the biggest selling item in 2017, making up slightly under 50% of the sales of bags and luggage in Western Europe, followed by wallets and coin pouches and cross body bags. In 2017, per capita spending on luggage and bags was USD 40.40 (ibid.).

3.3. Typology of leather products' value chains in the EU

Across the different relevant product types discussed in the previous chapters, distinct market segments can be identified. Each of these are connected to distinct value chain patterns. Below seven different forms of value chains for leather products in the EU are described. These represent different pathways that – theoretically – could be taken by Ethiopian producers. The value chains can be seen to be connected to four market segments: luxury, mid-high end, mass market branded and mass market unbranded. The first three of these present options for Ethiopian companies to participate in production for global brands or to develop domestic brands. A pathway to domestic brand development can involve starting with selling domestically and then expanding to sell in the EU market. Table 7 outlines the value chain types identified. Each value chain is outlined briefly below. Which value chains are likely to fit best for Ethiopian companies will be analyzed in chapter 5.2 after analyzing the structure of the Ethiopian LLP sector (Chapter 4).

Table 7: Value Chains for European Market

	Global Brand	Domestic Brand
Luxury	Value Chain 1: Luxury Brands OEM	Value Chain 2: Luxury Brand OBM
Mid-High End	Value Chain 3: Mid-High End OEM	Value Chain 3: Mid-High End OBM
Branded Mass Market	Value Chain 5: Branded Mass Market OEM/CMT	Value Chain 6: Branded Mass Market OBM
Unbranded Mass Market	Value Chain 7: Unbranded Mass Market	

Source: own elaboration.

3.3.1. Luxury market

Luxury products are sold for high prices and are associated with high quality materials and manufacturing processes. These can involve labor intensive features such as hand stitching. Luxury products can be considered as Veblen goods, characterized by the dynamic of increasing demand as the product becomes more expensive. The market relies on conspicuous consumption and brand identity is very strong.

The global luxury goods market grew by 5.2% in 2017 and amounted to USD 295.9 billion, which represented a CAGR of 4.7% between 2013 and 2017 (MarketLine 2018c). Europe accounts for 32.5% of the global market. Globally, apparel and footwear make up the largest portion of the luxury goods market, accounting for 30.2% of total value with a revenue of USD 89.2 billion (ibid.). Luxury leather goods, a category covering handbags, suitcases, briefcases and small leather goods, such as wallets, comprised 15% of global revenues in 2017 (Statista 2018c). Globally, this is a concentrated market with a small number of companies having a large presence. For leather goods, eight companies made up 81% of the worldwide revenue, namely LVMH (27%), Kering (17%), Coach (10%), Michael Kors (10%), Hermès (8%), Prada (6%), Richemont (2%), and PVH (1%).

EU producers maintain a dominant presence in the high-end segments of the EU's leather market (the luxury segment), making it difficult for new entrants to charge high prices for largely unknown brands (MarketLine 2018c).

Within the luxury segment there is the option to produce for EU brands or to develop domestic brands. Both options are discussed below.

3.3.1.1 Value Chain 1: Luxury brand OEM

The first type of value chain involves producing luxury/high end products for global brands. In this value chain the brand creates a design and selects input materials. The specifications of inputs are very important to the buyer. For luxury products, the brand typically buys or chooses the leather directly from the tannery. A reason for this are high demands with respect to the uniform quality of leather, as avoiding even small variations is very important for the quality level needed for this market.

Figure 21: Value chain for luxury brand OEM



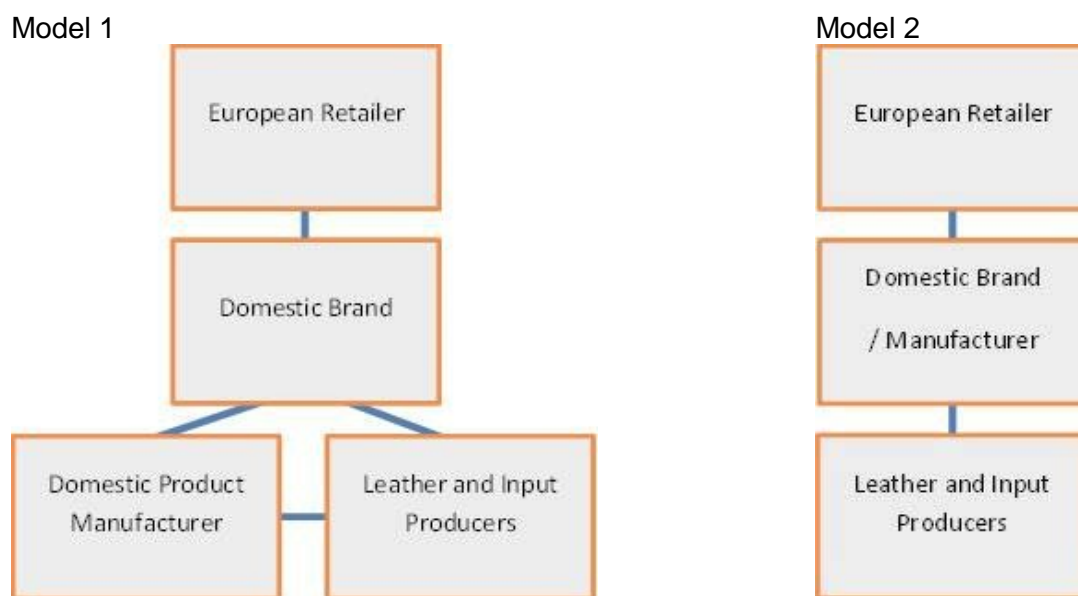
Source: own elaboration.

3.3.1.2 Value chain 2: Luxury brand OBM

The second type of value chain involves the local development of a luxury brand that could be sold in EU markets. In this case the Ethiopian brand can hire an Ethiopian manufacturer (model 1) or the brand and the manufacturer could be an integrated business (model 2).

This chain offers opportunities for the successful establishment of new brands via particular niche strategies (cf. MarketLine 2018c). New leather goods manufacturers rise within the market regularly, and in particular online retail creates new ways to reach consumers, such as through fashion influencers using social media. The efficiency of the transport and logistics is important for distribution for online retail models. New luxury brands can face challenges with growing as incumbents are very large and can absorb new brands that are seen as a threat (ibid.).

Figure 22: Value chain for luxury brand OBM



Source: Own elaboration.

3.3.2. Mid-high end market

Products in the mid-high end category in the EU are characterized by good quality and they often have special features which provide added value to customers. The special features range from having added functions (e.g. dedicated pockets for laptops, security features, etc.) to having non-tangible qualities that are valued by customers, such as, for instance, specific information on production conditions (a story about producers, information on social or environmental impact, being connected to a charity, a celebrity, etc.). Brands within this category can be small and often rely on selling their products through smaller boutique retailers. This segment also holds potential for Ethiopian manufacturers to produce for European brands or to establish domestic brands.

3.3.2.1 Value chain 3: Mid-high end OEM

This value chain involves a mid/high end global brand. In this value chain, some buyers may want to choose their own inputs to ensure quality. In this segment, a potential opportunity for Ethiopian small-scale producers arises to the extent that domestic production processes are

traceable and involve sustainable practices. This can be a key selling factor for some EU brands.

Figure 23: Value chain for mid-high end OEM



Source: Own elaboration.

3.3.2.2 Value chain 4: Mid-high end OBM

The fourth value chain is similar to the third but involves Ethiopian companies developing their own brands. As with Value Chain 2, this can involve a standalone company developing a brand and hiring manufacturers or an integrated brand-manufacturer. This market segment can also obtain premiums for specific added value offerings. This could involve marketing products as traceable with sustainable production, adding additional product features or creating an image or story that adds value for consumers. For example, products can highlight Ethiopian identity and include traditional design features or provide stories about individuals or communities involved in production.

Figure 24: Value chain for mid-high end OBM



Source: Own elaboration.

3.3.3. Branded mass market

Mass market branded products can be created by independent brands that are sold through various retail outlets. This category also includes private label lines developed in-house by retailers. Products in this category are increasingly subject to price competition. Much production for this market comes from very efficient and often large production facilities in Asia.

3.3.3.1 Value chain 5: Branded mass market OEM/CMT

The fifth value chain involves connecting with mass market global brands. These products have production based on designs agreed in advance by global buyers but can involve local design contribution. There are two models in which production can occur for this market.

In Model 1, the manufacturer is responsible for procuring the leather. The buyer would specify the characteristics and trust the manufacturer to get the appropriate material. The buyer expects the producer to have the necessary skills for raw material sourcing. However, in some cases buyers provide lists with approved suppliers. Particularly, global brands can have certified suppliers of labels, notions and other design related items.

In Model 2, which can be called cut-make-trim (CMT), the brand provides the materials to the manufacturer. The manufacturer is responsible for transforming the provided inputs into the agreed product design.

Figure 25: Value chain for branded mass market OEM/CMT

Model 1: OEM



Model 2: CMT



Source: Own elaboration.

3.3.3.2 Value chain 6: Branded mass market OBM

The sixth value chain involves developing a domestic mass market brand. As with the other domestic brand options described above, the brand can be integrated with manufacturing (model 1) or the stages can be fragmented (model 2).

Figure 26: Branded mass market OBM



Source: Own elaboration.

3.3.4. Unbranded mass market

Unbranded mass market items can be lower quality items. They could be sold through small retailers or hard discounters.

3.3.4.1 Value chain 7: Unbranded mass market

Finally, the seventh value chain involves creating unbranded lower end products. They can be sold to traders who would then sell them to retail outlets in the EU.

Figure 27: Value chain for unbranded mass market



Source: own elaboration.

3.4. European market requirements

Compliance with legal and buyer specific requirements are key in order to export to the EU market. This section first outlines key regulatory issues applicable to all leather imports in the EU and then presents requirements of different buyer types.

3.4.1. Legal requirements and regulations

A number of legal requirements must be met by exporters of leather and leather products to the EU. These include rules on product safety, chemicals, labelling, in addition to tariff duties.

Chemicals and product safety

In terms of chemicals, the Registration, Evaluation, Authorization, and Restriction of Chemicals (REACH legislation- regulation EC No 1907/2006 of the European Parliament and of the Council), which came into force in 2007, is the central legislation of the EU. The legislation mandates powers to the European Chemicals Agency (ECHA) in terms of implementation. Companies outside the EU, including those that export to the EU, are not bound by this legislation and the responsibility for fulfilling REACH requirements lie with the importers.

In terms of leather and textile products, REACH bans a number of chemical substances including:

- Tris (2,3 dibromopropyl) phosphate in textile articles intended to come into contact with the skin.
- Tris (aziridiny) phosphin oxide in textile articles intended to come into contact with the skin.
- Polybrominated biphenyls (PBB) in textile articles intended to come into contact with the skin.
- Mercury compounds in the impregnation of heavy-duty industrial textiles and yarn intended for their manufacture.
- Dioctyltin (DOT) compounds in textile articles, footwear or part of footwear intended to come into contact with the skin.
- Nickel in articles intended to come into direct and prolonged contact with the skin, such as rivets buttons, tighteners, rivets, zippers and metal marks, when these are used in garments.
- Azodyes which may release one or more of the aromatic amines listed in Appendix 8, in textile and leather articles which may come into direct and prolonged contact with the skin or oral cavity.
- Nonylphenol and nonylphenol ethoxylates in textile and leather processing. Chromium VI compounds in leather articles intended to come into contact with the skin.
- Polycyclic aromatic hydrocarbons compounds (PAH) in clothing, footwear, gloves and sportswear if any of their rubber or plastic components come into direct as well as prolonged or short-term repetitive contact with the skin or the oral cavity.
- Perfluorooctanoic acid ('PFOA'), its salts and PFOA related substances in textiles for protection of workers and membranes intended for use in medical textiles.

Other banned substances related to leather products are persistent organic pollutants (PoPs) (Regulation (EC) No 850/2004 of the European Parliament and of the Council). Biocidal products are also not allowed in textile and leather products (Regulation EU No 528/2012 of the European Parliament and of the Council of, 2012). Regulations on the use of chrome (restrictions on the use of chromium VI in leather products) are contributing to the growth of chrome free leather production. Leather products are also subject to the rules of the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES).

Product safety information is governed by the General Product Safety Directive.

The requirements are not provided in a specific piece of legislation but can be accessed through the General Product Safety Directive in the EU Export Helpdesk.

Labelling

Labelling is also an important area that producers must consider. Footwear must have labels with information on the material used in each of the main parts (upper, outer sole, and lining & stock). Textile and apparel products must also be labelled with fibre composition in line with EU rules and names (Textile Regulation No. 1007/2011). Overall, care labeling and eco-labelling are not mandatory. In addition to EU labelling requirements, some member states have further labelling requirements including the use of national language.

Import duties

Leather and leather products are also subject to import duties when entering the EU market. The Everything But Arms (EBA) Initiative, that Ethiopia benefits from, covers leather and leather products. This scheme grants duty free and quota free access to the EU Single Market. Within this scheme, leather and leather products are subject to the Rules of Origin (RoOs) requirements. Nonetheless, global tariffs remain important as they affect the competitiveness of Ethiopian exports vis-a-vis countries that do not benefit from duty free access.

Import tariffs vary between different products in the LLP industry (Table 8). Generally speaking, raw leather hides face a 0% tariff rate while tanned leather and leather products face higher tariffs. In some segments in leather products, those tariffs can be substantial, providing a country such as Ethiopia with duty free access an important advantage.

Table 8: Key European tariff levels for LLP

Subheadings (HS code)	Description	Minimum rate	Maximum rate	Average rate
4101, 4102, 4103	Raw hides and skins of bovine , sheep, lamb, and other raw aw hides and skins	0	0	0
4104	Tanned or crust hides and skins of bovine	0	6.5%	3.2%
4105	Tanned or crust skins of sheep or lambs	0	0	0
4106	Tanned or crust hides and skins of other animals	0%	2%	0.6%
4107	Leather further prepared after tanning or crusting	5.5%	6.5%	6.4%
4112	Leather further prepared after tanning or crusting of sheep and lamb	3.5%	3.5%	3.5%
4113	Leather further prepared after tanning or crusting of other animals	2%	3.5%	2.4%
4114	Chamois leather	2.5%	2.5%	2.5%
4115	Composition leather	0%	2.5%	1.3%
4201	Saddlery and harness for any animal	2.7%	2.7%	2.7%
4202	Trunks, suitcases, other types of cases (spectacle, camera, musical instrument), bags (travel, food or beverages, rucksacks, handbags, shopping-bags, wallets and purses	2.7%	9.7%	4.5%
4203	Articles of apparel and clothing accessories	4%	9%	6.2%
4205	Other articles of leather or composition leather	2%	3%	2.5%
6403	Footwear with outer soles of rubber, plastics, leather or composition leather and uppers of leather.	5	8%	7.9%
640510	Footwear with uppers of leather or composition leather	3.5	3.5	3.5

Source: World Trade Organization (WTO) 2018.

3.4.2. Buyer requirements by market segment

Potential buyers of Ethiopian leather and leather products in the EU are diverse. The main types of buyers found in the seven value chain models described above are outlined in Table 9. Buyers' requirements can be divided in those related to design, quality, quantity, transportation logistics and private standards – each of which are described below and summarized in Table 11.

Table 9: Buyer types for each value chain model

Leather Value Chain	European Buyer Types
VC1: Luxury Brand OEM	• High End/ Luxury Global Brand
VC2: Luxury Brand OBM	• High end/Luxury retailers
	• Intermediary/Agent
VC3: Medium/High End OEM	• Medium/High End Global Brand
VC4: Medium/High End OBM	• European retailer
	• Intermediary/Agent
VC5: Branded Mass Market OEM/CMT	• Mass market global brand
	• Intermediary/Agent
VC6: Branded Mass Market OBM	• European retailer
	• Intermediary/Agent
VC7: Unbranded Mass Market	• Intermediary/Wholesaler
Finished leather	• Manufacturer
	• Intermediary/Agent

Source: Own elaboration.

Design

Across the identified value chain models, domestic design capability requirements differ. For the OBM value chains, domestic design teams need to be aware of European trends. For OEM, CMT and unbranded mass market, design skills are less important as buyers provide design specifications.

Quality

In order to integrate into EU value chains, and in particular for higher-end products, increased scrutiny of production processes at all stages, which requires a high level of monitoring and quality control, is necessary. Most product designs require high levels of standardization, but there is also a market for less uniform “artisan” style products.

As leather is a natural product, the skins can have irregularities or blemishes that affect the quality. How animals are raised affects the quality of the leather. If animals suffer from scratches, diseases or infections, quality can be lower. Some buyers prefer leather to be from regions where animals are raised on farms and/or indoor, which can ensure the production of more uniform leather quality. Skins can be graded on a quality scale. Buyers can specify the grade of leather they want to have incorporated into a product. Smaller items or those with small patches of leather, can have the pattern pieces cut around blemishes that may mar the skin.

A number of product qualities are important to EU consumers. The smell of leather, for example, can be an issue, a factor that can be affected by the type of processing practices used to treat the skin. Color and texture are also important factors, in particular for higher-end buyers. Products can be returned if color does not match a buyers’ specification. The quality of trims can also be very important on high-end leather products. Snaps, zippers and other fastening devices need to hold up to regular use of the product.

The shipment process can also affect leather quality. If products are being shipped by boat and will be packaged for a long period of time, moisture can be a big issue. This can create white patches on the product that can make it unacceptable to buyers in the EU.

Quantity

Order sizes can vary among value chains and buyer types. Some large buyers will order smaller production runs. However, some buyers require high minimum orders that can be challenging to comply with for small suppliers. Value chains 1-4 would generally involve small production runs. Particularly for luxury goods, small order sizes are produced, with high markups (MarketLine 2018c).

