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MINISTRY OF INDUSTRIALIZATION
AND ENTERPRISE DEVELOPMENT

KENYA LEATHER INDUSTRY

Diagnosis, Strategy and Action Plan

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Economic Transformations Group, Inc.



Kingdom of the Netherlands



WORLD BANK GROUP

KENYA LEATHER INDUSTRY

DIAGNOSIS, STRATEGY AND ACTION PLAN

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ABBREVIATIONS

| | |
|----------------|--|
| AGOA | African Growth and Opportunity Act |
| AHITI | Animal Health and Training Institute |
| AI | Artificial Insemination |
| B2B | Business to Business |
| CFC | Common Facility Center |
| COMESA | Common Market for Eastern and Southern Africa |
| EAC | East African Community |
| EU | European Union |
| FDI | Foreign Direct Investment |
| FTA | Free Trade Agreement |
| GI | Geographic Indicator |
| GoK | Government of Kenya |
| ICT | Information Communications Technology |
| ILDIP | Indian Leather Development Programme |
| JICA | Japan International Cooperation Agency |
| KAM | Kenya Association of Manufacturers |
| KIRDI | Kenya Industrial Research and Development Institute |
| KITI | Kenya Industrial Training Institute |
| KLDC | Kenya Leather Development Council |
| KM | Kariokor Market |
| LAEA | Leather Articles Entrepreneurs Association |
| LIDI | Leather Industry Development Institute |
| LWG | Leather Working Group |
| MOU | Memorandum of Understanding |
| MSME | Ministry of Small and Medium Enterprises |
| NGO | Non-Governmental Organization |
| PPP | Public Private Partnership |
| R&D | Research and Development |
| SME | Small and Medium Enterprise |
| SPV | Special Purpose Vehicle |
| TPCSI | Training and Production Center for the Shoe Industry |
| UK | United Kingdom |
| UNIDO | UN Industrial Development Organization |
| US | United States |
| VAT | Value Added Tax |
| WTO | World Trade Organization |

EXECUTIVE SUMMARY

THE GLOBAL AND AFRICAN CONTEXT

World trade in leather—one of the most widely traded commodities—is currently growing and is estimated at over US\$100 billion a year.¹ In 2013, leather footwear accounted for half of that figure, amounting to US\$53.5 billion. Globally, demand for leather and leather products is growing faster than supply. Although the leather sector in Africa, including in Kenya, has many natural strengths, it risks missing out on opportunities in an expanding global market. Despite the growing global market for leather products such as footwear, fine leather, handbags, and auto upholstery, African countries, including Kenya, remain marginal players. The key questions concern whether and how Kenya can grow its leather industry, increase its competitiveness in leather and leather products, grow exports and jobs, and create a viable and sustainable industry to propel the country toward inclusive prosperity.

Despite owning a fifth of the global livestock population, African countries account for only 4 percent of world leather production and 3.3 percent of value addition in leather. Most African nations, including Kenya, are essentially exporters of raw hides and skins and wet blue leather and maintain a low production capacity for finished leather. Just to Kenya's North, Ethiopia is emerging as an exception to this trend.

THE KENYAN CONTEXT

Although Kenya served as a leather footwear hub for East Africa two decades ago, it is currently a very minor exporter of leather and leather products (only US\$140 million,

0.14 percent of world export in 2013). Kenya is also significantly less competitive than global leaders including China, Italy, and Vietnam in all competitiveness indicators, except availability of and access to raw materials. Its competitive position has been eroded by global imports of new low-cost footwear penetrating Kenyan and East African markets and second-hand imported footwear invading domestic markets. Today, Kenya is a low-cost producer of undifferentiated, low-end shoes and boots, producing an estimated 3.3 million pairs of leather footwear per year, mostly for the domestic market. For instance, Bata, Kenya's largest and dominant footwear maker, has significantly reduced its production of low-end, men's leather shoes for the domestic market, and its export of leather shoes to the East African market has also declined.

Currently, most Kenyan leather is produced and sold as a commodity with little quality or design differentiation. Kenya's leather exports consist of semi-processed tanned "wet blue" leather (89 percent), raw hides and skins (5 percent), finished leather (2 percent), and leather footwear and handbags, travel ware, and other leather products (4 percent). Up until the imposition of an 80 percent export tariff on raw hides and skins in 2009, raw hides and skins accounted for more than 25 percent of Kenya's total leather exports. Interviews with industry experts confirm that despite the tariff, there continues to be a high level of smuggled exports of raw hides and skins. Unfortunately, trade in raw and semi-processed leather only generates a marginal trickle-down effect on the rest of the Kenyan population.