Transaction Logistics

Logistics processes vary greatly for the different value chain types. To be able to quickly process orders, producers can keep some standard leather products on hand to be ready to meet orders with tighter timelines. Mass market global branded leather products have about 5 to 6 months from order to delivery. Leather products are made in 3 to 4 months, then shipped by boat due to high weight. As leather is a heavy product, shipment by boat is more cost effective for larger orders. Smaller buyers in the EU receive small shipments from Ethiopia typically by air.

Private Standards

Standards required or desired by EU buyers can be related to product attributes or the processes that were used to make the product. These standards can reflect industry

standards that individual buyers look for when choosing a supplier or, in addition, be defined by individual buyers. Adhering to standards can involve different processes. Some require producers to pay to get certification. Others involve production facilities being inspected by buyers or independent auditors when a potential commercial relationship is being discussed. Four key types of standards are product health and safety standards, management system standards, environmental standards and labor standards.

In terms of product health and safety standards, retailers may look for certified organic products, which can be seen as being healthier for consumers. A key standard which certifies leather as having higher product safety is the OEKO-TEX Leather Standard. This standard takes into account the use of substances that have been legally banned or regulated as well as harmful chemicals that have not been legally regulated.

Buyers can look for management system certifications from suppliers or view buyers more favorably who have these standards. ISO 9001:2015, for example, certifies the quality management system of a company, demonstrating the ability to consistently provide products and services that meet customer and applicable statutory and regulatory requirements, and aims to enhance customer satisfaction through the effective application of the system, including processes for improvement of the system and the assurance of conformity to customer and applicable statutory and regulatory requirements. Buyers may also look for specified quality control practices from potential suppliers.

Environmental standards can be related to practices and substances that are used during a product's production. For leather products, a key area of environmental impact is the tanning stage. However, all stages of production can have environmental impacts that can be connected to activities such as energy use, waste disposal and transportation. For some buyers, environmental standards are part of a large set of requirements. For some buyers environmental standards are a key part of their brand identity. Examples of environmental standards relevant for leather producers include ISO 14001:2015 and ECO₂L.

Some buyers have joint initiatives that have goals for reducing the environmental impact of their suppliers over time. Several large EU companies have signed up to Greenpeace's Detox 2020 campaign, which requires that companies phase out 11 priority hazardous chemical groups at all stages of production. Another initiative that is shaping some large buyers' decisions related to the environmental impact of production is the ZDHC Roadmap to Zero Programme, which also seeks to eliminate the use of specific chemicals.

Large EU retailers often have labor standards which can be expressed as codes of conduct related to the final stage of manufacturing. Being able to have products sold in such retail outlets can involve production site inspections. These standards can cover aspects of health and safety at the workplace and also employment relations. Key issues include working hours, payment systems, minimum working age and discrimination. Buyers with labor codes of conduct often draw reference from conventions of the International Labor Organization. Widely accepted labor standards in the EU are the Ethical Trade Initiative Base Code and the BSCI Code of Conduct. However, many retailers have their own labor codes of conduct that can have distinct requirements for producers. Details of private supplier codes of conduct are often available on buyers' websites.

Individual buyers can have their own specific requirements related to a variety of practices carried out by suppliers. Some large buyers offer training programs for suppliers to help the supplier to upgrade and to meet their requirements.

Table 10: Buyers' product preferences and expectations overview

European Market Segment	Buyer Types	Buys	Materials and Accessories	Design	Quality	Quantity	Transaction Logistics	Key Standards
VC1: Luxury European Brand	<ul style="list-style-type: none"> High End/Luxury Global Brand 	<ul style="list-style-type: none"> Manufacturing as a service 	<ul style="list-style-type: none"> European brand 	<ul style="list-style-type: none"> European Buyer 	<ul style="list-style-type: none"> High 	<ul style="list-style-type: none"> Small-medium 	<ul style="list-style-type: none"> Plane and boat 	<ul style="list-style-type: none"> Legal requirements
VC2: Luxury Ethiopian Brand	<ul style="list-style-type: none"> High end/Luxury retailers Intermediary/Agent 	<ul style="list-style-type: none"> Finished product 	<ul style="list-style-type: none"> Producer/production country brand 	<ul style="list-style-type: none"> Ethiopian Brand 	<ul style="list-style-type: none"> High 	<ul style="list-style-type: none"> Small-medium 	<ul style="list-style-type: none"> Plane and boat 	<ul style="list-style-type: none"> Legal requirements
VC3: Mid/High-End European Brand	<ul style="list-style-type: none"> Medium/High End Global Brand 	<ul style="list-style-type: none"> Manufacturing as a service or finished product 	<ul style="list-style-type: none"> Leather chosen by producer, accessories provided by buyer 	<ul style="list-style-type: none"> European buyer or buyer supplier collaboration 	<ul style="list-style-type: none"> Medium-high 	<ul style="list-style-type: none"> Small-medium 	<ul style="list-style-type: none"> Usually by plane 	<ul style="list-style-type: none"> Environmental certification Labor codes of conduct Legal requirements
VC4: Mid/High-End Ethiopian Brand	<ul style="list-style-type: none"> European retailer Intermediary/ Agent 	<ul style="list-style-type: none"> Finished product 	<ul style="list-style-type: none"> Producer/production country brand 	<ul style="list-style-type: none"> Ethiopian Brand 	<ul style="list-style-type: none"> Medium-high 	<ul style="list-style-type: none"> Small-medium 	<ul style="list-style-type: none"> Usually by plane 	<ul style="list-style-type: none"> Legal requirements
VC5: Branded Mass Market European Brand	<ul style="list-style-type: none"> Mass market global brand Intermediary/Agent 	<ul style="list-style-type: none"> Manufacturing as a service or finished product 	<ul style="list-style-type: none"> European brand or producer 	<ul style="list-style-type: none"> European buyer or buyer supplier collaboration 	<ul style="list-style-type: none"> Medium 	<ul style="list-style-type: none"> Small-large 	<ul style="list-style-type: none"> Usually by boat 	<ul style="list-style-type: none"> Labor codes of conduct Quality assurance standards Environmental standards Legal requirements
VC6: Branded Mass Market Ethiopian Brand	<ul style="list-style-type: none"> European retailer Intermediary/Agent 	<ul style="list-style-type: none"> Finished product 	<ul style="list-style-type: none"> Producer/production country brand 	<ul style="list-style-type: none"> Ethiopian Brand 	<ul style="list-style-type: none"> Medium 	<ul style="list-style-type: none"> Small-large 	<ul style="list-style-type: none"> Usually by boat 	<ul style="list-style-type: none"> Legal requirements
VC7: Unbranded Mass Market	<ul style="list-style-type: none"> Intermediary/ Wholesaler 	<ul style="list-style-type: none"> Finished product 	<ul style="list-style-type: none"> Producer 	<ul style="list-style-type: none"> Ethiopian Brand 	<ul style="list-style-type: none"> Low-medium 	<ul style="list-style-type: none"> Small-large 	<ul style="list-style-type: none"> Varied 	<ul style="list-style-type: none"> Legal requirements

Source: Interviews 2018; own elaboration

3.5. Trends

The following section provides a summary of key trends with important impacts on the European leather and leather products sector and value chains (see Azmeh/Alexander 2018 for a more detailed analysis). The section differentiates between general and product specific trends (Table 11). The trends are a summary of various interviews and market reports (e.g. Euromonitor 2015; MarketLine 2018b).

3.5.1. General trends

Increasing competition, downward price pressure and growing opportunities in Africa

The increasing global competition in the manufacturing segment of the LLP GVC has led to a downward pressure on margins for manufacturers. New manufacturing opportunities for production in low wage countries are created in the context of rising labour costs in China. Many African countries such as Ethiopia could become a more important region for sourcing leather products in the near future.

Increased automation could make labour cost less important in the future

While many leather products rely on high levels of manual labour, use of automation and capabilities for automation are likely to grow in the future. With increased automation, labour costs become less of a factor for sourcing decisions. This trend is starting to make an impact in the EU already with growing potential for reshoring production that had previously moved overseas. For example, Clarks, a large UK shoe company, has just opened a new factory in the UK twenty years after closing their last domestic factory.

Movement to smaller scale and more customized production

Global manufacturing trends are moving to smaller scale, more customised production runs. This is particularly an issue for the industrial model used by many Chinese producers. Their large-scale factories need large orders to be able to survive and cover overheads. Similar to garments, the leather sector is moving toward smaller production runs and more flexible sourcing partially due to companies trying to postpone their sourcing decision point. This can provide advantages for locating production near consumption sites.

Increasing of sourcing through direct buyer-seller relationship without agents

While historically, overseas production has largely been facilitated by agents, a growing number of buyers and suppliers are beginning to develop direct relationships. This can involve either party having a presence in the other's home location or can be facilitated through well-developed long-distance communication practices.

Changing Trade Policy Environment is Affecting Sourcing Decisions

When companies make their sourcing decisions, trade policies can be a contributing factor. Growing uncertainty surrounding global trade agreements can make companies cautious when making sourcing plans. Key concerns related to this dynamic are UK sourcing from the EU related to Brexit uncertainty and European sourcing from China in the face of the risk of an escalating trade war between the US and China.

Growth of Synthetics

Another notable trend is the use of synthetics as a leather replacement. The quality of these alternative products has improved. Also, brands selling products marketed as vegan can sell products using synthetic leather at higher price points. The shift towards synthetics has been cited as a key reason for sluggish global demand growth for leather and leather products.

Growing demand in luxury segments

The demand for luxury leather products in the EU is growing, particularly for bags and luggage. The market development is particularly strong since tourists often buy luxury leather products in the EU. In addition, there is also a trend to affordable luxury.

Growing Demand from 50-plus Customers

As Europe's population ages, a growing market for items specifically targeted to senior citizens is developing. Germany, with Europe's oldest population, is particularly a large market for products aimed at the 50-plus age group, which tends to have higher disposable incomes than younger consumers.

Sportswear is increasingly popular

Across footwear, apparel and apparel accessories, sportswear is increasingly popular. EU consumers are buying more products for sports activities and have adopted the 'athleisure' trend, which involves wearing sports inspired items for daily activities.

Sustainable production

The trend towards sustainable production involves processes and final items that have reduced negative environmental and social impacts and ideally involve positive environmental and social impacts. The EU has a growing market for sustainable products. Thus incorporating sustainability as a brand's unique selling point can be advantageous in the EU market. A stage of production with major sustainability concerns in leather product production is tanning.

Chrome-free leather

Chrome-free – or free of chrome (FOC) – leather is tanned without chromium (III), a metal commonly used in leather production. This is associated with limiting environmental impact of production. Thus, products made from chrome-free leather are being marketed by retailers as an ecologically sustainable option.

Traceability

For some European markets, traceability is a growing concern. Traceability involves the buyer being able to identify the origins of raw materials or intermediate products. It can also involve identification of the businesses involved in various stages of turning a raw material into a final product. Traceability in the LLP GVC often only involves the segments from tanneries to consumers and not necessarily the origin of raw hides and skins.

Traceability is important for both quality and corporate social responsibility (CSR) reasons. For quality, ensuring that animals are cared for in ways that ensure a consistent blemish free product is important. Subsequent processes used in slaughter and leather processing also have a large impact on the quality of a final product. For CSR issues, the leather industry is particularly subject to pressures related to issues of animal welfare and high levels of pollution that occur in early stages of the production process.

Traceability is particularly increasing in importance for branded mass market shoe producers. A representative of a large UK based shoe manufacturer described that the reason its company has a list of tanneries that they provide to manufacturers is that tanneries are very important for issues of quality and environmental damage. According to the interviewee, these pressures have increased in the last few years. Previously tanneries were reluctant to being inspected by buyers of manufactured products but this is changing. This interviewee described that the company may work with existing suppliers to address issues around traceability and environmental standards but when acquiring a new supplier they now demand that the supplier meets traceability standards right from the beginning.

Increased consolidation in the tanning industry

The trends of sustainable production and traceability are leading to increased cooperation in the tanning industry. Over the last few years, there has been a global push for the consolidation of tanneries, partially due to increasing buyer requirements and issues around economies of scale. Additionally, tanneries are operating common effluent treatment plants.

Fast fashion

The idea of fast fashion involves retailers frequently providing new styles which have the latest fashions at low prices. Methods through which companies meet these objectives include reducing quality, limiting service in stores, taking advantage of economies of scale and reorganizing supply chains. This trend cuts across product categories. Fast fashion brands that have traditionally focused on clothing and accessories are entering the footwear market, with Zara, Primark and H&M being strong drivers in the EU's footwear market. Low priced fast fashion retailers are creating downward price pressure on mid-range retailers.

Growth of online retailing

Online retailers are becoming increasingly important in the European market. This trend is particularly visible in the UK where several high-profile department stores have recently faced severe financial difficulties.

3.5.2. Product specific trends

A summary of product specific trends is presented in Table 11. EU's footwear consumption growth is moderate, with particular market segments (sportswear, luxury market) and regions (Eastern EU) growing faster than others. The market for children shoes is declining. There is also a decrease in use of goat and sheep leather for shoes. For apparel, market development is stronger for leather jackets than for trousers. Including non-leather products, sportswear, shapewear and season-less design products and market segments are the most promising in the EU. Leather apparel accessories are in trend, but unit prices are decreasing.

Leather bags, luggage and backpacks are in trend and market development is relatively strong in the EU. Demand for high and low priced products is generally stronger. Handbags are particularly benefiting from fast fashion retailers increasing their offerings. There is an increasing demand for new security features for wallets, backpacks and luggage.

Table 11: Product specific trends in the EU market

Footwear	Apparel	Apparel accessories	Bags, luggage, backpacks, etc.
<ul style="list-style-type: none"> Moderate growth in EU's footwear consumption Increasing competition/downward price pressure Luxury market is growing Market for children shoe's declining Decrease in use of goat and sheep leather for shoes "Increasing" importance of design Trend towards fast fashion Mass market sports footwear Niche market for specialty footwear Trend towards sports footwear (performance focused and sport inspired styles) Western Europe market stagnating, and Eastern European market growing Shoe sales per capita remain constant, but less money is spent per pair of shoes Footwear retailers diversify products (handbags and other products) 	<ul style="list-style-type: none"> Moderate growth in the EU apparel retail industry Increasing competition/downward price pressure Market development better for leather jackets than for trousers Market for season-less design is growing Sportswear market is growing Shapewear market is growing Potential decrease in labour intensity of production 	<ul style="list-style-type: none"> Limited growth for accessories in the EU, but promising outlook for leather accessories Milder weather affecting growth for items such as scarves, hats and gloves Sports accessories (fashion/functional) demand increasing Decreasing unit prices (increasing competition, price conscious consumers, frequent price promotions) 	<ul style="list-style-type: none"> Moderate market growth Increasing demand for high and low prices items Leather handbags, luggage, wallets and backpacks are in trend Handbags benefit from fast fashion retailers increasing their offerings Growing luggage and backpack market Increasing demand for new security features (wallets, backpacks, luggage) EU increases efforts to limited counterfeit production/imports (particularly handbags)

Source: e.g. Euromonitor 2015; MarketLine 2018b; Interviews

4. MAPPING THE ETHIOPIAN LLP SECTOR

4.1. Introduction

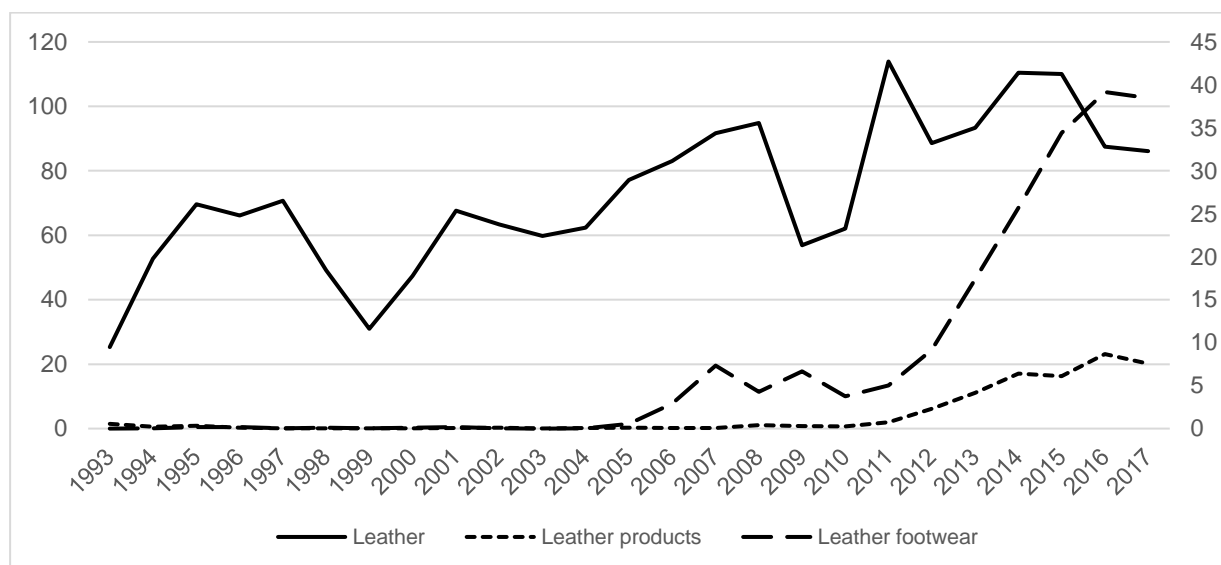
Ethiopia has one of the largest livestock sector in the world and the formal LLP sector has existed for almost a century (LIDI 2017). The government under the Emperor Haile Selassie started to regulate the sector and established the Livestock and Meat Marketing Board in 1964 (Abebe/Schaefer 2015). The Derg-regime expelled foreign investors and established the National Leather and Shoe Corporation to manage eight tanneries and six large shoe factories (ibid.). With the end of the Derg-regime came a reorientation towards market-oriented economic reforms and privatization processes. This, in combination with an industrial policy focus implemented since the early 2000s allowed for the expansion of and upgrading in the Ethiopian LLP sector, leading to increasing FDI-inflows and local investments since the mid-to-late 2000s and early 2010s.