¹ All dollar amounts are U.S. dollars unless otherwise indicated.

Footwear is the biggest leather goods subsector in Kenya, while the handbag subsector is the most competitive vis-à-vis global markets.

In the case of leather handbags, travel ware, and cases, Kenya's exports in 2013 (US\$2.2 million) were almost quadruple the export size of Ethiopia's (US\$0.57 million) in the same year. Kenya can build on its reputation for quality hand bags, travel ware, and cases by improving the quality of its products, building the "made in Kenya" brand distinction, and creating a mass customization delivery capacity. There is also a range of other leather product categories where opportunities exist such as belts, industrial boots, and gloves. However, they would be starting with a scale and level of competitiveness that is extremely low and would be at a competitive disadvantage when faced with the labor intensive, global market.

Employment in Kenya's leather industry is relatively low (estimated at 14,000 during peak times) and the informal sector is the bigger employer, accounting for 10,000 of the 14,000 workers. According to the Kenya National Bureau of Statistics, Kenya's leather sector accounted for only 2 percent of formal manufacturing employment and 1.3 percent of manufacturing value added in 2013.

Under the prevailing structure of the leather industry, wealth is very narrowly distributed among a small number of traders/manufacturers. The industry has failed to generate any significant level of employment because most of the value is captured by the tanneries, which represent the most capital intensive and employment light segment of the value chain. The mode of competition that exists within the leather industry and the

prevailing business models both fail to capture growth potential or broadly distribute the wealth created.

INDUSTRY COMPETITIVENESS

Kenya's leather sector competitiveness is currently based on the nation's comparative cost advantages, derived from its abundant natural resources of cattle, goats, and sheep (Kenya is the third largest livestock holder in Africa), its relatively low labor costs, and its comparative disregard for environmental and related social costs.² The leather sector's costs of production are subsidized to the extent that government policies (and their poor enforcement) fail to force producers to internalize environmental and social costs associated with sustaining the sector, including most importantly, water resource clean up, long term health care, and natural resource replenishment costs.

Several factors hinder the growth of Kenya's leather industry. In the footwear subsector, Kenya's lack of cost competitiveness results from the following three major constraints that disadvantage Kenyan producers: (i) the high cost of domestically sold leather and leather inputs (including 25 percent duty on imported inputs); (ii) the high cost of labor; and (iii) the high cost of electricity. In addition, on the demand side, it is very difficult for local leather footwear producers to compete in the domestic market against the inflow of cheap and new leather and non-leather footwear imports (mainly from China and India) and against the growth of the second-hand Mitumba market, which offers an enormous range of high and low quality leather and non-leather footwear at bargain prices.

² As will be evident further on in the report, some tanners have already invested heavily to safeguard the environment. However, they are the exception and not the norm.

Meanwhile, Ethiopia is emerging as a new world-class player in leather footwear due to its low cost skilled labor, improvements in the quality of its raw material supply, the stable business climate, and the establishment of new economic zones. Ethiopia is attracting an increasing number of foreign investors who are using the country as a production site, predominantly to enter the EU and US markets—the latter through the AGOA program.

Ethiopia has made tremendous productivity gains in recent years and now surpasses Kenya in terms of a cost competitiveness advantage. Indeed, it is approximately 30 percent more costly to produce a pair of low-cost men's leather shoes in Kenya than in Ethiopia. In Kenya, the cost of producing a pair of low-cost men's shoes is approximately US\$9.44, compared to Ethiopia's US\$7.28 for a pair of men's loafers.

INDUSTRY STRUCTURE

There is a vibrant and competitive informal sector, concentrated in the Kariokor Market cluster in Nairobi, that produces low cost leather footwear and goods for Kenya and the region. Most of the leather good producers are micro and small enterprises and many prefer to stay in the informal sector in order to remain competitive. There is an intricate link between the formal and informal sector but it is weak and unbalanced. Many institutes and associations exist to support the industry—most of which are government owned or controlled—, but few play a significant role due to lack coordination, funding, and authority.

Additionally, only a few tanneries process finished leather for sale in the domestic Kenyan market. The finished leather market is tightly controlled and often resembles a seller's market. Kenya's largest and most modern tannery, Alpharama, dominates the production and commands a great influence over the market. For the tanning subsector of the leather value chain, the relatively high cost of raw materials and chemicals in Kenya (largely due to the 25 percent import duty on inputs) represents its most significant competitiveness challenge.³

The current comparative cost advantage of Kenya's tanneries in the production and export of semi-finished wet blue leather derives from the fact that North American, South American, the EU, and most recently, Chinese governments are unwilling to continue to absorb externalities in the sector, including most importantly, those associated with environmental clean up. As a result, they are attempting to "export" those costs to nations such as Kenya that are willing to absorb them in exchange for production cost structures, which are artificially depressed. Over the long term, these deferred costs may reemerge in various forms including, for instance, reduced life spans, increased medical costs, and significantly increased costs associated with water purification. Sustainable production should thus be a high priority for government policy.

STRATEGY FOR THE INDUSTRY

According to our competitive analyses, the most promising targets for Kenya's leather industry include three key products with corresponding market thrusts.

² Tanners who export have access to surface treating agents under EAC duty remission. Tanneries selling into the EAC market must pay the duty.

| Strategic Products | Strategic Markets |
|-------------------------------------|---|
| Low value added leather footwear | <ul style="list-style-type: none"> • Domestic Market—increase share of domestic leather footwear market, particularly with low-cost men’s shoes, low-cost school shoes, and boots. • Regional Market—increase exports to EACs of low cost-men’s shoes and boots. |
| High value added specialty products | <ul style="list-style-type: none"> • EU and US Markets—increase exports of specialty leather products, leather handbags, travel ware, and cases, with a focus on EU and US markets. • Domestic and EAC Markets—increase domestic and regional sales, especially safari-type products sold to tourists in Kenya and EAC. |
| Finished leather | <ul style="list-style-type: none"> • China and EU Markets—Increase exports of higher value added finished leather (and crust leather), especially to China and EU. |

RECOMMENDATIONS

To increase the competitiveness of the leather industry and accomplish the above product-market objectives, strategies and actions are recommended in Table 1 and grouped according to a framework, which consists of three key strategies. The table also matches action initiatives to the three product/market

competitiveness strategies for low-value-added leather footwear, high-value added specialty products, and/or finished leather. A detailed evaluation of these recommended initiatives and a priority action plan, including how they should be staggered over time, is provided in the full report.

Table 1: Leather industry strategy & actions

| | Recommendations to improve the competitiveness of: | | |
|---|--|-------------------------------------|------------------|
| | Low value-added leather footwear | High value-added specialty products | Finished leather |
| Strategy 1: Promote the dynamic restructuring of the leather industry | X | X | X |
| 1.1 Establish a collaborative, stakeholder-driven leather industry strategy implementation process | X | X | X |
| 1.2 Strengthen the Kenya Leather Development Council (KLDC) | X | X | X |
| 1.3 Improve the regulatory framework to reduce production costs and safeguard the environment | X | X | X |
| Strategy 2: Increase access to markets and induce greater demand for Kenyan leather & leather products | | | |
| 2.1 Develop a leather marketing entity to increase awareness, coordinate branding and promote exports | X | X | X |
| 2.2 Design a transparent public procurement policy | X | X | X |
| Strategy 3: Build quality and standards | | | |
| 3.1 Improve the Production Process, Technology and Machinery | | | |
| 3.1.1 Establish leather product development accelerators (or “leather wealth creation centers”) | | | |
| i. Nairobi Leather Accelerator (for formal sector) | X | X | X |
| ii. Kariokor Market Satellite Leather Accelerator | X | | |
| 3.1.2 Develop a leather industry park | X | X | X |

| | Recommendations to improve the competitiveness of: | | |
|--|--|-------------------------------------|------------------|
| | Low value-added leather footwear | High value-added specialty products | Finished leather |
| 3.2 Improve skills | | | |
| 3.2.1 Restructure and upgrade the Training and Production Center for the Shoe Industry (TPCSI) | X | X | |
| 3.2.2 Strengthen university leather design, technology, and marketing capacities | | X | X |
| 3.2.3 Enhance human resource placement services for the leather industry | | X | X |
| 3.3 Encourage quality & enforce standards | | | |
| 3.3.1 Align incentives for quality and promote quality certification systems | X | X | X |
| 3.3.2 Develop leather award and recognition programs | X | X | X |
| 3.3.3 Initiate regional branding of the leather industry to promote specialization | | X | X |
| 3.3.4 Increase enforcement of quality standards for imported leather products | X | X | |

Due to the highly fragmented structure of the Kenyan leather industry, the limited linkages among stakeholders, and lack of a coherent and shared competitiveness strategy by private sector, government, and other institutions, the overall plan is to improve access to markets, while enhancing productivity and movement to value addition and strengthening collaboration in the industry. Three important strategies are recommended: (i) promote the dynamic restructuring of the industry; (ii) increase access to markets and induce greater demand for leather and leather products; and (iii) build quality and standards throughout the value chain.