A key shift in the development of the Ethiopian LLP sector was initiated by the introduction of an export tax on different types of semi-processed leather since the late 2000s. A major challenge of the Ethiopian LLP sector used to be the high share of raw hides and skins as well as semi-processed leather exports. The value of finished leather is much higher than that of raw hides and skins or semi-finished leather.⁴ This is even more true with respect to the value of manufactured products, which is a main motivation for promoting processing industries in Ethiopia. Since the introduction of the export tax, Ethiopia has successfully increased finished leather and leather product exports while exports of semi-processed skins and hides started to disappear. Nonetheless, the increase of export earnings after the introduction of the export taxes stayed well below the expectations of the government (Oqubay 2015), in part because the increase of higher value exports was accompanied by lower volumes (UN Comtrade 2018).

The expansion and upgrading processes are reflected in trade and employment data. The value of LLP exports increased from an average of USD 53 million between 1996 and 2000 to USD 135 million between 2013 and 2017 (UN Comtrade 2018; Figure 28). The increase in exports in recent years has been mostly driven by FDI companies in the leather footwear and gloves sub-sectors. Today, the most important leather exports include finished leather (USD 86.1 billion in 2017), leather footwear (USD 38.5 billion) and leather products (esp. gloves and bags) (USD 7.6 billion). Similarly, employment almost doubled from 11,365 employees in 2012/13 to 21,094 in 2017/18 (Figure 29), mainly due to growth in the footwear-sub-sector. Employment levels in tanneries, on the other hand, are stagnating.

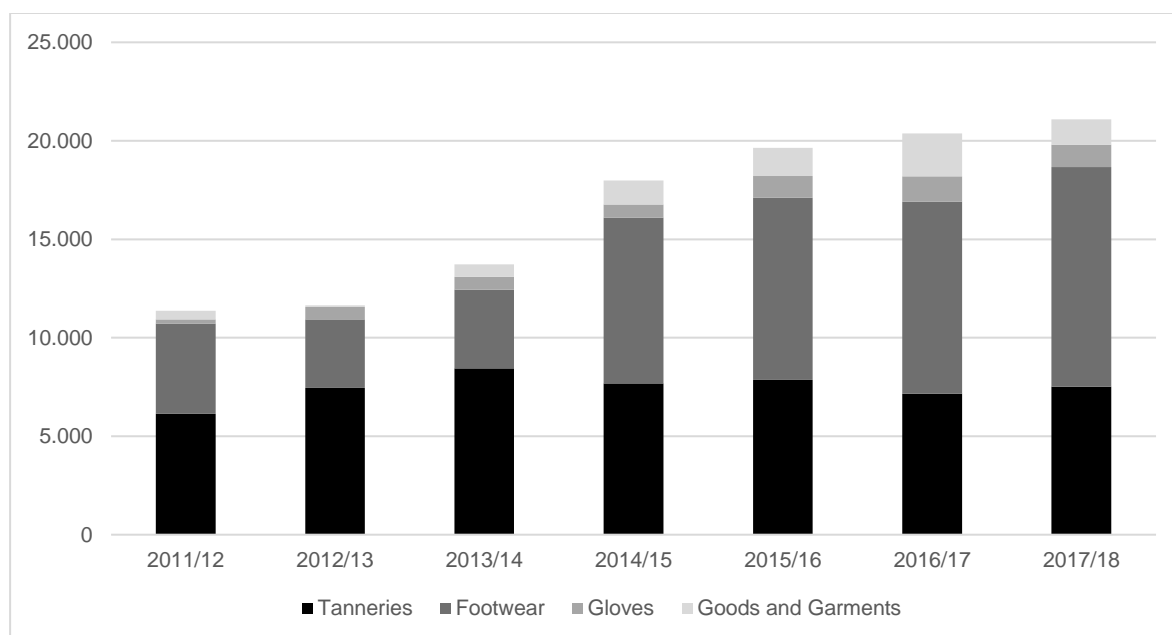
⁴ The value addition of finishing varies significantly, depending on the specific specifications, but it can account for multiples of the value of semi-finished leather.

Figure 28: Ethiopia's leather and leather products exports (USD million, 1993-2017)



Note: Leather includes HS41; Leather products includes HS42; Leather footwear includes HS6403 (uppers of leather) and HS640510. Data represents global imports. Leather data includes raw hides and skins.
Source: UN Comtrade 2018 (WITS).

Figure 29: Employment in the Ethiopian LLP sector (2011/12-2017/18)



Note: LIDI 2018a

4.2. The structure of the Ethiopian LLP sector

The Ethiopian LLP value chain can be roughly divided into five key segments (see Annex I (a) for a detailed map): (i) the livestock sector, which is dominated by small-scale farmers; (ii) collectors and local traders that link farmers with tanneries; (iii) tanneries, which produce wet blue, crust and finally coated or finished leather. Tanneries export either directly with further manufacturing taking place abroad or supply (iv) local leather

manufacturers (e.g. footwear, gloves, bags, jackets) that (v) may export to global buyers or supply the domestic market. Leather product manufacturers also need inputs besides hides, e.g. soles from sole producers and different types of, in the case of Ethiopia mostly imported, accessories in the footwear sector.

The Ethiopian **livestock sector** largely involves small cattle farmers without many large-scale ranches. Around 12.5 million households, or 70% of the total population, depend fully or partly on cattle for their livelihoods (FAO 2018). The production of skins and hides is of comparatively minor importance for the livelihood of farmers in comparison to the production of meat and dairy products, since skins and hides are only byproducts of meat production. Ethiopia has one of the world's largest livestock population with around 58 million cattle (the largest in Africa and 6th in the world), 29 million sheep (3rd in Africa and 10th in the world) and 30 million goats (3rd in Africa and 8th in the world) (LIDI 2017). The off-take rate⁵ is 14% for cows, 27% for goats and 40% for sheep.

The key challenge in the livestock sector is the limited production of quality skins and hides due to parasitic skin diseases, traditional husbandry practices (flaying, branding, curing) and weak post-mortem management of skins and hides (backyard slaughtering and sub-standard collection, storage and transportation) (cf. Abebe/Schafer 2015: 130). There has been a stagnating trend of hides and skin supply to tanneries in recent years. What is more, interviewees have indicated that the quality has been deteriorating. In 2017, only 1.4 million bovine hides and 20 million sheep and goat skins-pieces were supplied to Ethiopian tanneries (LIDI 2017).

Another challenge in the livestock sector is the seasonality of production in accordance to the three festival seasons in September (Ethiopian New Year, Meskel and Arefa), January (Ethiopian Christmas, Epiphany and wedding season) and May (Ethiopian Easter, Ramadan and wedding season). The seasonality of production and hence supply for a more or less uniform demand over the year lead to erratic price developments. As a result, most households in urban areas like Addis Ababa sell skins at or below the break-even point during holiday season in the last couple of years. At slack seasons, however, tanneries suffer from the lack of supply and are forced to buy at elevated prices. This was not the case for many years as either tanneries or raw hides and skin traders had the financial capacity and liquidity to absorb seasonal oversupply and store for slack seasons.

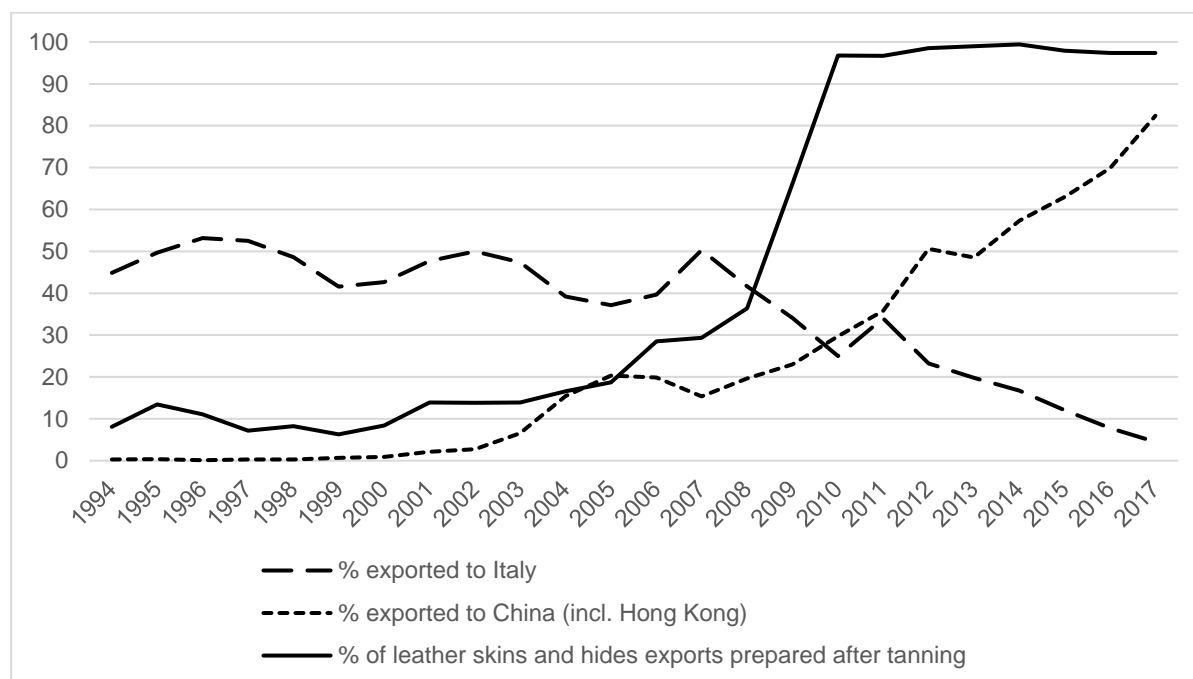
In 2018, Ethiopia had 30 **tanneries** with 7,516 employees processing hides and skins to different types of finished leather. In 2018, the total wet-end installed capacity amounted to around 275 million square feet per year (LIDI 2018a). The sector experienced significant FDI-inflows in recent years (10 out of the 30 companies were FDI in 2018), which indicates a significant shift in the sector's structure, the latter having been dominated by locally-owned companies until the 2000s. FDI has been mainly attracted by raw material potential, competitive wages, preferential market access agreements and generally less stringent environmental practices. Some of these FDI-companies bought already existing tanneries and upgraded the facilities and products. The remaining FDI-companies invested mainly by dislocating and reconditioning their existing tannery and plant-machinery.

Since the late-2000s and in the context of comprehensive industrial policies and the introduction of the export tax on semi-processed leather, the sector successfully upgraded to the production and export of higher value-added finished leather products. The upgrading processes coincided with a shift in end-markets and increasing shares of FDI-companies in exports. The key reason for the shift in end markets is the need for different buyers. The EU and in particular Italy used to be the key export market of semi-processed

⁵ The ratio of animals slaughtered to livestock numbers.

skins and hides, but the upgrading processes shifted end markets towards Asia, in particular China (Figure 30). In 2017, Ethiopia exported USD 86 million of finished leather mostly to China (incl. Hong Kong; 82% by value), the EU (12%; esp. Italy 5% and the UK 6%), India (2%) and Indonesia (2%). The increase of FDI-companies' share in leather exports from 32% in 2007/08 to 73% in 2017/18 is not only a consequence on increasing FDI investments, but also because locally-owned companies often lack the necessary capabilities and capacities to produce and export competitive finished leather, since the know-how necessary to produce and sell finished leather is significantly higher relative to semi-processed leather.

Figure 30: Export share of leather skins and hides by markets and products (% , 1994-2017)



Note: Data represents global imports. % of leather skins and hides exports prepared after tanning includes HS410420, HS410620, HS410431 and HS410439.
Source: UN Comtrade 2018 (WITS).

The **footwear sector** has experienced significant growth and an increasing export-orientation in the context of FDI and local investments since the mid-2000s. By mid-2018, the footwear sector consisted of a few thousand artisanal footwear manufacturers and 19 to 22 formal firms. The formalized footwear sector employed 11,145 people and produced roughly 5 million pairs of leather shoe in 2017/18 (2010 E.C.) (LIDI 2018a). The capacity utilization rate is only around 47%, with locally-owned companies generally having lower utilization rates.

There are currently 16 locally-owned footwear companies and almost all have their own design and brand for the local market, and in particular medium- and larger-sized companies are able to offer a wide array of services to global buyers (from CMT to private brand manufacturing). Many companies offer CMT and FOB services depending on the buyers' demands, but only a few companies are able to export their own brands to key consumption markets. The six foreign-owned companies (mostly CMT), most of which were established in the mid-to-late 2000s and early 2010s, currently employ around one-third of total employees in the footwear sector (LIDI 2018a). There are unconfirmed rumors that the Huajin Group, one of the largest FDI companies in the sector, might significantly

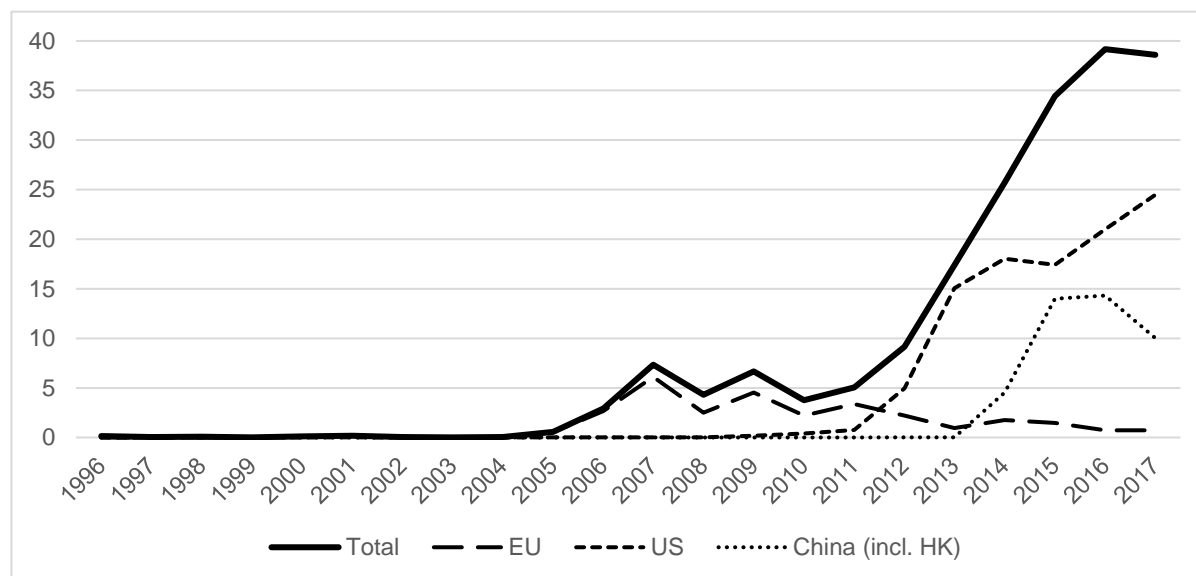
increase investment to employ 50,000 persons or more in the near future. Six footwear companies, mostly locally-owned, are vertically integrated (or have the same owners) and some companies also produce other leather products. Many artisanal footwear manufacturers are located in clusters and organized in cooperatives. One of the best organized cooperatives is the Ethio-International Footwear Cluster Cooperative Society (EIFCOOS) in the Yeka district of Addis Ababa, linking 173 enterprises and employing around 1,557 workers (UNIDO 2016).

The local market continues to be the most important sales channel, in particular for locally-owned footwear companies, since foreign-owned companies are not allowed to sell on the local market and are geared towards global key consumption markets (LIDI 2018a). In 2017/18 around 68% of total production by volume was sold on the local market (LIDI 2018a; UN Comtrade 2018). Competition on the local market increased in recent years due to increasing production capacities of local firms and imports. Ethiopian leather footwear imports increased from an average of USD 1.4 million between 2006 and 2010 to USD 9.6 million between 2012 and 2016, most of which is imported from China (56% in 2016), India (32%) and Turkey (14%) (UN Comtrade 2018).⁶ In 2016, leather footwear accounted for 5% of total footwear imports (USD 120 million; 83% of which was imported from China).

Footwear exports increased from almost insignificant levels until the mid-2000s to USD 7 million in 2007. The stagnation of the late 2000s was followed by a period of strong growth between 2010 and 2017. In 2017, exports of leather footwear amounted to USD 39 million (85% of total footwear and 1.7% of total merchandise exports) (UN Comtrade 2018). Ethiopia's footwear products used to be almost exclusively exported to the EU in the late-2000s (esp. Italy, Germany and Austria). However, since the early 2010s exports to the US and China have significantly increased while exports to the EU almost vanished. In 2017, the US (64% of Ethiopia's leather footwear exports by value) and China (26%, incl. Hong Kong) were by far the most important export markets followed by Canada (7%) and the EU (2%, esp. UK, Spain, Italy, France) (Figure 31). The development of the US market in recent years is a result of FDI, for example the Chinese Huajin Group and the Taiwanese George Shoes. In 2017/18, FDI-companies share in footwear exports by value amounted to 87% (LIDI 2018a).

⁶ Data represents Ethiopian imports.

Figure 31: Development of Ethiopia's footwear exports by end-market (2003-2017, USD million)



Note: Data represents global imports and refers to HS6403 and 640510.

Source: UN Comtrade 2018 (WITS)

The **leather products** (excluding footwear) sector should be differentiated between manufacturers of leather bags, jackets, wallets and belts, and manufacturers of gloves. The first sub-sector is dominated by locally-owned SMEs, including three footwear manufactures, producing bags, jackets, wallets and belts mainly for the local market. By mid-2018, 42 formal companies produced leather products (excluding gloves and footwear), employing 1,285 thousand persons.⁷ Almost all of the locally-owned manufacturing companies have their own design and brand for the local market, but only a few of these companies have the capacity and capability to export a significant share of their production. In the leather products sub-sector, CMT and FOB is predominant, but some companies are also able to export their own designs and brands due to their small scale and more direct sales channels to retailers.