According to the first strategy, a critical cornerstone for improving the competitiveness of the leather industry is a well-functioning set of institutions to support the industry, coupled with a strong legal framework and business climate. This involves (i) establishing a leather cluster working group and strategy implementation process, (ii) strengthening and positioning KLDC as a driving institutional vehicle

to enhance leather industry competitiveness, and (iii) improving the regulatory framework to reduce the sector's production costs—by reducing import duties on intermediary goods—and safeguard the environment—by adopting and enforcing international leather-related environmental standards, particularly at the tannery level.

Increasing access to markets for Kenyan leather is the key ingredient for the success of the leather industry. To this end, the second strategy suggests (i) developing a leather marketing entity to increase domestic and international awareness of Kenyan leather, coordinate the branding of Kenyan leather, and promote exports. Such an entity could promote exports by organizing match-making between international buyers of crust and finished leather and Kenyan producers, and leveraging global business-to-business (B2B) e-commerce platforms. Importantly, the strategy to increase access to markets would also include (ii) facilitating access of local producers to the domestic market by improving

their opportunities to succeed with public procurement contracts, in line with the *Buy Kenya, Build Kenya* policy.⁴

Kenya’s leather industry trails behind global and regional competitors in terms of productivity, quality, and cost of products.

Strategies and actions to enhance quality and standards throughout the leather value chain are vital to Kenya’s ability to compete both within its own domestic market and globally. The third strategy rests on three pillars: (i) improving the production process, technology and machinery; (ii) enhancing training and skill development centers; and (iii) encouraging quality and enforcing standards. The first of these pillars can be achieved by establishing an industry accelerator for the formal sector and a common manufacturing facility for the informal sector—both to support firm development and linkage—, and by developing critical infrastructure, including a water effluent treatment facility in, potentially, a leather industrial park. Critically, if the latter is to succeed, then it must have a strong market orientation. The World Bank believes that a publicly-driven industrial park will not achieve the goals the Government of Kenya envisions for the industry.

Regarding skills and training in the industry, the government could restructure and upgrade the Training and Production Center for the Shoe Industry (TPCSI) and place it under the direction of KLDC. In parallel, leather design, technology, and marketing skills could be strengthened at the tertiary level through the endowment of professorships in these areas, such that current and future students enrolled in leather-related degrees receive

high-level training. Relatedly, a human resource placement service for the leather industry could be organized in order to develop an efficient market for technically competent managers, technicians, and workers. Lastly, professional certification programs within the industry could be improved and extended to assure that critical skills and competencies remain current and competitive through post graduate, continuous training. These measures would greatly enhance the level of skills and training in the industry.

The third pillar of the strategy aimed at building quality and standards rests on a combination of encouragement and enforcement.

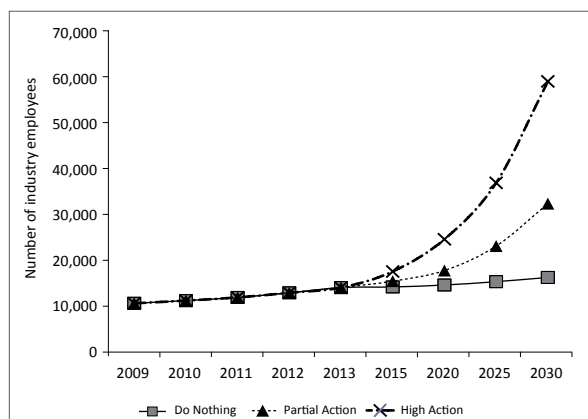
Throughout the value chain, and particularly at the very beginning with animal husbandry, incentives for quality should be aligned and quality certification systems promoted. Regional branding of the leather industry can further help by promoting geographic specialization and distinction (i.e. “Turkana Leather, A Tradition as Old as Man”). At the manufacturing end of the value chain, leather quality awards and recognition programs can be developed to induce innovation and foster competition based on distinct quality and design. Finally, the enforcement of quality standards can be increased, particularly for imported products.

Regarding the second-hands goods trade, the World Bank believes that its benefits in terms of employment generation and a lower cost of living for all Kenyans outweigh its costs in terms of a smaller domestic market for leather goods producers. To this end, the target market segments for the Kenyan leather industry are those where second-hand leather products are less prevalent, while a do-nothing course of action is suggested for ‘Mitumba.’

⁴ The Ministry of Industrialization and Enterprise Development is in the process of finalizing The Buy Kenya, Build Kenya policy, which is seen as a way of creating markets for local products and services. The policy aims to reduce government and private expenditure on imported products and services and reduce the unemployment rate by supporting the local economy to grow.

It is envisaged that the recommendations and action plan proposed in this report will provide the basis for Kenya's leather industry to increase its competitiveness and grow jobs and income. Projections of future leather industry employment have been generated to show the likely impact of minimal vs. substantial implementation of recommended policy initiatives (see Figure 1).

Figure 1: Leather industry employment projections 2015-2030



Source: ETG Projections

Three scenarios have been generated to depict the future of the Kenyan leather industry.

- Do Nothing Scenario:** If no significant effort is observed on the policy level, and private sector-led initiatives are not implemented, we project a stagnant industry where there is no notable growth.
- Partial Action Scenario:** According to this scenario, there will be a minor improvement in the competitiveness of both the formal and informal sectors, resulting from the

successful implementation of only a few recommended actions.

- Action across vs. Scenario:** This positive scenario implies successful implementation of many of the recommended initiatives, improvement in the competitiveness of both the formal and informal sectors, which results in a quadrupling of leather industry employment within 15 years. If Kenya successfully brings transformation across the value chain, scenario C is feasible.

Based on a cross-country (China, Vietnam, Turkey, Ethiopia) average estimate of 1,500 formal jobs per million pairs of shoes produced, if Kenya was able to increase its competitiveness, market share, and annual production of shoes by 15 million pairs—from its current 3.3 million pairs of shoes to 18.3 million—, then employment in the leather footwear industry would grow by 22,500 jobs (from 14,000 to 36,500 jobs). This estimate is roughly consistent with Scenario B above. In terms of value, the net exports of the leather industry could grow from US\$140 million a year to close to US\$500 million.

To achieve this target and more, Kenya's public and private sector leaders will need to collaborate and work intelligently to create this vision and strategy, implement actions, and develop the conditions for a renewal of competitive strength and dynamism in the leather industry.

INTRODUCTION AND BACKGROUND TO THE STUDY

In 2014, Kenya's Ministry of Industrialization requested technical assistance from the World Bank to conduct competitiveness assessments and develop competitiveness strategies for four key industries: textiles and apparel, food processing, furniture, and leather and leather products. The Ministry selected these four industry sectors for serious consideration as priority sectors for industrial development and job creation in Kenya.

The Economic Transformations Group, Inc. (ETG), a sustainable economic development consultancy from New York and Silicon Valley, was contracted to complete the analysis and strategy for the leather industry. ETG built on prior analytical work by Kyram Consultants Ltd.

In the context of Kenya's long-term vision to become an industrialized middle-income country by 2030, its leather and leather products sector offers an important opportunity for industrialization and diversification of exports. However, value addition in the leather sector has been minimal, and most of Kenya's exports have been in the form of unprocessed, raw hides and skins. The leather sector can contribute to economic growth through expanding exports of both semi-processed and finished leather goods. The development of the sector involves improving the raw material base (especially the quality of hides and skins), boosting the tanning subsector, producing leather goods, and marketing.

Key strategic questions about the leather industry include: what is the status of development of the industry, what are the

most critical competitiveness challenges and opportunities, what are the most promising leather products that Kenya should focus on moving forward, and how can support be increased to value addition and exports by upgrading production processes, technology, marketing and branding of leather products.

The basic research methodology followed a standard approach of gathering existing reports and data, and interviewing a wide range of local and international experts (see Annex 2). The study team also visited Ethiopia's Leather Industry Development Institute, and footwear firms in Vietnam. Due to the challenge of very minimal and poor quality data, particularly about the domestic market for leather products, and unrecorded exports of hides and skins, the team relied heavily on interviews with key experts, industry stakeholders, and adapted a modified Delphi methodology to establish expert consensus estimations for leather production levels, size of markets, and cross-country comparative analyses of competitiveness indicators and production costs.⁵ We asked selected industry experts to rank and scale competitive advantage of Kenyan leather producers in comparison to other counterparts in the market. Similarly, a modified Delphi methodology was used to conduct a competitiveness benchmarking exercise, which entailed surveying a number of leather experts, policy makers, and business leaders in Kenyan leather industry to rate country competitiveness. Selected experts were asked to compare Kenya's leather industry performance and ten competitiveness indicators against that of the three representative countries. Further

⁵ The modified Delphi method is a structured communication technique or method developed as a systematic, interactive forecasting method which relies on a panel of experts. The experts answer questions in two or more rounds, and after each round, a summary of the experts' forecasts from the previous round as well as the reasons they provided for their judgments is presented. Experts are encouraged to revise their earlier answers in light of the replies of others. It is believed that during this process the range of the answers will decrease and the group will converge towards the "correct" answer.

analysis was conducted to compare cost of production of shoes in Kenya vs. Ethiopia, drawing on a combination of costs indicated in reports, confirmed by expert opinions of producers and industry experts.