The leather glove sub-sector has a fundamentally different dynamic since it is mainly driven by FDI. By mid-2018, four foreign-owned companies⁸ and one new Ethiopian investment (Dev Impex Enterprise by Bahadir Tannery) employed a total of 1,148 persons. Ethiopia has a significant competitive advantage for the manufacturing of gloves due to the characteristics of its sheep leather and, in addition, there is only a small local and regional market for gloves due to the climatic conditions.

The increase of leather products exports since the early 2010s has been driven by FDI in the manufacturing of leather gloves. Exports of leather products increased from insignificant levels until the early 2010s to USD 7.6 million in 2017 (Figure 28). In 2017, the most important exported leather products were gloves (79% of leather product exports, excluding footwear), bags (11%) and cases (8%) (Table 12). Other products such as jackets, belts and wallets are currently of lesser importance. The US is the largest importer of Ethiopian leather products (66% by value in 2017), followed by the EU (24%, in particular Germany, Italy and the UK), China (6%) and Japan (2%) (Table 13).

⁷ Field research indicated that employment in this sector is likely to be slightly higher.

⁸ Including Pittards Products Manufacturing (UK), Otto Kessler Glove Ethiopia (GER) and Lyu Shoutao Factory (CHN).

Table 12: Exports of leather products (HS42) by article (USD million, 2010-2017)

Top exporting products	2010	2013	2017	% of exports (HS42)
Articles of apparel and clothing accessories (HS4203)	0.08	3.57	6.09	79.92
<i>Gloves (HS420329)</i>	<i>0.06</i>	<i>3.55</i>	<i>5.99</i>	<i>78.61</i>
<i>Apparel, e.g. jackets (420310)</i>	<i>0.02</i>	<i>0.02</i>	<i>0.09</i>	<i>1.18</i>
Trunks, cases, bags, etc. (HS4202)	0.19	0.57	1.53	20.08
<i>Cases and containers with outer surface of leather etc. (HS420211 and 420291)</i>	<i>0.02</i>	<i>0.08</i>	<i>0.58</i>	<i>7.61</i>
<i>Handbags with outer surface of leather etc. (HS420221)</i>	<i>0.06</i>	<i>0.05</i>	<i>0.54</i>	<i>7.09</i>
<i>Handbags with outer surface of sheeting of plastics or textile materials (HS420222)</i>	<i>0.01</i>	<i>0.35</i>	<i>0.26</i>	<i>3.41</i>
Others	0.00	0.01	0.00	0.04
Total (HS 42)	0.27	4.15	7.62	100

Note: Data represents global imports. Totals may not add up due to rounding.
Source: UN Comtrade 2018 (WITS)

Table 13: Exports of leather products by country (USD million, 2010-2017)

Top importing countries	2010	2013	2017	% of exports (HS42)
United States	0.08	2.29	5.02	65.88
European Union	0.16	1.69	1.86	24.41
<i>Germany</i>	<i>0.05</i>	<i>0.87</i>	<i>1.16</i>	<i>15.22</i>
<i>Italy</i>	<i>0.09</i>	<i>0.36</i>	<i>0.26</i>	<i>3.41</i>
<i>United Kingdom</i>	<i>0.02</i>	<i>0.07</i>	<i>0.22</i>	<i>2.89</i>
China	0.00	0.00	0.44	5.77
Japan	-	0.12	0.16	2.10
Others	0.03	0.05	0.14	1.84
Total (HS 42)	0.27	4.15	7.62	100.00

Note: Data represents global imports. Totals may not add up due to rounding.
Source: UN Comtrade 2018 (WITS)

4.3. Industrial policy design and business enabling environment

4.3.1. Industrial development plans and policies

The governments' focus on the LLP started with the export promotion strategy drafted in 1998 and the Industrial Development Strategy (IDS) in 2002 (Abebe/Schaefer 2013, 2015). The strategies aimed at developing a fully vertically integrated and export-oriented LLP sector as well as emphasized the need to tackle key sectoral challenges and encourage investments, but the strategy did not articulate specific policy measures. In order to increase the quality of raw hides and skins for further processing, the strategy paper emphasized the need of collective slaughtering and skin gathering.

In 2005, the Ministry of Industry (MoI, the former Ministry of Trade and Industry) and the UNIDO prepared 'A Strategic Action Plan for the Development of the Ethiopian Leather and Leather Products Industry'. Based on the resulting documents, the MoI developed a concrete action plan and implemented upgrading programs for tanneries and footwear producers often in collaboration with UNIDO and other international donors.

From an institutional perspective, the establishment of the Leather and Leather Products Technology Institute (LLPTI) in 1998 and its expansion to the Leather Industry

Development Institute (LIDI) under the MoI in 2010 was of major importance. LIDI is the lead agency in the sector with the goal to support firms' upgrading processes and exports.

The first (2010/11-2014/15) and second (2015/16-2019/20) Growth and Transformation Plan (GTP) confirmed the priority status of the LLP sector. In both plans, the underperformance relative to the governments' expectations are discussed and new targets are set. The GTP II objective is to employ 336 thousand people in the LLP sector until the end of the plan period and increase export earnings more than fivefold from USD 131.6 million in 2014/15 to USD 706.5 million in 2019/20 (GTP 2015).

In order to achieve these ambitious goals, the government and in particular LIDI implemented a comprehensive set of industrial policies. A key turning point for the LLP sector and export structure was the introduction of a 150% export tax on raw hides and skins and between 5% and 20% on wet-blue and pickled leather in 2008 to support upgrading processes and the exports of more processed leather. In 2011, the government also introduced an export tax on crusts (the last step before finishing) to increase manufacturing and exports of finished leather and leather products. Although these taxes were an important policy, it was not sufficiently linked to a comprehensive package for supporting upgrading of locally-owned tanneries to produce finished leather and facilitate marketing to new buyers (cf. Oqubay 2015).

MoI's and in particular LIDI's core activities to support the development of the LLP sector include (i) the provision of various services to promote the capacities, capabilities and competitiveness of LLP firms (e.g. training, consultancy services, co-financing of foreign experts, etc.); (ii) provide educational programs to improve the quantity and quality of the workforce, also in cooperation with universities and their engineering degree programs; (iii) the promotion of investments by informing and assisting domestic and foreign investors on investment opportunities; (iv) promote public-private coordination in order to jointly address the opportunities and challenges in the sector; (v) collect data and monitor and evaluate the development of the sector in general and the effectiveness of industrial policies in particular (cf. Mbate 2016: 96ff.). But LIDI has limits particularly in terms of coordination along the value chain, including with the livestock sector, and among Ministries and public agencies and hence of being a 'one stop shop' for the sector (Brautigam et al. 2016).

The training of the workforce is linked to (higher) education programs, in particular with regard to middle-level managers for the footwear and leather goods manufacturing sub-sectors. In addition, the Engineering Capacity Building Program (ECBP) has been launched to support skill development in the industry.

In addition, exporting companies of the LLP sector (and other priority sectors) benefit from various incentives, mostly managed by the Ethiopian Investment Commission (EIC), the Development Bank of Ethiopia (DBE), the Ethiopian Revenue & Customs Authority (ERCA) and the Industrial Parks Development Corporation (IPDC), including (i) income tax exemptions (generally up to 6-7 years); (ii) exemptions from custom duties and other taxes on capital goods, construction materials, spare parts and other equipment; (iii) exemptions from custom duties and other taxes on inputs for exported products (various schemes exist, including a duty drawback system, bonded warehouses, industrial zone schemes, and others); (iv) improved access to land and infrastructure (e.g. in industrial zones or parks); (v) income tax exemptions for expatriate experts; (vi) skills development and retention cost-sharing grant for locally-owned manufacturers; and (vii) improved access to finance and foreign exchange (cf. LGC 2016).

The LLP sector is among the key manufacturing sectors eligible for a special loan facility with a lower interest rate (7.5%), a longer grace period (up to 3 years) and a longer loan period (15 years), earmarked to exporters. The Development Bank of Ethiopia (DBE) can finance up to 75% of the total investment cost of a project, with 25% cash equity contribution of the investor without collateral. There is also an export credit guarantee scheme. In addition, the country to some extent witnessed the expansion and consolidation of private commercial banks, which are mobilizing financial resources to finance fixed investments and working capital focusing on export sectors including the LLP sector. Similarly, equity capital financing is emerging as a new option in financing sector expansion and modernization.

According to the Planning, Monitoring and Evaluation Directorate, the performance of the LLP sector has been again significantly below the governments' expectations in 2017/18. The government identifies national unrest, work ethic deficits, limited liabilities in public services, lack of foreign exchange, power supply shortages, limited manpower and technological limitations, low quality input supply and limited export orientation as the key issues (LIDI 2018b).

4.3.2. Institutional setup

The following section presents a brief overview of the key governmental, private and international donor organizations and actors in the Ethiopian LLP sector. An overview of the key actors is presented in Figure 32, and a broader discussion of different actors and the business enabling environment, which includes actors and services that are only more loosely connected to the sector, is presented in LGC (2016).

4.3.2.1 Governmental organizations

The Prime Ministers' Office (PMO) is the high-level institution developing the general development agenda and making strategic decisions. The Ministry of Industry (Mol) is the key Ministry implementing the different development plans and is also in charge of monitoring and evaluating the industrial policy design. The Textile & Leather Sector State Minister is based directly under the Minister of the Mol and responsible for the Leather Industry Development Institute (LIDI). Other ministries and institutions, such as the Ministry of Agriculture and Livestock Resources or the Environmental Protection Authority, also deal with issues related to the LLP value chain.

LIDI is the key governmental organization in charge to develop the LLP in terms of quantity and quality of output, employment, environmental sustainability and exports by implementing sector specific industrial policies and providing various services to promote upgrading.

Mol and LIDI work in close collaboration with more autonomous government institutions. The Ethiopian Investment Commission (EIC) under the Ethiopian Investment Board chaired by the Prime Minister is in charge of promoting local investments and foreign direct investments (FDI) by providing fiscal and non-fiscal incentives (e.g. income tax or import duty exemptions and improved access to foreign exchange). In addition, the Development Bank of Ethiopia (EDB) provides soft-loans and an export credit guarantee scheme. The Industrial Parks Development Corporation (IPDC), a public enterprise established in 2014, is in charge of Ethiopia's industrial parks and provides pre- and post-investment services. The Ethiopian Privatization Agency (EPA) is in charge of privatization processes, but the EPA's role in the sector has been decreasing since most companies are already privatized.

The African Leather and Leather Products Institute (ALLPI) has the mandate to support the leather sector within the Common Market for Eastern and Southern Africa (COMESA). ALLPI has currently ten member states. Key activities of ALLPI include the promotion of educational programs, investment and trade, information dissemination and consultancy services.

The Ethiopian Industrial Inputs Development Enterprise (EIIDE) is a public enterprise established to ensure, amongst other things, the sustainable supply of industrial inputs to Ethiopian companies. EIIDE has replaced the former EDDC that has a long experience in procuring and distributing consumable items (mainly sugar and oil) from both the local and foreign market.

There are many other governmental organisations that have some involvement in the Ethiopian LLP sector, such as the Federal Micro and Small Enterprises Development Agency (FeMSEDA), the Regional Micro and Small Enterprises Development Agency (ReMSEDA), and various organizations targeting the agricultural sector (Ministry of Agriculture, National Agricultural Research System, Agricultural Technical and Vocational Education and Training Learning Institute, and others).

4.3.2.2 Civil society and private sector organizations

The Ethiopian Leather Industries Association (ELIA) was established in 1994 and represents the interests of local- and foreign-owned tanneries and leather manufacturers. The association currently has 75 member and provides market information services, market promotion activities, assists with the importation of inputs and functions as a bridge between the government and the private sector. The Ethiopian Raw Hides and Skin Suppliers' Association (ERHSSA), on the other hand, represents the interests of raw hides and skins traders and has roughly 45 members.

Many micro- and small-enterprises in the LLP sector are also organized in clusters and cooperatives, often consisting of sub-networks. The most important clusters are located in Addis Ababa and include the Ethio-International Footwear Cluster Cooperative Society (EIFCOOS), the Merkato cluster and the Kirkos Leather Goods Cluster, comprising a total of 377 enterprises and employing almost 4,000 workers (UNIDO 2016).

Many other civil society organizations, such as the Addis Ababa Institute of Technology (AAIT), or the Women Entrepreneurs Association (WEA), are to some extent involved in the Ethiopian LLP sector.

4.3.2.3 Donor organizations

The United Nations Industrial Development Organizations (UNIDO) is by far the most important donor organization in the Ethiopian LLP sector. UNIDO has supported all segments of the local value chain and implemented a wide range of initiatives from technical assistance and capacity building to policy advice since the 1990s (see UNIDO 2012 for more details). In 2009, for example, the MoI and UNIDO designed the 'Technical Assistance Project for the Upgrading of the Ethiopian Leather and Leather Products Industry' and provided a wide range of technical assistance to promote upgrading in the LLP sector (e.g. production layout, management, marketing, etc.). UNIDO's technical assistance amounted to USD 80 million between 1990 and 2012 (ibid.).

Today, UNIDO's key project in the LLP sector is the establishment of Modjo Leather City (MLC) in cooperation with the MoI, LIDI, IPDC and other institutions. The MLC is an industrial park for LLP companies with a common wastewater treatment plant. The project titled "Leather Initiative for Sustainable Employment Creation" (LISEC) is co-funded by the

EU for a total of EUR 15 million. At the end of the project, MLC is planned to have a maximum capacity to produce 133,500 tons of raw hides and skins in an eco-friendly way (UNIDO 2015).

In addition, UNIDO continues to implement technical assistance programs and specifically supports clusters of footwear and leather product manufacturers as well as linkages between SMEs and tanneries. UNIDO also signed cooperation agreements with LIDI and the Federal Small and Medium Manufacturing Industry Development Agency (FeSMMIDA). The UNIDO's Investment and Technology Promotion Office (ITPO) Tokyo office in Addis Ababa also supported the participation of Japanese firms in the leather manufacturing sector to enable the export of high-value products to Japan (ibid.).

The Transformation Triggering Facility (TTF) is an EU funded programme consisting of four components to support Ethiopia's four main priority sectors, including the LLP sector: (i) SME and market development (promoting competitiveness of SMEs through investment and export promotion, market development, knowledge transfer and skill development (managed by MoI); (ii) Business skill enhancement and fostering of innovation through an innovation center and scholarships (managed by the Addis Ababa University); (iii and iv) Hubs' development and capacity building and policy fine tuning (managed by the Ministry of Finance and Economic Development). The TTF, for example, supported capacity building (design and marketing) in six footwear manufacturers by way of hiring international experts.

The U.K. Department for International Development (DFID) supports three of Ethiopia's priority sectors, including the LLP sector, by implementing the Enterprise Partners/Private Enterprise Programme (PEPE) in cooperation with the World Bank, the Ministry of Finance and Economic Development and others with a budget of almost GBP 70 million between 2013 and 2020. The project specifically targets SMEs owned by women. In the LLP sector, PEPE for example supports the upgrading of tanneries (e.g. finishing capacities) and leather manufacturers (e.g. produce high-value products and support marketing activities in particular in the US) as well as provides financial assistance to increase exports.

The Japanese International Cooperation Agency (JICA) supports the LLP sector with the Project on Capacity Building for KAIZEN Implementation for Quality, Productivity and Competitiveness Enhancement (2015-2020). The KAIZEN project supports LLP manufacturers and tanneries in capacity building including the implementation of the KAIZEN management philosophy. JICA also supported marketing activities for the Japanese high-end market by developing the Ethiopia Highland Leather (EHL) brand for sheep leather 'champion products' in cooperation with ELIA and LIDI. JICA recently also started to implement the Industrial Promotion Project (2016-2022) focusing on the development of industrial parks.

The international network organization Solidaridad, in partnership with the Dutch chemical supplier Stahl and the business network CSR Netherlands (MVO Nederland), started to implement the three-year program Green Tanning Initiative (GTI) in order to improve the environmental sustainability of tanneries and support the development of environmentally friendly products ('chrome-free leather'). The GTI project adopts a value chain approach and will most importantly offer technical support in eco-friendly production, business management to tanneries. In addition, GTI supports abattoirs to improve practices and the quality of hides and skins supplied to tanneries. The GTI project also includes match-making sessions to support EU market entry for tanneries and leather manufacturers, as well as plans to offer support to local knowledge institutes to facilitate technology transfer and promote skill development and local capacities on cleaner processing and sustainable production

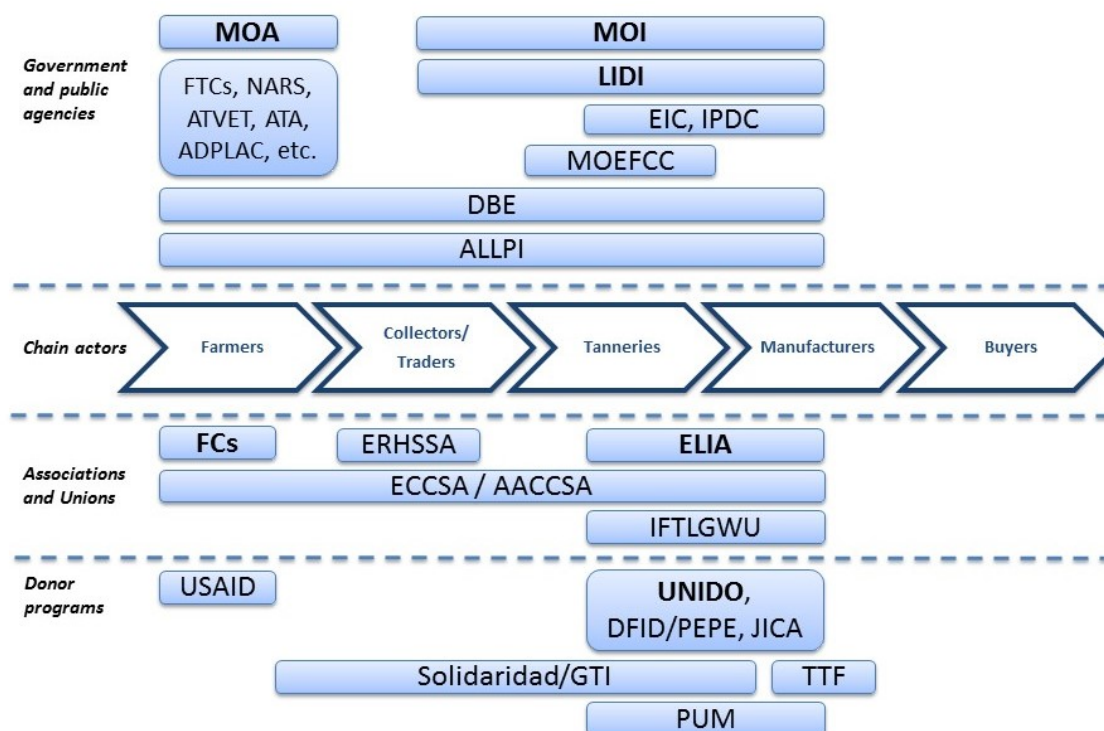
PUM Netherlands senior experts is a volunteer organisation providing training services to SMEs in developing countries and emerging markets. PUM NL is active in the Ethiopian LLP sector since a decade and has provided technical assistance to a handful of small manufacturers producing belts, bags and similar items. PUM is currently researching possibilities to support leather associations and tanneries in the sector.