The analysis and recommendations herein emphasize the tanning and manufacturing segments of the leather and leather goods value chain—and the markets to which these

sell—over the animal husbandry and abattoir segments of the chain. Very little information and analysis existed about the former, while a significant number of reports had been written already about the latter. In addition, while the recommendations for tanning and manufacturing fall under the purview of MOIED, the interventions necessary for the earlier stages of the value chain are largely the responsibility of the Ministry of Agriculture.

GLOBAL TRENDS IN THE LEATHER INDUSTRY

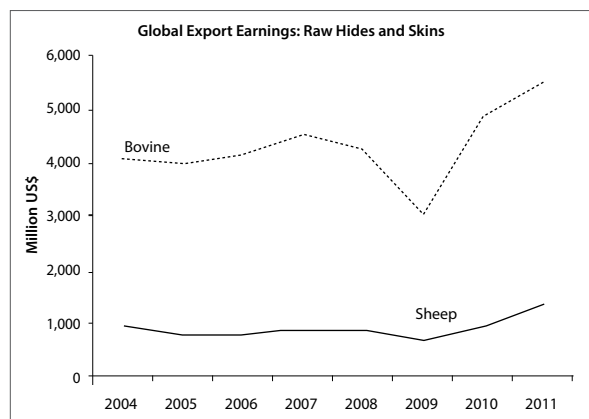
1.1 DEMAND FOR LEATHER AND LEATHER PRODUCTS IS GROWING FASTER THAN SUPPLY

A major global shift has taken place in leather and leather products production, with a resetting of competitive advantage from Europe to Asia (and within Asia from East Asia to South Asia). In 2013, total leather production in Europe was 6.3 billion sq. ft., while Asian countries (e.g., China, India, Vietnam, Korea, Japan etc.) produced almost double that amount (12.1 billion sq. ft.). Of total annual global leather production (approximately 23 billion sq. ft.), the leather footwear industry uses 65 percent of leather (or 14.9 billion sq. ft.). The remaining 8.1 billion sq. ft. (35 percent of total leather production) goes into the manufacturing of a diversity of other types of leather products—for example, furniture (14 percent), automobile seats and interiors (10.2 percent), garments

(10 percent), and miscellaneous other leather products (8.0 percent).⁶ The US is currently the largest importer of footwear in the world, accounting for 2.3 billion pairs, 24.8 percent of the world footwear trade, at a value of US\$24.2 billion in 2013.⁷

The big message coming from comparisons of demand and supply across regions is that demand for leather products is growing much faster than supply.⁸ Moreover, long term growth rates for leather products in developing countries are twice as high as in developed countries. This phenomenon has two causes: more rapid population growth, particularly within younger population cohorts, and rapidly increasing disposable income. Yet, insofar as the market is concerned, this is expected to result in chronic supply deficits and increased upward pressure on prices.

Figure 2: Global export earnings from raw hides and skins



Source: UN Comtrade

Recent years show a growth in earnings for raw hides and skins (Figure 2) as well as exported leather. In 2010, global export earnings from raw hides and skins increased by nearly 60 percent (and a further 18 percent in 2011). At the same time, export earnings from leather products increased by 28 percent in 2010 and 14 percent in 2011, while the value of footwear exports grew by a more modest 11 and 13 percent, respectively, over the two years. All leather-producing regions of the world showed a broadly similar pattern. Prices for all categories

⁶ M. Mwinyihija, (2014). "Emerging World Leather Trends and Continental Shifts on Leather and Leather Goods Production," *Advances in Business Management and Administration*, Vol. 1 (1): 1-13.

⁷ United States International Trade Commission (USITC) Trade Dataweb - <http://dataweb.usitc.gov/> - compiled from tariff and trade data from the U.S. Department of Commerce, the U.S. Treasury, and the U.S. International Trade Commission. <https://www.wewear.org/assets/1/7/usimportsfootwear1312.pdf>

⁸ Demand for leather within certain product segments fluctuates. For instance, sports footwear is now almost 99% synthetic. Car upholstery is also shifting, and now only visible parts of the seat are made of leather.

of leather, including raw, wet blue, crusted, and finished leather have increased since 2009, and they reached new highs in 2013 and 2014.⁹

1.2 CHINESE TANNERIES FACING INCREASINGLY STRINGENT ENVIRONMENTAL REGULATIONS

China remains one of the major producers of leather products in the world, yet the nation's recent change in direction to become more environmentally sustainable has caused a significant drop in leather production. In March 2014, local governments in the northern provinces of Hebei and Xinji stopped a number of tanneries from operating due to excessive effluence.¹⁰ In April of the same year, over 100 community members raided a tannery complex in Quanzhou, in the eastern Fujian Province, over pollution concerns.¹¹ Although China continues to import a great amount of raw hides and skins, its environmental regulations are expected to become all the more stringent. This internalization of environmental costs, rising production costs associated with an increasing private sector share in tanning, as well as labor demand issues have sapped the competitiveness of Chinese leather manufacturers with the result that the world's third largest leather exporter has become one of the largest emerging importers of finished leather.