There are some initiatives to improve sector coordination in the sector (i.e. with regard to coordinating foreign trainers). In the past, the Gesellschaft für Internationale Zusammenarbeit (GIZ) and USAID have supported Ethiopia's LLP sector in a comprehensive way.

4.3.2.4 Private services

Most of the support services tend to be generic and not specific to the requirement of LLP sector. This is a critical constraint in the well function of the leather sector core markets. Therefore, specialized support services such as investment advisory services, certification services, marketing services, input supply services and maintenance services are among the key services required for the smooth operation of the sector, but are seldom supplied. There are also only few agents that could link Ethiopian manufacturers to global buyers in the country.

Figure 32: Key actors in the Ethiopian LLP value chain



Note: Allocation reflects core activities of organizations. So far not mentioned abbreviations include FC = farmer cooperative; FTC = farmer training center; NARS = National Agricultural Research System; ATVET = Agricultural Technical and Vocational Education and Training; ADPLAC = Agriculture Development Partners Linkage Advisory Council; ATA = Agricultural Transformation Agency; MOEFCC = Ministry of Environment, Forest and Climate Change.

Source: own elaboration.

4.4. Sustainability issues in the Ethiopian LLP sector

Sustainability issues in the LLP sector are manifold, include environmental, social and economic issues and extends throughout the entire value chain (see e.g. Ernst & Young 2013 for an overview). The major sustainability issues in the LLP value chain relate to five aspects: (i) animal welfare during husbandry and slaughtering, (ii) the environmental impacts of tanning, particularly the management of liquid and solid wastes, (iii) the high water requirements of tanning, (iv) the health and safety at work of tannery workers, (v) the labor conditions of workers in the shoe and leather products sector, and (iv) child and forced labor, both in animal husbandry and tanning. All of these issues are particularly acute in low-income countries, which have become major producers of LLP during the last 30 years.

On the other hand, the key economic benefits of the LLP sector are income, employment and linkage creation as well as foreign exchange income. The LLP value chain has the potential of delivering income to different actors along and linked to the chain, starting with smallholder farming communities, large and small slaughter houses, hides and skins collectors, artisan and of industrial tanneries and manufacturers of leather footwear and other leather products and more. These actors come from all social classes, ranging from smallholders to workers as well as local and foreign owners of larger manufacturing and tanning companies. It is within this context that the LLP industry is considered among the top priority sectors in many low-income countries including of Ethiopia to promote transformation from an agriculture-based to a manufacturing-based economy.

The following section particularly focuses on social and environmental sustainability issues along the whole chain of the Ethiopian LLP sector. A summary of the sustainability issues and benefits is presented in Table 14.

4.4.1. Livestock

The livestock segment provides raw hides and skins for leather industry and is a renewable resource. The sustainability issues, therefore, related with the optimal rate of harvest of the livestock to avoid depletion of the resource base. This is key in order to ensure sustainable supply of raw hides and skin for the leather industry. The raw hides and skins are a by-product of the meat production industry (cattle, sheep and goat) and the 'optimal harvest issue' is thus not directly influenced by the leather industry.

With regard to the sink function, the sustainability issue in the livestock segment is mainly related to the generation of greenhouse gases (GHG). According to the Climate Resilient Green Economy (CRGE) strategy document, the livestock sector contributes to about 40% of Ethiopia's total GHG emission. (CRGE 2011).

USAID is the most important donor supporting the Ethiopian livestock sector, but there is currently no donor that particularly focuses on the link between the livestock and the LLP sector on a significant scale.

4.4.2. Raw hides and skins

Raw hides and skins are produced as a byproduct of meat production. The first sustainability issue is the high volume of production and thus the need to dispose a large amount of hides and skins. The second sustainability issues in the raw hides and skins market segment is related to the wastes generated during the preservation, storage and transporting of raw hides and skins. The common preservation method is known as wet salting technique, which involves the use of common salt as a dehydrating and bacteriostatic agent. The disposal of the salt used for such preservation purposes can

pollute and contribute to the salinity of the soil. Re-usage of the salt is possible during the pickling stage of tanning which reduces the volume of salt used and disposed to the environment.

4.4.3. Tanneries

Tanning involves the use of large quantities of water as well as inorganic and organic chemicals. Machines convert the putrescible raw hide and skin into what is known as non-putrescible and strong leather. During this process, sizable liquid, solid and gaseous wastes are generated. According to LIDI, tanneries in Ethiopia generate about 12,500 m³ liquid waste and 150 tons of solid wastes per day (LIDI, 2013). Some tanneries in Ethiopia have primary and secondary treatment to manage their wastes, but not all tanneries treat the wastes properly due to the high costs involved. This problem has increased since many tanneries, in particular in Addis Ababa, are now often located closer to or in cities in the context of the cities expansions.

Ethiopia has a regulatory framework to reduce the environmental impact of tanning, but the laws are often not enforced properly. In recent years, tanneries had to increase their investments in effluent treatment plants in order to remain operational. A major goal of the government is to relocate tanneries outside of cities and to industrial zones. The main donor active to promote the environmental sustainability of tanneries is UNIDO (Modjo City), but there are also others, like Solidaridad, who for example seek to promote the production of chrome free leather (The Green Tanning Initiative).

4.4.4. Footwear and leather products

The labor-intensive nature of footwear and leather product manufacturing particularly contributes to employment opportunities for women. Women are preferentially selected for some of the higher-detail work within the factories including finishing work, sewing, cutting and pattern-making. Currently, women account to between 70% and 80% of employees in these segments of the chain. Therefore, increasing the leather finishing capacity in tanneries and subsequently leather goods manufacturing units will also increase job opportunities for women.

The Ethiopian labor code has important provisions in connection with female employment. The law restricts any type of discrimination as regards employment and payment. It also contains provisions with respect to the special conditions of work for women particularly during pregnancy, allowing for a special leave of up to 90 days with payment during pregnancy, during delivery and after delivery.

There is currently no law that provides for a minimum wage and thus no uniformity in the application of minimum wages exists. The tax law exempts any monthly wage below ETB 600 from taxes, which by some employers is thus considered as a default minimum wage. At the current exchange rate of ETB 28/USD (January 2019), this is equivalent to USD 0.80 per day. Given the USD 2 per day absolute poverty line income, the minimum wage would need to be set at least roughly to ETB 1,500. The information obtained from our interviews with LLP companies suggest that wages paid typically exceed this threshold, though in general LLP sector wages are considered to be rather low, in particular when compared to service sector wages.

The current Ethiopian labor law contains articles with respect to the maximum working hours per week, overtime hours, and employment conditions. For instance, the law limits the maximum working hours to 8 hours per day and 48 hours per week, respectively. Overtime work has to be paid extra, with remuneration rates equivalent to between 1.25 to 2.5 times the regular hourly wage rate depending on the date, time and conditions of

overtime hours worked. The ILO reports that an increasing share of both men and women work overtime, which indicates widespread poverty and the need for overtime work to secure a basic living standard (ILO 2013).

In terms of its environmental impact, the footwear industry's footprints (water, energy and CO₂) arise from its upstream suppliers of inputs, notably fabric and interlining, paper (packaging), sole, adhesives, and finished leather. The actual shoe-making itself has a comparatively lower ecological footprint. A specific environmental health concern is exposure of workers to harmful volatile organic compounds (VOCs) arising from adhesives.

4.4.5. Child Labor and Forced Labor

Ethiopia has ratified both ILO Convention No. 182 on the Worst Form of Child Labor and Convention No. 029 on Forced Labor, both in the year 2003. Ethiopia's Federal Constitution provides for the protection of children from child labor and economic exploitation, and prohibits their engagement in work that jeopardizes their health, safety and right to education. The Labor Code likewise has provisions for protecting children from abuse. Working conditions and the occupational safety and health of working children are covered by the labor inspectorate service which conducts preventive, complaints based follow-up.

To date, however, studies and data show that child labor remains a problem in Ethiopia. The ILO reports that in 1999 a total of 19.6 per cent children aged 5 to 17 years were involved in productive activities in urban areas: some 21.4 per cent of boys and 18 per cent of girls. The results of the Child Labour Survey 2001 show a 2.6 point decrease from 1999. In 2009 a further decline of 8.3 points was recorded. In terms of gender, decreases have been observed both in 2001 and 2009 for both sexes (ILO 2013).

On child and forced labor in the LLP value chain, the US Department of Labor publishes an annual list of goods produced by child labor or forced labor. With regard to the LLP sector, the main thrust of child and forced labor abuses relates to Asia and South America. Product-wise, cattle is listed as a top 5 good in agriculture, which uses child and forced labor, and footwear as a top 4 good in global manufacturing using child labor. For Ethiopia, only child labor for cattle is listed as a problem (US Department of Labour 2018). The practice of using child labor in animal husbandry is well-documented, and deeply rooted in traditional agricultural society.

4.4.6. Summary of main sustainability issues

Table 13 provides a summary overview of key sustainability issues along the LLP value chain. Though multiple problems persist, in our view the key sustainability challenges relate to the following issues:

- Child labor in livestock husbandry: though declining, child labor remains a structural problem in rural areas. Government policies should be reinforced to incentivize school attendance of children, e.g. through conditional cash transfer programs.
- Environmental pollution in the tanning industry: though some progress has been achieved, tanneries are still struggling to comply with government regulations, mainly because of the high costs of the needed investments. The solution to the problem will have to involve better access to subsidized long-term investment loans for tanneries, stricter enforcement of government regulations and the relocation of tanneries to industrial zones with common effluent treatment plans (Modjo City). The industry should get accreditation for regional testing laboratories to comply for various ISO

standards and to meet customers' requirements. The REACH program which is a requirement for the EU and other markets also needs to be taken into account fully by Ethiopian LLP producers (LGC 2016).

- Low wages and high turnover in the shoe and leather products industries: though the shoe industry has been expanding recently mainly due to Asian FDI, and thus contributed significantly to employment creation, wages remain very low, leading to overtime work, high labor turnover rates and low productivity growth. This presents an impediment for upgrading into higher value segments of shoe and LLP GVCs. In the medium to long-term, productivity-oriented wage policies should be promoted by the Ethiopian government, which could be facilitated by government support to organize LLP workers in trade unions. In the short term, the government could introduce a statutory minimum wage well above the poverty line.

Table 14: Summary of sustainability issues in the Ethiopian LLP

Market/operation	Source function of environment	Sink function of environment	Social and labor
Livestock	No major risk: renewable resource	Livestock accounts for 40% of GHG emission in Ethiopia	Some degree of child labor, but declining
Raw hides and skins (RHS)	RHS is a byproduct of the meat production and production is not influenced by the leather sector	Generation of liquid and solid wastes during slaughtering of the animal Generation of salt based wastes and gases during preservation and storage	No major risk
Tanning	The processing chemicals are based on non-renewable resources and are subject to depletion	The generation of hazardous wastes is disposed without proper treatment and will pose a serious problem to the community, fauna and flora of the environment	Protection and safety of labor in the work place from the gases, dusts, chemicals and machineries is limited
Shoe and leather products	Inputs like fabric, interlining, paper (packaging), sole, adhesives, and finished leather	Shoe-making itself has a comparatively low footprint in terms of water, energy and CO2	High degree of employment for women; but low wages Exposure of workers to harmful VOCs arising from adhesives
Transportation and exports	Fuel is based on non-renewable resources	Transportation for the local and in particular for export markets contributes to CO2 emissions	No major risk
Retailing	No major risk	No major risk	No major risk

Source: own elaboration

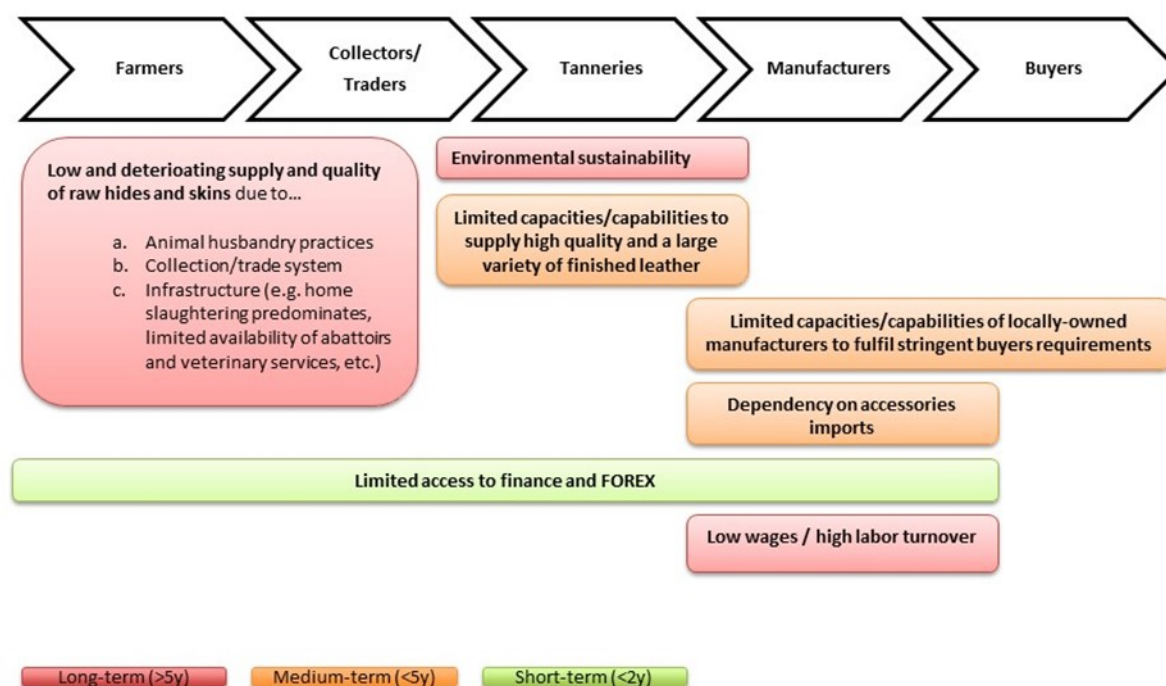
5. OPPORTUNITIES AND CHALLENGES IN THE ETHIOPIAN LLP SECTOR

This chapter presents a more detailed analysis of the key challenges and opportunities in the Ethiopian LLP sector. The analysis builds on the field research conducted in July and October 2018 and on existing studies (UNIDO 2012; Oqubay 2015; Abebe/Schaefer 2013, 2015; Brautigam 2011, 2016).

5.1. Key Challenges

The industrial policy regime in the Ethiopian LLP sector is quite extensive and the government provides services and incentives on various levels to support its growth, but many bottlenecks and challenges remain (Figure 33). In the following chapter, we differentiate between systemic challenges, sustainability issues and export-related challenges. Systemic challenges and sustainability issues not only affect exports, but the sector as a whole, including exports.

Figure 33: Overview of key challenges in the Ethiopian LLP sector



Source: own elaboration.

5.1.1. Systemic challenges

Limited quality and supply of raw hides and skins

The key bottleneck in the Ethiopian LLP sector is the lack of quality and supply of raw hides and skins from the livestock sector, with important implications for the whole value chain. The low, and currently also deteriorating, quality of raw hides and skins supply is a result of parasitic skin diseases as well as the prevalent animal husbandry (flaying, branding, curing) and post-mortem management practices (backyard slaughtering and sub-standard collection, storage and transportation) in the context of a limited availability of infrastructure and services (abattoirs, veterinary services, etc.). The underlying issue is

the low commercial value of hides and skins, which limits the interest of farmers to improve current practices. The seasonality of supply due to the three festival seasons in January, September and May adds to the challenge of tanneries to source hides and skins for further processing. As a result, (i) tanneries are operating at low capacity utilization rates; (ii) global buyers to some extent stopped or reduced imports of finished leather from Ethiopia, in particular since global demand for different colors increased in recent years (black tanned leather might cover defects); (iii) leather manufacturers have difficulties to locally source quality leather for export markets.

Limited access to finance

Despite the developments in the private financial sector and the efforts of Ethiopian government and the DBE to provide various financial facilities for investment and working capital in the LLP sector, many locally-owned companies, in particular smaller companies and actors in the upstream segments of the chain (smallholders, collectors, traders, etc.), suffer from limited access to finance due to a lack of collateral and/or high interest rates. A decade ago, tanneries used to be the main sources of supplier's finance and provided finance to the big raw hides and skins traders, which in turn advanced loans to their respective suppliers. Tanneries also supply finished leather to leather manufacturers on a consignment basis, financing the downstream industry. However, with the introduction of the export tax on semi-processed leather exports, the latter being a very profitable business, tanneries lost their financial strength. In addition, as a consequence of upgrading into finishing, tanneries' working capital requirements grew over threefold for keeping buffer stocks in the form of raw materials, intermediary inputs, goods in process and finished goods in the prolonged production process. The financial sector was not flexible enough to respond to these new business requirements in a timely manner. Over time, the financial problems accumulated and contributed to low capacity utilization rates, foregone economies of scale, low productivity growth and lack of price competitiveness.

Limited access to foreign exchange

The limited and/or often timely delayed access to foreign currency is a general challenge for locally-owned companies, and in particular for exporting companies due to prolonged lead times. Exporting companies get preferential access to foreign exchange, but many companies argue that the current system is not sufficient (i.e. foreign exchange income is automatically exchanged to Ethiopian Birr after only one month).

Dependence on imported inputs

Another key bottleneck is the dependence on imported inputs (e.g. chemicals, soles, zippers, etc.), which increases costs, lead times, stock and working capital capacities as well as the need for foreign exchange access. The lack of a local accessories sector that supplies quality inputs is particularly challenging for manufacturers; while tanneries suffer from the limited local availability of chemicals and other inputs. Industrial policies seek to mitigate this problem in various ways, but they cannot make up for the lack of local production.

Limited availability of skilled workers

The educational programs to train the necessary workforce for the Ethiopian LLP sector have improved significantly, but access to skilled labor continues to be a major challenge. The main bottlenecks are designers and marketing managers that are able to target export markets.

Increasing competition on the local market

Another challenge for Ethiopian leather manufacturers, in particular footwear, is the increasing competition due to increasing production capacities of locally-owned firms and imports. Despite a 35% tariff on footwear, imports from China, India and Turkey are flooding the Ethiopian market, limiting opportunities of locally-owned companies to diversify to the local non-leather footwear market. Imports of leather footwear has also increased in the last decade, further increasing the pressure on Ethiopian companies. Many company-owners tend to dismiss the threat of Chinese imports of leather footwear due to low quality imports and increasing awareness of consumers.

5.1.2. Sustainability issues

Minor importance of hides and skins for smallholders

The Ethiopian LLP value chains comprises different actors with different vested interests. The LLP value chain differs from many other agro-chains in which smallholders, women, children and elderly are often in the weakest position. The LLP value chain, in contrast, is of relatively minor importance for smallholders due to the low commercial value of hides and skins, which are considered a byproduct, and explains the big difficulty to improve animal husbandry practices.

Relatively low wages affecting mostly women

The LLP sector is characterized by relatively low wages, which contributes to high labor turnover rates and increases training costs for companies. The low wage level is particularly problematic for women, considering that 70% to 80% of employees in the LLP industry, in particular in the manufacturing segment, are women. The main reason for the relatively low wages is the weak bargaining power of workers in the context of high unemployment rates and fierce international competition. Companies that pay more than the minimum wage often have lower turnover rates and are able to build long-term relationships with their most productive employees.

Limited environmental sustainability of and workers protection the tanning industry

The key sustainability challenge in the LLP sector is the limited environmental sustainability of the tanning industry. The tanning process is characterized by the production of different kinds of wastes that are often discharged into the environment. The intensity of the problem has been growing since many tanneries are now located in urban areas (in particular Addis Ababa), instead of its outskirts, due to the cities' rising population and territorial expansion. Ethiopia has relatively tight regulatory standards, which are however often not enforced. In recent years, increasing pressure of the government has spurred costly investments of tanneries in wastewater treatment plants, but the problems arising from pollution are far from being solved. The limited environmental sustainability also limits demand from environmentally conscious buyers. An additional challenge is the limited protection and safety of workers in tanneries. In the shoe industry, workers are also exposed to volatile organic compounds (VOC) arising from adhesives.

5.1.3. Export-related challenges

Sluggish global demand development

Global trade development has been sluggish and has even decreased in recent years. Ethiopia could nonetheless increase its market share in the context of shifting GVC dynamics and the decreasing global supply of China.

Limited supply of export quality leather to local manufacturers

Key bottlenecks in the Ethiopian LLP sector are the limited capacities and capabilities of tanneries, in particular locally-owned tanneries, to produce export quality of different types of finished leather and the limited supply of export quality leather on the local market. The introduction of the export tax has furthered functional upgrading of Ethiopian tanneries, but many tanneries continue to struggle to find new buyers in new end-markets. Furthermore, many tanneries have only invested to a finishing stage that makes the product eligible for exports ('semi-finishing'), limiting the availability of different types of finished leather to local buyers. FDI tanneries generally produce finished leather in export quality, but they are often vertically integrated and tend to export to their mother company. In addition, all tanneries generally prefer to export directly instead of supplying local manufacturers with export quality finished leather. Tanneries would not have to pay duties on imports when selling to local manufacturers in case the latter export the manufactured product, otherwise selling to locals would not help tanneries in getting access to much needed foreign exchange. As a result, (i) many tanneries struggle to export and are operating at low capacity utilization rates; (ii) the value of leather exports by value stagnated in recent years; (iii) local manufacturers struggle to source export quality finished leather; (iv) tanneries tend to supply non-export quality finished leather to local manufacturers; and (v) companies, in particular FDI firms, started to import leather for manufacturing and exports since the early 2010s, from insignificant levels in the early 2000s to an average of USD 18 million between 2013 and 2016 (mostly from Sudan, Mali, China and India) (UN Comtrade 2018).

Limited capabilities and capacities of locally-owned manufacturers to access key global consumption markets

The manufacturing sector focuses – with the exception of FDI companies – on the local market due to its higher margins and the limited capabilities and capacities of many locally-owned manufacturers to export and access foreign markets. The low share of exports and limited access to foreign markets are the result of (i) low margins for global exports in the context of strong international competition and the reliance on intermediaries to access export markets; and (ii) often inadequate price-quality ratios. Prices are often too high because manufacturers price their products higher than the going market price in order to compensate for the loss of low capacity utilization rates and a lack of export pricing strategy. The quality of products differs widely among manufactures, but many manufacturers in the different sub-sectors have the capability and capacity to manufacture export-quality products. The product quality, however, often suffers due to the (ii) limited local supply of the necessary export-quality finished leather demanded by buyers. The leather is often also not supplied in the necessary consistency. Another challenge is that (iii) lead times are too long to enter specific value chains due to the need to import inputs and the difficulty of locally sourcing the requisite type and quality of finished leather. Importing inputs is hindered by the limited access to foreign exchange. Ethiopia is, in addition, a land-locked country that relies on the 'distant' port of Djibouti for sea freight. There are also ongoing negotiations to facilitate access to the Eritrean ports in the near

future. Many manufacturers also have (iv) only limited manufacturing capacities and are thus not able to link to specific GVCs that demand higher volumes. Many locally-owned manufacturers also (v) lack management capabilities/capacities to access foreign markets (i.e. time and resources; knowledge about buyer requirements) and, for example, do not have the necessary communication skills to manage orders of global buyers (i.e. quickly answer to buyers' requests, English skills) and lack marketing capacities/capabilities, such as export pricing or market differentiation strategies to enter global markets. (vi) Some companies also do not fulfill buyer requirements in terms of working conditions and environmental sustainability, but differences across buyer requirements and/or companies standards are high.

Limited horizontal cooperation between companies

Despite the existence of a business association (ELIA), horizontal cooperation among companies in the Ethiopian LLP sector is limited. As such, there is no common sector strategy that could improve market access (e.g. develop a market access strategy and Ethiopia as a brand, share large orders, facilitate learning across firms, etc.). The main problem is that, on the horizontal level, most companies perceive each other as competitors and not as potential partners. Exceptions exist for example between members of clusters (e.g. EIFCOOS) and some organizations (e.g. the Center for Accelerated Women's Economic Empowerment, CAWEE).

5.2. Key opportunities

High growth potential due to key advantages and diverse market opportunities

The shifting GVC dynamics and China's decreasing global supply of leather products opened a window of opportunity to link to GVCs and increase exports for low cost countries such as Ethiopia. Even though global trade development has been sluggish, Ethiopia could increase its market share if the sector's competitiveness can be increased. Ethiopia has, in addition, not only market opportunities in key consumption markets due to duty-free-quota-free market access, but also in the regional markets with high growth potential and the relatively large local market.

The Ethiopian LLP sector has a high growth potential, despite the challenges and bottlenecks discussed in the previous chapter. The key strengths of the Ethiopian LLP sector include (i) one of the world's largest livestock sector; (ii) the availability of high quality and internationally renowned sheep leather; (iii) relatively low production costs (wages, electricity); and (iv) an institutional regime that is committed to support the Ethiopian LLP sector and improve its performance through industrial policy.

In addition, Ethiopia has market opportunities on the local, regional and global markets due to (v) duty-free and quota-free market access to key consumption markets⁹; (vi) a relatively large local market; (vii) and a regional market with high growth potential and market access (Common Market for Eastern and Southern Africa, COMESA).

Foster integration into GVCs and increase global exports

The current shift away from China as the key global supplier of leather products opens a window of opportunity for low-cost countries such as Ethiopia. It is important, however, to study the implications of this trend in terms of production organisation. A number of experts interviewed for this report highlighted that one of the weaknesses of China in the industry

⁹ Ethiopia has access to tariffs of Everything but Arms (EBA) in the EU and the African Growth and Opportunity Act (AGOA) in the USA.

is high fixed costs associated with the large scale production model in the country. If Chinese factories cannot secure large orders, their economic survival will be at risk because of these high fixed costs. New entrants to the market should be cautious when considering whether to replicate the Chinese model as the market demand is shifting toward more flexibility. As such, it is important to design a production model that benefits from economies of scale but also maintains a degree of flexibility. New producers can work with industrial organisation experts in the leather industry to achieve these objectives. For Ethiopia, it is important to consider how to develop such business models especially for small and medium enterprises.

Ethiopia's factor endowment and industrial policy regime could provide the necessary basis to increase global exports of finished leather and manufactured products. For manufactured products, the market opportunities are diverse, but most importantly include key consumption markets such as the US and the EU. At the moment, exports are mainly driven by FDI, but also locally-owned companies have the potential to increase exports. Gloves, handbags and footwear are currently the most competitive products produced in Ethiopia. Ethiopian gloves are particularly competitive due to the availability of high-quality and international renowned sheep leather.

Exporting to the EU or the US is – depending on the specific value chain – very demanding and often not very profitable due to low margins. Linking to these GVCs can nonetheless be beneficial in case they act as a channel for learning, potentially supporting the competitiveness of the sector and exports in value chains with higher margins.

Increase exports of locally-owned footwear and handbag manufacturers to the EU

Promoting companies, foreign or locally-owned, that are embedded in the local economy is important since they are more likely to create linkages and support a countries' industrialization process. In the following, given CBIs mandate, in particular the opportunities to increase exports of locally-owned manufacturers to the EU are discussed in more detail.

The most promising Ethiopian leather products for exports to the EU are handbags, footwear and gloves given the structure of the Ethiopian LLP sector (chapter 3) and the EU's market development (chapter 4). The most competitive locally-owned companies in the Ethiopian LLP sector are producing footwear and handbags, even though many of them struggle to increase exports. Gloves are currently almost exclusively produced by FDI companies. Garments (mostly jackets) are mostly produced for the local market. Many manufacturers also produce other products such as belts and pocket-goods, mainly for the local market and often only to add value to leather waste.

Global imports of the EU (excl. intra EU trade) for most Ethiopian products have been sluggish (Table 15). Recent import development has been more promising for handbags, pocket-goods and footwear; and less promising for gloves, belts and garments. Gloves exports to the EU have nonetheless great potential due to the high quality of Ethiopian sheep leather, but at the moment there is only one newly established locally-owned company that could be supported. In addition, decreasing import trends do not necessarily imply limited market opportunities, since countries like Ethiopia have the potential to gain an increasing market share in the context of the shifting GVC dynamics.

It is also important to take into account that the EU market remains fragmented between different countries with important differences in terms of exporters, retailers, standards, etc. Whilst many large companies sell their products across the EU market, each country maintains a base of domestic retailers. As discussed in this report, there are differences between these markets in terms of growth reflecting both structural factors (long-term

trends in consumer preferences) and more cyclical factors (the impact of overall economic performance on demand). As shown in chapter 3, some of those countries have experienced growing demand in the past decade, in particular Eastern European countries, while others have experienced a decline. Eastern European markets also have more options for buyers that do not require formalized private standards.

In the following, we will focus on the opportunities of locally-owned handbag and footwear manufacturers to increase exports to the EU. The export of other leather products (pocket-goods, belts, garments, etc.) are often produced by the same companies and could be supported as well, but should not be considered as high-priority at the moment.

Table 15: EU import trends of key Ethiopian products (2005-2017, USD billion)

Products	2005	2010	2014	2017	Long	Medium	Short
Footwear	7.18	8.54	9.44	8.57	++	o	-
Handbags	1.86	3.06	3.63	3.47	+++	++	-
Trunks, cases, etc.	1.07	1.55	1.71	1.66	+++	++	-/o
Garments	1.27	1.25	1.24	0.84	---	---	---
Pocket-goods (e.g. wallet)	0.65	1.04	1.37	1.42	+++	+++	o/+
Gloves	0.50	0.56	0.65	0.52	o/+	-	--
Belts	0.2	0.23	0.23	0.19	-/o	--	--

Note: Excludes intra-EU trade; Short = indicates change between 2014 and 2017; Medium = indicates change between 2010 and 2017; Long = indicates change between 2005 and 2017.

Source: UN Comtrade 2018 (WITS).

Since locally-owned handbag and footwear manufacturers in Ethiopia differ in terms of size, capacities and export orientation (chapter 4), they need to link to different value chains in the EU (chapter 3) in order to successfully fulfil the value chain specific buyer requirements. Footwear manufacturers are generally larger, often employing 300 to 1100 persons, and focus on the local market. Most of the companies have their own designs and brand and some have a well-developed distribution network (e.g. own small retail shops in larger cities). Most of these companies also have some export experience, but often struggle to maintain orders from abroad. Handbag manufacturers, on the other hand, are relatively small and only few employ more than 100 persons. There are important differences among handbag manufacturers in terms of market orientation, since some companies are more strategically oriented towards export markets and perceive the local market only as their side business.

Given these differences, we argue that most Ethiopian footwear manufacturers will have greater opportunities in value chain 5 (branded mass market OEM/CMT), which has higher volume, medium quality requirements and short lead-times. Some footwear manufacturers that are able to produce high quality shoes might also successfully integrate into mid-high end chains. Handbag manufacturers, on the other hand, are more likely to be successful in value chain 3 (mid-high end OEM) and value chain 4 (mid-high end OBM), which are characterized by lower volumes, higher quality and have longer lead times.

Luxury segments of the market also offer an opportunity although they require capabilities and consistency that might be difficult for Ethiopia in the early stages of developing the industry. In terms of branding, whilst there might be a space for “made in Ethiopia” as a brand, it is difficult to see this as possible in the near future and the dominance especially of Italian producers in the EU market creates significant barriers to entry. The development of specific USPs, such as the great quality of Ethiopian gloves due to its sheep quality, could be important entry points for the mid-high end and luxury segments of the market.

In terms of marketing channels, the rapid growth in online retail in the clothing and leather industries could be an important entry point for Ethiopian manufacturers. Options include using large scale online retailers or building a platform for leather products from a specific country (e.g. a website selling ethically sourced leather products from Ethiopia).

Benefit from the large local and regional market

Local and regional markets are an important source for learning, in particular with regard to design and brand development. Ethiopia has the benefit of a relatively large local market and increasing consumptions levels. The local leather product market is characterized by relatively high margins and lower quality requirements. For this reason, many leather manufacturers (in particular in footwear) focus on the local market and market their own designs and brands. Against the background of increasing competition due to imports and increasing local capacities, learning processes might even grow in the future.

6. POLICY RECOMMENDATIONS AND INTERVENTION AREAS

6.1. Key interventions throughout the entire value chain in Ethiopia

In order to take advantage from the opportunities of the LLP sector, Ethiopia must continue to reduce key bottlenecks and constraints in order to support upgrading and increase production and exports of finished leather and leather products. In the following, we present policy recommendations which address the key constraints in the Ethiopian LLP sector, by particularly focusing on promoting exports of manufactured products (Figure 34).

Figure 34: Summary of key intervention areas

Segment	Constraints	Intervention Area	OUTCOME	Key actors
Livestock	Poor supply of quality hides and skins due to diseases, animal husbandry practices and lack of infrastructure	Increase health of livestock	Improved Quality and quantity RHS supply	MoA, farmer cooperatives (& USAID)
Raw hides and skins market	Poor slaughtering practices leads to supply of limited quality and quantity of raw hides and skins	Improved formal slaughtering and collecting system	Improved quality and supply to tanneries	
Tanneries	Limited finishing capacity/capability and export orientation, of tanneries, leading to low supply of finished leather to local manufacturers (quantity/quality/consistency)	Increase finishing capacity/capability of tanneries and incentivize the supply to export-oriented manufacturers	Increased quality and quantity of finished leather as well as supply to local manufacturers	MOI, LIDI, ELIA & various donors
Producers	Limited capacities/capabilities to fulfil stringent buyers requirements in key consumption markets	Improving factory capacity utilization and market competitiveness	Competitive footwear and other leather products produced and supplied	

Source: own elaboration.

Improve supply and quality of raw hides and skins to tanneries

The poor supply of quality hides and skins continues to represent one of the key structural constraints for the LLP sector. Improving the supply and quality of raw hides and skins to tanneries is an important prerequisite for improving the quality of tanned leather, which is the key input to LLP production of high-quality products that are fit for exports to international and European markets. The challenges in this regard are structural in nature and will thus only be solved in the longer-term. The investments needed are substantial due to the dominance of smallholders with limited interests in the trade of raw hides and skins as well as the limited availability of infrastructure.