1.3 GROWING PUSH TOWARDS CLEAN PRODUCTION TECHNOLOGIES

The leather industry is a heavily polluting industry as effluents produced by tanneries have a significant negative impact on local water and air resources. In particular, chromium contamination and high chemical oxygen demand are typical problems associated with tannery effluents, both of which can pose serious risks to the environment and human health.¹² In many low-income countries these pollutants are responsible for the contamination of nearby surface and groundwater systems with severely high levels of chromium.¹³ Human Rights Watch has noted that workers might be handling tanning chemicals without any sort of hand protection). Thus, while global leather demand is on the rise, consumers in developed countries especially are pushing for an acceleration of the 'green'¹⁴ leather industry. Today in the US, green apparel and accessories make up 2 percent of the fashion industry—a marketable increase from 0.25 percent a decade ago.¹⁵ Major brand names—Timberland (Earthkeepers), H&M (Conscious Collection), and Gucci (Rainforest Alliance)—have introduced new materials that are stylish and fully recyclable (attractive to consumers), and at the same time cost-cutting. Their product lines are buttressed by the technological advances of leather research centers around the world: in 2009, Centre

⁹ M Mwinyihija, (2014).

¹⁰ Litehide, (2014), "Northern Chinese Government enforces new policy, tanneries closed until they become compliant," April 3. <http://litehide.com/archives/3403>

¹¹ World Watch Institute, (2015), "Villagers Attack Factories over Pollution in Eastern China" May 22. <http://www.worldwatch.org/villagers-attack-factories-over-pollution-eastern-china>

¹² Z Song, C.J. Williams, and R.G.J. Edyvean, (2000), "Sedimentation of Tannery Wastewater." *Water Research*, Vol. 34, No. 7: 2171-2176.

¹³ Mohammad Amir Hossain, Bhuiyan, et al. (2010) "Investigation of the Possible Sources of Heavy Metal Contamination in Lagoon and Canal Water in the Tannery Industrial Area in Dhaka, Bangladesh." *Environmental Monitoring and Assessment*, Vol. 175, No. 1-4: 633-649; and <http://www.hrw.org/sites/default/files/reports/bangladesh1012webwcover.pdf>

¹⁴ Just what constitutes 'eco-friendly' or 'green' leather is ambiguous. Generally, a leather product is considered 'eco-friendly' if it has been produced through means other than chromium sulphate tanning (which, along with about 250 other chemicals typically used in the tanning process, releases unfriendly toxins into the atmosphere). It is not clear, however, whether this assumes that the husbandry involved in delivering the hide was done so in an organic and/or humane manner.

¹⁵ Business Insider, (2013), "The Rise of Green Fashion," April 28. <http://www.usatoday.com/story/money/business/2013/04/28/the-rise-of-green-fashion/1996773/>

Technique Cuir (France) opened a state-of-the-art laboratory in Dongguan, China following the request of domestic producers; in 2012, Stahl Holdings (Denmark) developed ‘Stahlite’ in order to reduce the weight of finished leather by 40 percent, thus requiring less extensive chemical finishing; and in 2013, TILEATHER researchers (Spain) pioneered titanium tanning as an alternative to chromium.

In the developing world, where there is less disposable income (although rising) and therefore less demand for ‘green’ leather products, governments have begun to step in. In China, the Ministry of Industry and Information’s (MOI) 2009 directive Guiding Options of Tanning Industry Structural Adjustment proclaimed that tanneries whose production scale fell below 30,000 pieces of standard cattle hide per year would be shut down, while those producing below 100,000 pieces would be subject to limits. The MOI expressly encouraged Chinese tanneries to obtain “Eco-Leather” certification¹⁶ as defined by the China Leather Industry Association (CLIA). Since 2003, the CLIA has encouraged tanneries to meet or exceed international standards in the production process and as regards the finished goods themselves—in terms of leather quality, the use of specialized ‘green’ chemicals, pollution control, waste treatment, and corporate social responsibility.