Key intervention areas and actors:

In order to improve the competitiveness of the Ethiopian LLP sector, the supply and quality of raw hides and skins need to be increased by improving the animal husbandry and post-mortem-management practices via educational measures and training, and by investing

in infrastructure in terms of the collecting/trading system as well as the availability of abattoirs and veterinary services. A selective approach to improving the supply and quality of raw hides and skins could reduce initial investment costs and improve the investments' effectiveness.

The scale of the problem implies that there is no single actor that could abolish the problem, but, instead a group of government actors, led by the MOA and related institutions, farmer cooperatives in cooperation with international donors (e.g. USAID, GIZ and others) could support the livestock as well as raw hides and skins sectors and their links to the LLP sector, mitigating the scale of the problem over time.

What can CBI contribute?

In close cooperation with the responsible governments' institutions and the donor community, CBI could potentially contribute to such a program by sending agricultural and technical experts.

Increase supply of export quality finished leather to local manufacturers

Ethiopian tanneries have traditionally been suppliers of semi-finished leather to the local and international market. With the shift in government policies to promoting exports of finished leather and leather products in the second half of the 2000s, tanneries faced a severe upgrading challenge, which coincided with tightened government regulations on the treatment of wastes and effluents. While some improvements on both fronts are visible, the technical and environmental modernization of the tanning industry is still on-going. Thus, the limited supply of export quality finished leather remains a key challenge for local manufacturers. Besides, tanneries often prefer exporting directly to receive foreign exchange income or supply their mother company in the case of FDI companies.

For these reasons, it is important that tanneries increase their capabilities and capacities to produce 'proper' export-quality finished leather in order to supply not only export markets but also the local LLP sector. Investments could be incentivized by more targeted financial incentives. Training facilities could also strengthen the capabilities of locally-owned tanneries (i.e. quality management, marketing, etc.). The Ethiopian industrial policy regime and donors to some extent already provide improved access to finance and training.

Most tanneries are, however, unlikely to increase their capacities in times of low capacity utilization rates. The main challenge in this regard is the relative overcapacity in the Ethiopian LLP sector to produce 'semi-finished' leather and the limited capacity to produce export-quality finished leather demanded by foreign buyers and export-oriented manufacturers. For this reason, it is likely that many tanneries need to specialize more on specific segments of processing to avoid sectoral overcapacities.

As a consequence of limited domestic supply, manufacturers also import finished leather. Managing imports is however time consuming, is constraint by the difficult access to foreign exchange, and often difficult to manage for SMEs given their limited capacities. Besides, it often increases lead times. In order to reduce costs, SMEs could jointly source finished leather, but in the mid to long term, Ethiopia should focus on improving 'proper' finishing capacities of tanneries and increase supply to local manufacturers.

Key intervention areas and actors:

The problem of the limited interest of tanneries to sell export-quality finished leather to local manufacturers could be mitigated for instance by regulation implemented by the MOI that obliges manufacturers to share foreign exchange income with finished leather

suppliers, and/or by policies that incentivize tanneries to sell a specific share of their products to export-oriented manufacturers.

What can CBI contribute?

As CBI will not focus on the tanning industry, but on manufacturing, the issue as such is beyond the scope of CBI's program activities. Nevertheless, the availability of export-quality leather might have a negative impact on the implementation of CBI program activities and hence cooperation with other projects that focus on addressing these constraints will be crucial for the effectiveness of the CBI intervention at the manufacturing level. CBI thus needs to discuss with the participating LLP SMEs, whether the availability of export-quality leather presents particular problems. If so, CBI should either support the import of high-quality leather necessary for export production or facilitate the establishment of sourcing relationships between LLP SMEs and locally based tanneries, which e.g. participate in Solidaridad's Green Tanning Initiative or other donor programs, and thus could be incentivized to produce the kind of quality leather needed by local export-oriented companies.

Attract embedded FDI and promote technology transfer

Though the industrial strategy of the Ethiopian government has been quite successful in attracting FDI in the LLP sector, particularly from Asia, our results indicate that FDI LLP companies are not really embedded into the domestic economy. With the exception of the employment of local labor, linkages and spillover effects to the local LLP sector are thus scarce. Attracting more embedded FDI that is committed to creating linkages to the local LLP sector should be one of the core targets of Ethiopia's industrialization strategy. The Ethiopian industrial policy regime is conducive to increasing FDI in export-oriented industries due to the government's investments in infrastructure, in particular industrial parks, and the provision of various incentives (e.g. tax breaks). The main challenge is to go beyond employment creation and export increases, and maximize the creation of learning spillovers between FDI and locally-owned companies to promote technology transfers (e.g. via linkages through sub-contracting or the sourcing of local finished leather), or labor market spillovers (e.g. former managers of FDI companies that might later be employed by locally-owned companies). In the LLP sector, the main challenge to create backward linkages to tanneries is the supply of quality leather by tanneries.

Key intervention areas and actors:

Learning spillovers between FDI and locally-owned manufacturers, on the other hand, could be further incentivized (ex-ante or ex-post), i.e. by reducing the rent in industrial parks for local LLP companies or other measures that incentivize the creation of production clusters between local and FDI companies. In policy terms, measures would include a mix of regulatory policies, in particular performance requirements, which would e.g. promote joint ventures between local and FDI companies, and incentives (subsidies, tax exemptions). These policies would need to be implemented by the competent government agencies, in particular the Ministry of Industry (MOI), the Ethiopian Investment Commission (EIC) and the Industrial Parks Development Corporation (IPDC). Donor agencies could facilitate such policies by providing both political support vis-à-vis their home governments as well as technical assistance in the design of proper policies.

What can CBI contribute?

As CBI's program activities focus on domestic SMEs, FDI policy is beyond the scope of the program. But attracting more embedded FDI that is willing to link with local manufacturing firms through subcontracting relations can be an important learning channel

for local firms. Hence, in activities around policy dialogue and donor platforms the importance of focusing on this type of FDI and seeing FDI strategically in the context of a local learning process and not only in terms of employment and foreign exchange generation can be stressed.

Building a local accessories industry

A key bottleneck in the Ethiopian LLP industry is its dependence on imports of accessories. The development of an Ethiopian accessories industry would have important positive impacts on the export competitiveness of the sector, most importantly due to reduced lead times and the reduced need for foreign currency. A local accessories industry would not only benefit the leather industry, but also the growing apparel sector, which is another of the priority sectors of the Ethiopian Growth and Transformation Plan (GTP II).

The accessories industry is capital intensive and disposes of economies of scale, which is why attracting strategic FDI is of major importance. Locally produced export-quality accessories would increase the overall competitiveness of the leather manufacturing as well as textile and apparel sector.

Key intervention areas and actors:

Major accessories producers reside in Asia and Europe, particular Turkey. A first step would be to attract strategic FDI from major international accessories producers through targeted government incentives. The potential for forming joint ventures with local LLP as well as textile and apparel companies should be seriously considered. Key government institutions responsible for such efforts would include MOI, EIC and IPDC. The donor community again could press ahead with discussion on the potential for forming joint ventures between FDI and local firms in accessories production.

What can CBI contribute?

As CBI's program activities focus on domestic SMEs, FDI policy as such is beyond the scope of the program. Availability of high-quality accessories might however have an impact on the export performance of the LLP SMEs participating in the CBI program. Thus, CBI needs to discuss with the participating LLP SMEs, whether the availability of high-quality accessories presents particular problems. If so, CBI should either support the import of high-quality accessories necessary for export production or facilitate the establishment of sourcing relationships with particularly European accessories providers.

Improve access to finance and foreign currency

The Ethiopian government provides improved access to finance for exporters in the LLP sector, but many companies continue to face serious constraints in accessing finance. Efforts to supply subsidised working and investment capital, in particular for export-oriented companies, should thus be intensified. Access to foreign exchange for export-oriented firms is also too rigid. The automatic exchange of foreign currency into local currency after only one month seriously limits the flexibility of exporters to source necessary inputs from the international markets. Accessing foreign exchange is, in addition, bureaucratic and takes time, prolonging lead times and limiting the ability of exporters to link to global buyers. In order to circumvent these limitations, buyers often directly supply Ethiopian manufacturers with the necessary inputs (i.e. send accessories to manufacturers to reduce their dependence on foreign exchange and shorten lead times).

Key intervention areas and actors

Limited access to finance and foreign exchange is pervasive and stretches throughout the whole LLP value chain. The main actors to mitigate the problem are high-level government institutions (such as the Prime Minister's Office, the Ministry of Finance and the MOI), the DBE and private commercial banks. Investment loans for expanding production capacities, upgrading production technologies and finance environmental investments in tanneries should be provided for by government backed programs via public banks, in particular the DBE. Working capital facilities could be provided by private commercial banks, backed by government guarantees or through refinancing facilities provided by DBE. Donors could also provide financial assistance either for working capital or investment purposes (see e.g. the investment support program of UNIDO for EIFCOOS), or support the efforts of the Ethiopian government in securing financial support from multilateral financial institutions.

What can CBI contribute?

Providing financial assistance is beyond the scope of CBI program activities. CBI could nonetheless link SME LLP firms with donors that provide financial assistance. In the framework of Dutch and EU development cooperation, particularly EU Aid for Trade programs, CBI could however point to the need for enhanced financial support for export-oriented industries in Ethiopia.

Increase environmental and social sustainability of the Ethiopian LLP sector

We have identified a variety of sustainability issues in the Ethiopian LLP sector, amongst which feature prominently the treatment of wastes and effluents from tanneries, child labor in animal husbandry, and working conditions and well as wages for workers in LLP manufacturing.

Increasing the environmental and social sustainability in the sector will not only benefit the environment and workers in the LLP sector, but can also support Ethiopia's position as a sustainable sourcing destination in the LLP GVC. The key opportunities in this regard are:

- (a) The implementation of good practices and the development of chrome free leather by tanneries, supported by LIDI and other donors (e.g. Solidaridad), as a (potentially) more sustainable and higher value added alternative to chrome tanned leather. Chrome free leather could be used for export of finished leather and leather products;
- (b) Increasing wages by raising productivity levels: Though increasing wages will be challenging in the context of an export-oriented manufacturing sector characterized by strong international competition, the gradual introduction of an efficiency wage policy is necessary in order to support learning and the upgrading of workers' skills so as to be able to compete on high-quality markets such as the European market. Promoting the loyalty and dedication of a skilled workforce will be all the more important to local LLP companies given the establishment of large FDI companies in Ethiopia, which will lead to a concomitant increase in the demand for LLP workers in the future and thus exacerbate the already high turnover rates in the industry.
- (c) the reduction of environmental pollution of tanneries via common effluent treatment plants and stricter enforcement of environmental laws by government agencies (e.g. MOEFCC)

Key intervention areas and actors:

The limited environmental sustainability of the tanning industry in Ethiopia not only negatively affects the environment, but also constrains the development of Ethiopia as a sustainable source for LLP. The main problem in this regard is the high cost of investments needed to reduce and treat waste, respectively, even though tighter government regulations in the context of the expansion of Addis Ababa have spurred investments in recent years. The most promising strategy to make the tanning industry more sustainable is the development of clusters, such as Modjo Leather City developed by LIDI, UNIDO and others (UNIDO 2015), and the investment in common effluent treatment plants to reduce investment costs for individual companies. Regional testing laboratories could help to comply with various ISO standards and to meet customers' requirements. The REACH program which is a requirement for the EU and other markets also needs to be taken into account fully by Ethiopian LLP producers (cf. LGC 2016).

With respect to working conditions, health and safety at work in tanneries as well as wages are important issues. While the legal framework provides for acceptable standards at a formal level, arguably with the exception of a proper minimum wage regulation, implementation and enforcement are lacking. The Ethiopian government (MOI, MOLSA) via the labor inspectorate should increase its enforcement work with respect to working condition. With respect to wages, the government should either introduce a statutory minimum wage or encourage collective wage agreements negotiated between employers' federations and trade unions, respectively that include minimum wages and take account of productivity increases and inflation. With respect to child labor, the government should provide incentives to rural communities to reduce child labor, by e.g. promoting conditional cash transfer systems. The donor community could support the promotion of working conditions and decent jobs by promoting CSR programs and certification mechanisms in the LLP sector and beyond.

What can CBI contribute?

Complying with CSR standards demanded by European buyers will be a key requirement for successful promotion of LLP exports to the EU. Upon an assessment of CSR compliance of prospective participating companies at the beginning of its program in Ethiopia, CBI should define specific training and technical support measures to support CSR compliance with EU standards. In addition, insofar as certification is still lacking in individual companies, CBI should support certification processes. In this context, CBI might also need to assist specific LLP firms in sourcing inputs that fulfil buyers' requirements in cooperation with other donors (PUM, Solidaridad or others).

6.2. Key interventions for increasing the export competitiveness of Ethiopian leather products manufacturers in the EU market

Develop capacities and capabilities of locally-owned manufacturers to increase exports of leather products with a comparative advantage in EU markets

Promoting companies, foreign or locally-owned, that are embedded in the local economy is important since they are more likely to create linkages and support a countries' industrialization process. Ethiopia has a well-developed leather manufacturing sector producing various leather products for exports and the local market. Apart from FDI companies, this report argues that opportunities for exports of locally-owned manufacturers exist particularly for leather footwear, handbags and – potentially in the future – gloves. Since locally-owned footwear and handbag manufacturers differ, most importantly in terms of their size, we argue that they should target different GVCs. For

exports into the EU, the generally larger locally-owned footwear companies are more likely to be successful in value chain 5 (branded mass market OEM/CMT), while some might also be able to integrate into mid-high end chains. Handbag manufacturers, on the other hand, are more likely to be successful in value chain 3 (mid-high end OEM) and value chain 4 (mid-high end OBM).

Ethiopian gloves have a USP due to the availability of high-quality and internationally renowned sheep leather, but until today, leather gloves are almost exclusively produced by FDI companies. Locally-owned companies seeking to integrate into the manufacturing of gloves should thus be particularly supported.

With respect to export capabilities, our research points to deficits in the following areas: (i) marketing and market intelligence with respect to the EU market, (ii) design, (iii) pricing strategies, (iv) customer relationship management, (v) quality management of production, (vi) sourcing capacities.

Key intervention areas and actors:

The main challenge for locally-owned manufacturers, in addition to the lack of export-quality input supply and limited access to finance and foreign exchange, are their limited capacities and capabilities to fulfil buyer requirements in key consumption markets such as the EU and the US, as discussed in the previous chapter. There are two key channels that could promote capacities and capabilities of locally-owned manufacturers: (i) spillovers by embedded FDI firms (see above); and (ii) training with respect to design, marketing, customers' relation management, quality management and pricing. Agents could also play an important role in linking locally-owned manufacturers to global buyers and providing market intelligence services to Ethiopian LLP producers.

What can CBI contribute?

In cooperation with the local LLP companies participating in the CBI program, CBI should make an assessment of the strengths, weaknesses and key bottlenecks of the companies with regard to their export competitiveness. Upon that basis a training program should be developed containing both general training programs for the whole group of participating companies as well as tailor-made training programs for individual companies. The training activities should also be coordinated with other donors working in the LLP sector, such as UNIDO, Solidaridad, PUM, JICA or TTF, and with the responsible government agencies, in particular the MOI and LIDI. Cooperating with LIDI, ALPPI or other local institutions in the development and implementation of training programs will also facilitate the transfer of expertise to local actors. It might for instance be useful to use the twinning method, i.e. form tandems of trainers (1 international expert, 1 local expert), who will be jointly responsible for implementing certain training modules.

Increase cooperation and develop an Ethiopian brand for leather products

Developing the EU market will be a task that will be extremely demanding for many individual Ethiopian LLP SME, given the high constraints on their capacities. Export promotion to the EU would thus greatly benefit from increasing cooperation between firms. With respect to export market development, LLP manufacturers could jointly target specific markets via common marketing strategies. Such a strategy must aim at making Ethiopian LLP visible and recognizable on the EU market. Ethiopian LLP products must become associated with a narrative imaginary that stresses quality as well as particular other aspects, e.g. cultural and geographical facets that contribute to attaching a certain identity and uniqueness to Ethiopian leather products. Against the background of the experiences

obtained from the JICA-sponsored Ethiopian Highland Sheep Leather project,¹⁰ developing other Ethiopian brands for e.g. shoes and/or leather products should be seriously considered. Production-wise, working for the EU market might necessitate joint production involving a number of Ethiopian LLP companies. In case buyers demand volumes that go beyond a single firm's capacity, orders would be split and jointly executed by a number of companies.

Key intervention areas and actors:

In a business environment that is characterized by strong competition, promoting cooperation between companies will only work if a clear “win-win” case for all participants can be established. This will become the more difficult the more companies and segments of the value chain are involved. Thus the formation of cooperating networks should focus on particular issues, such as e.g. developing an export brand, elaborating a marketing strategy for the EU market, or designing a training program to increase export competitiveness for LLP SMEs. Existing organizations and networks, such as ELIA and the women entrepreneurs' network CAWEE should provide the organizational platform for such cooperation activities. Donors could play an important role in the joint development of brands and market penetration strategies, for example by supporting business organizations technical capacities and marketing capabilities. Brand development should be coordinated with JICA and the other cooperation partners involved in the Ethiopian Highland Sheep Leather (EHSL) project, i.e. ELIA and LIDI.

What can CBI contribute?

Throughout the implementation of its program activities, CBI should emphasize that export competitiveness for the EU market is not just an individual challenge for each single company, but a systemic issue that can only be tackled collectively. It should thus adopt an approach that promotes cooperation amongst companies and facilitates the development of a team spirit between company managers. The assessment of challenges, needs and opportunities as well as the design of program activities should be done jointly by involving all participating companies as well as representatives of business organizations and the government. Brand development must not only involve international marketing experts, but could be aligned with the branding strategies adopted under the JICA EHSL project, as well as already established brands by Ethiopian companies that do enjoy a certain popularity at local and regional level (e.g. the Anbessa shoe brand).

Continue protection of the local market

The local market is an important source of income and learning for locally-owned manufacturers. Many manufacturers have their own designs, brands and sometimes retail shops for the local market, but at the same time, they are currently often only able to integrate as CMT or FOB firm in GVCs. The local market thus provides an important learning channel for functional upgrading. The relatively high margins on the local market also make it an important source of income, in particular since the export competitiveness of many firms needs to be established first, and margins on exports to the EU are currently rather small, particularly for shoes. Competition on the local market is, however, increasing due to growing local production capacities, and imports particularly from Asia (even though there are high tariffs). Further liberalization of the domestic market for shoes and leather products will thus arguably erode margins for domestic companies, making it more difficult for them to export to European and other high-end markets. However, pressure should be upheld upon local firms to export in order to improve their capabilities and not remain

¹⁰ For more information, see <https://www.jica.go.jp/ethiopia/english/office/topics/180402.html>

inefficient behind the protection wall. Hence, policy and program support should in return demand to meet export targets and if this is not achieved should be stopped. Such control mechanisms are crucial to ensure effectivity of support.

Key intervention areas and actors:

The export promotion strategy for priority sectors such as the LLP sector has been vigorously pursued by the Ethiopian government during the last years. Results so far are however not meeting the government's performance targets, notwithstanding the multitude of promotional measures and resources provided for by the government. On the other hand, the efforts to attract FDI have also exacerbated pressures to liberalize trade, which is a typical by-product of investment liberalization. Requesting from companies to tackle international export markets like the US or the EU, which puts high demands on companies, both in technical and financial terms, while at the same time liberalizing imports and thus eroding profit margins for domestic companies, must however produce contradictory results. Donors should thus urge the Ethiopian government, in particular the MOI, to adopt a cautious approach to import liberalization, particularly in those sectors that are targeted by the government for export promotion.

What can CBI contribute?

Though clearly beyond CBI's mandate, together with other donors CBI could use contacts and discussions with Ethiopian government authorities and point to the importance of the overall balance between export promotion activities and import protection, particularly for the business models of local SME companies.

6.3. Ensuring the institutional sustainability of export promotion

In case the CBI project commences, it is also important to ensure the institutional sustainability of the project. This report argues that focussing on training programs with mostly international experts targeting individual companies will arguably have positive effects for the selected companies, but does not guarantee that export promotion becomes a regular or systemic element of the LLP sector in Ethiopia. While other donors have been already active in similar export promotion activities, the build-up of systemic local capacities and capabilities for export promotion is still lacking. For this reason, CBI should promote the institutionalisation of export promotion in the Ethiopian LLP sector. The important aspect is to build domestic capabilities and create a knowledge base with competent local experts with respect to key elements of export competitiveness like market intelligence for important export markets, design of new and innovative products, or modern quality management in production.

We propose four different models that could ensure a higher degree of institutional sustainability of export promotion activities: (i) capacitation of individual local experts via training programs and twinning with international experts; (ii) the capacitation of a domestic *lead company* that is then responsible for upgrading other local companies; (iii) the setting-up of an *export promotion agency* that provides training and export services to the sector, a model that has been applied by many industrialized countries; (iv) the setting up of a *private commercial agency* that supplies training and export services to the sector. An overview of the merits and de-merits of the four different institutional models is presented in [Table 6.1](#). Regardless of the specific institutional approach chosen, it is important to stress vis-à-vis Ethiopian stakeholders in the LLP sector that exporting to international markets like the EU market is a long-term undertaking. The critical factors for success do not only relate to improving the competitiveness of individual companies, but will crucially depend on the commitment and cooperation of the whole sector. Improving the export competitiveness of

the whole LLP sector will thus require a long-term systemic approach that will necessarily involve the domestic build-up and promotion of export promotion services.

Table 16 Regardless of the specific institutional approach chosen, it is important to stress vis-à-vis Ethiopian stakeholders in the LLP sector that exporting to international markets like the EU market is a long-term undertaking. The critical factors for success do not only relate to improving the competitiveness of individual companies, but will crucially depend on the commitment and cooperation of the whole sector. Improving the export competitiveness of the whole LLP sector will thus require a long-term systemic approach that will necessarily involve the domestic build-up and promotion of export promotion services.

Table 16: Four models of institutional sustainability for export promotion

Model	Merits	De-Merits
Individual local experts Individual local experts are contracted for trainings in individual firms	<ul style="list-style-type: none"> • Direct and unbureaucratic support to selected companies 	<ul style="list-style-type: none"> • Weak institutional sustainability of model
Lead company A domestic company is capacitated and then responsible for upgrading other local companies	<ul style="list-style-type: none"> • Cooperation between companies might be enhanced • Additional business for lead company 	<ul style="list-style-type: none"> • Initial government/donor support is concentrated on individual company • Conflict of interest between own competitive position of lead company and those of potential competitors
Export promotion agency Corporate sector sets up a joint agency that provides training & export services	<ul style="list-style-type: none"> • Combined effort of the sector • Mixed financing model (membership fees, service fees, government support) increases financial sustainability 	<ul style="list-style-type: none"> • Internal governance conflicts
Private agency A private commercial agency supplies training & export services	<ul style="list-style-type: none"> • Potential long-term sustainability depends on effective demand from business sector 	<ul style="list-style-type: none"> • Initial seed financing from government/donors necessary • High exposure to market shocks

Source: own elaboration.

In addition to its core mandate of providing targeted training to individual companies, CBI could use its program to promote such a systemic approach to export competitiveness by raising awareness with regard to the benefits of different institutional models. CBI could e.g. organize visits to export promotion agencies in Europe for government and sector representatives from MOI, LIDI, ELIA or ALPPI, or organize workshops/conferences to share experiences and present the work of particular export promotion agencies in Ethiopia.

6.4. Next Steps

This report has shown that opportunities exist for locally-owned manufacturers to increase exports to the EU, but that various bottlenecks exist along the whole chain that need to be mitigated (Figure 33). The promotion of exports, however, does not depend on solving all issues at once, but can be successful through selective interventions. The report has highlighted that various government, private sector and donor organizations are actively

seeking to mitigate bottlenecks along the whole chain (Figure 32, Figure 34), and that there is still room for a project to actively promote exports of locally-owned manufacturers to the EU. Given the strong presence of other donors in the sector, linking the potential CBI program to the existing (informal) donor coordination platforms will be crucial in order to avoid redundancies, identify complementarities and increase the programs' impact. In the preparatory and initial phase of the CBI project, particular attention should be given to the following issues:

- Engage in discussions with MOI, LIDI, ELIA and existing (informal) donor coordination platforms (and, in particular, with UNIDO) in order to identify cooperation possibilities and to avoid duplications.¹¹
- Identify potential donor cooperation partners (e.g. PUM, CSR Netherlands, UNIDO, and others) and discuss the potential to jointly develop a sustainable value chain geared towards the EU market.
- Connect to CAWEE and its members in the LLP sector for activities that particularly promote female entrepreneurs.
- Connect to ALLPI and discuss the possibilities for cooperation and the regional scaling-up of program activities

¹¹ ÖFSE provided CBI with a list of companies that have already received support by different donor programs. CBI thus needs to make sure to support different companies OR that the support provided is complementary.

7. CONCLUSION

The shifting GVC dynamics and China's decreasing global supply of leather products opened a window of opportunity to link to GVCs and increase exports for low cost countries such as Ethiopia. Even though global trade development has been sluggish, Ethiopia could increase its market share if the sector's competitiveness can be increased. Exporting to the EU or the US is highly demanding and – depending on the specific value chain – margins are often very low. Integrating in EU/US value chains can nonetheless have important learning effects and support manufacturers in exporting to markets with higher margins. Ethiopia has, in addition, not only market opportunities in key consumption markets, but also in regional markets with high growth potential and in the relatively large local market.

This report has highlighted that the Ethiopian LLP sector has many strengths and the necessary preconditions to become a key regional and global supplier of LLP products. The major advantages of the sector include a large livestock sector, the availability of high quality and internationally renowned sheep leather, low production costs (wages, electricity) and an institutional regime that is committed to support the sector and improve its performance through industrial policy.

In order to take advantage of the opportunities, the key bottlenecks in the LLP sector need to be mitigated. Some constraints are structural in nature and will take time to solve on a larger scale, reducing key bottlenecks on a step-by-step basis will nonetheless suffice to link to GVCs and gradually increase exports. The key bottlenecks include the limited supply and quality of raw hides and skins to tanneries; the limited supply of export-quality finished leather to local manufacturers in the necessary consistency; and the limited capacities and capabilities of locally-owned manufacturers to link to GVCs and fulfil buyers' requirements. Improving the horizontal and vertical cooperation in the sector and the development of a common export strategy will be crucial in order to fulfil the high demanding buyers' requirements.

The lack of capacities and capabilities of locally-owned manufacturers to link to GVCs and fulfil buyers' requirements highlights the importance and potential of supporting measures as offered by CBI. This report has identified Ethiopian footwear, handbags and – potentially in the future – gloves as high potential leather products for increasing exports of locally-owned manufacturers to the EU. We argue that footwear and handbag manufacturers need to link to different value chains in the EU, given the different structure of the leather sub-sectors in Ethiopia and the varying buyers' requirements in specific value chains. The generally larger footwear manufacturers are more likely to succeed in the branded-mass market (CMT/OEM), and to a more limited extent, in the mid-high end market segments (OEM). Handbag manufacturers, on the other hand, are relatively smaller in size and are more likely to link to the mid-high end market segments (OEM).

If CBI implements a project in support of locally-owned leather manufacturers in Ethiopia, it is also important to ensure its sustainability and maximize its impact. Linking up to existing donor coordination platforms will be a key factor to avoid redundancies, identify complementarities and maximize the impact of CBI's program. In addition, in order ensure the sustainability of its interventions, CBI should promote institutional cooperation between the LLC sector stakeholders in order to increase export competitiveness, either through promoting one of the proposed models for the institutionalisation of export promotion or similar measures.

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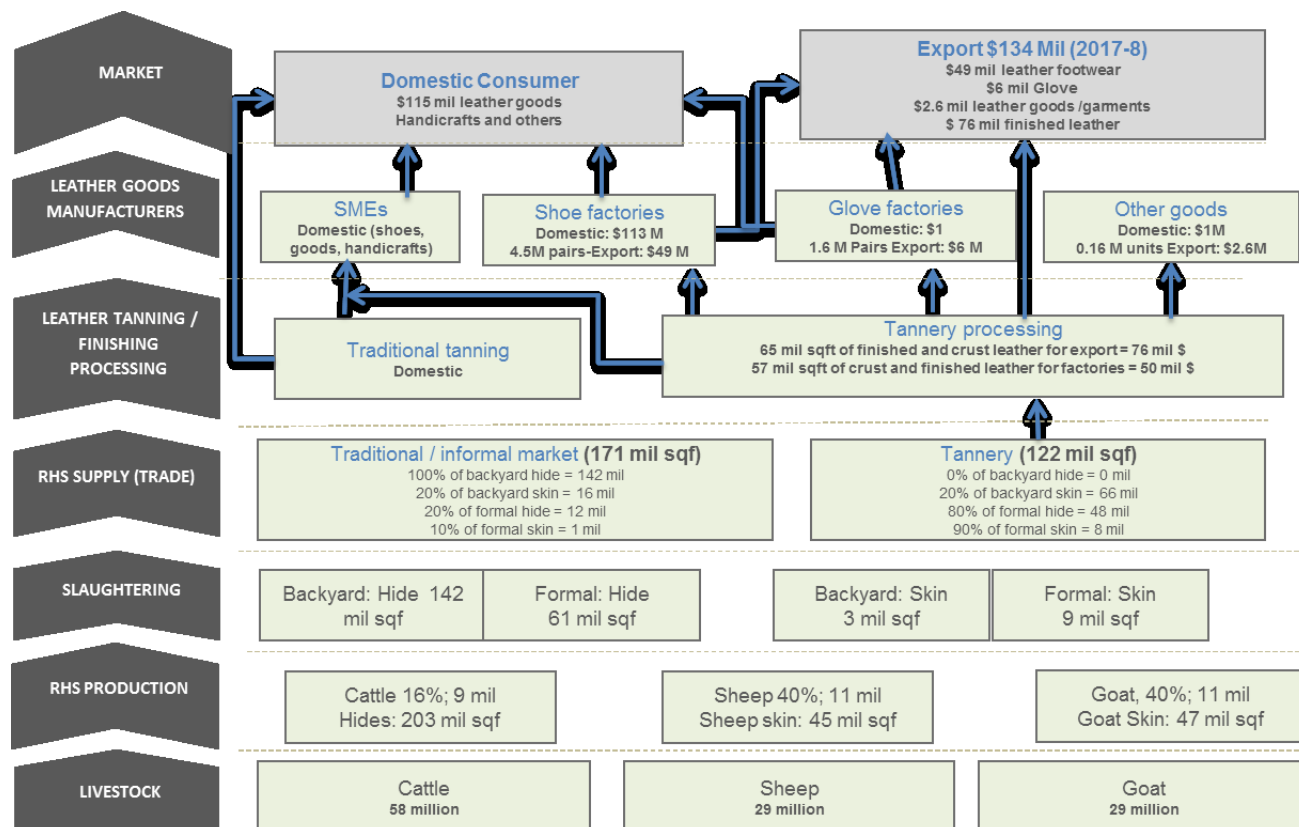
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ANNEX I – ADDITIONAL INFORMATION

(a) Detailed LLP Value Chain

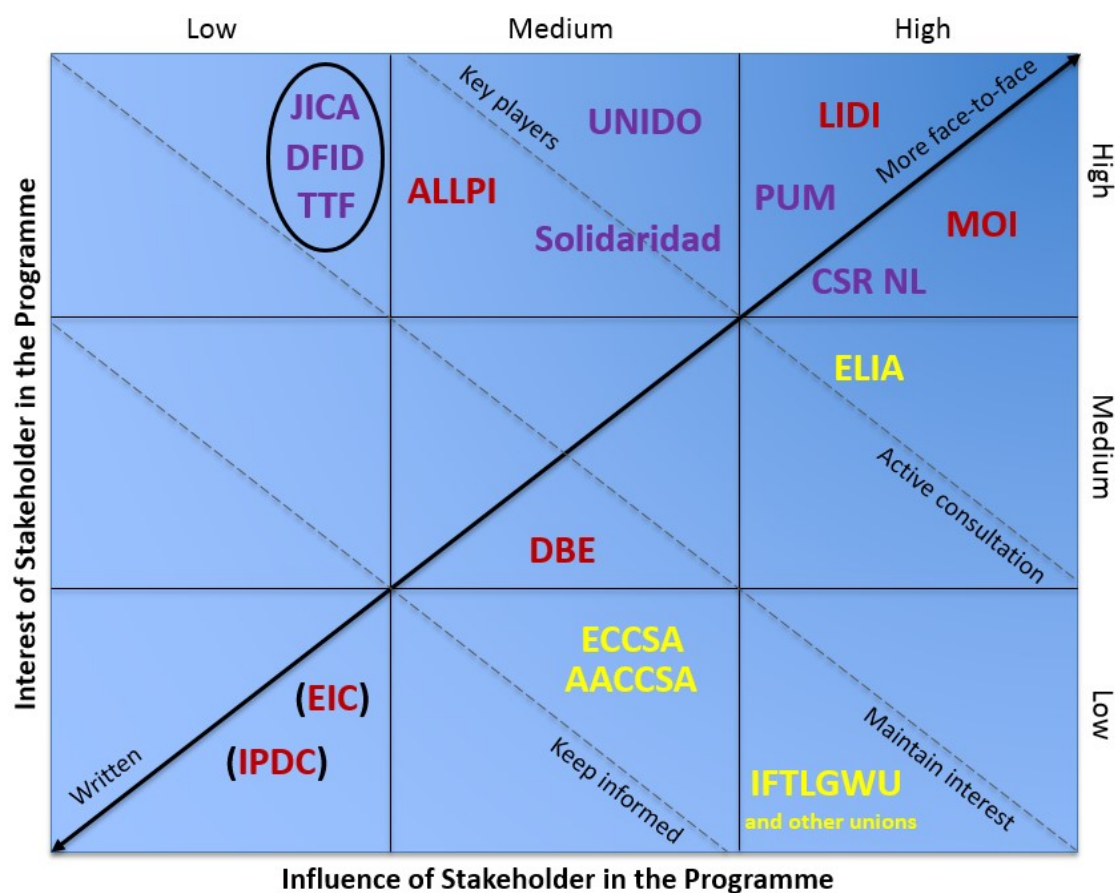
Figure 35: Detailed overview of the Ethiopian LLP value chain



Note: (Trade) Data slightly differs from the rest of the report due to a different sources (LIDI vs. UN Comtrade mirror data) and timeframes (Ethiopian vs. Gregorian calendar).
Sources: LIDI 2018a; Expert estimates.

(b) Stakeholder Assessment Grid

Figure 36: Stakeholder assessment grid



Source: Assessment by the authors.

Note: Red = government organizations; Yellow = Private organizations; Purple = donor organizations. On the governmental level, the key organizations for the implementation of the CBI program are the MOI and LIDI. Donor consultations should be made in close collaboration with UNIDO (the leading donor organization in this sector) and other donors such as DFID, JICA and TTF. PUM, Solidaridad and CSR Netherlands are key Dutch donors in the sector that are likely to be more directly involved in the CBI program. ELIA is the most important business association in the sector and might play an important role in the implementation of the CBI program; ECCSA and AACCSA could also play a role in this regard, but their focus is not sector specific. ALLPI has mentioned their interest in the CBI program, but their potential role in the program needs to be discussed further. DBE might play a role in facilitating finance for companies in the program. EIC and IPDC are important actors in the sector, but they are likely to play only a minor role in the implementation of the CBI project.