Regarding the leather industry in Africa, although environmental measures have been introduced (usually along the lines of EU regulations), there tends to be a lack of cohesiveness. According to UNIDO, “Governments have established environmental protection offices in different departments and bureaus with insufficient

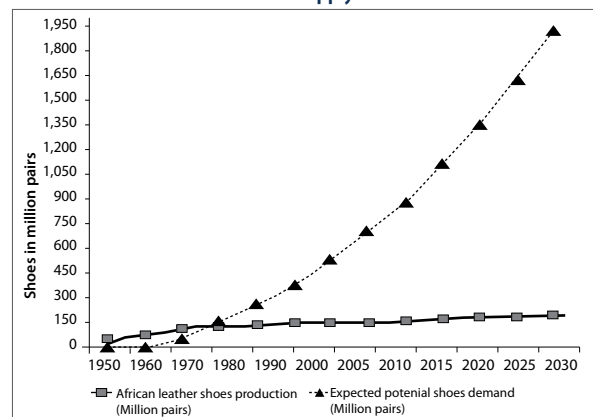
coordination between them. This leads to frequent discrepancies within the activities of regulation and control, and results in inefficient implementation.”¹⁷ Therefore, it may be capacity-building (in industrial strengthening, standardization, and technology), motivated by national development planning, which can instill an environmentally friendly leather processing culture.

1.4 IMPLICATIONS FOR KENYA

Capitalize on global trends

Even though the global market for leather products (footwear, fine leather, etc.) is trending upwards (Figure 3), African countries remain marginal players. Despite owning a fifth of global livestock population, African countries account for only 4 percent of world leather and leather products production.¹⁸ Most African nations, including Kenya, are essentially exporters of raw hides and skins and wet blue leather, and maintain a low production capacity for finished leather. Consequently, there is an emerging imbalance of supply and demand for leather products. Figure 3 demonstrates this trend for the leather footwear industry; unsurprisingly, Africa is a significant net importer.

Figure 3: Demand for leather shoes in Africa far exceeds local supply



Source: UN Comtrade

¹⁶ Leather International, (2010). Government backs CLIA's Eco-Leather mark, February 2010.

¹⁷ UNIDO, (2010), “Future Trends in the World Leather and Leather Products Industry and Trade.”

¹⁸ Mwinyihija Mwinyihija, and W. Quisenberry, (2013), “Review of the challenges towards value addition of the leather sector in Africa,” Global Advanced Research Journal of Management and Business Studies (ISSN: 2315-5086) Vol. 2(11): 518-528, November, 2013.

On the other hand, developing country markets—particularly in Africa including Kenya—offer attractive niches for aspiring shoe manufacturers. A major factor is at work here: increasing per capita demand for shoes (taking into account rising disposable income and population growth, particularly among school-aged children).

Beyond the regional market, there is an emerging opportunity for Kenyan tanneries to export more forms of processed leather to China, where imports are growing. Figure 4 shows that Chinese raw leather imports, as well as tanned and further prepared leather increased between 2007 to 2013.

Yet when considering direct imports from Kenya over this same period, China appears to be importing an increasing percentage of tanned leather (wet blue and crust) (Figure 5).

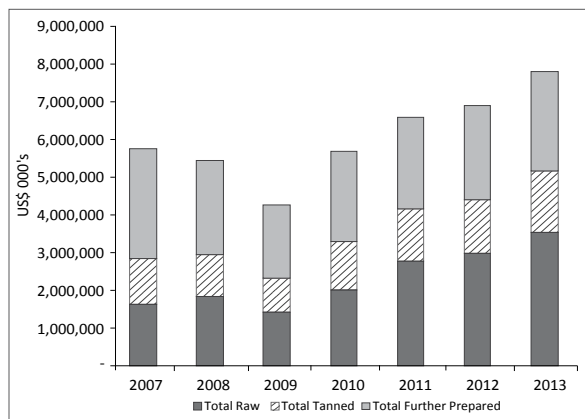
The implications of reduced Chinese production and competitiveness for Kenyan leather producers are profound. Stricter enforcement of environmental regulations in China make importing Kenyan-produced

intermediate goods more attractive (this is confirmed by increased activity of Chinese buyers in Kenyan markets of wet blue and crust leathers). With its Vision 2030,¹⁹ the Kenyan government is aiming towards a prosperous nation anchored by competitive high value industries, abundant human and social capital, political maturity, and sound infrastructure. Kenya is thus looking to capture a significant share of the world employment opportunity that will be generated by China's expecting shedding of millions of jobs in the light manufacturing industry, including the leather industry.²⁰

1.4 KEY FINDING OF CHAPTER 1

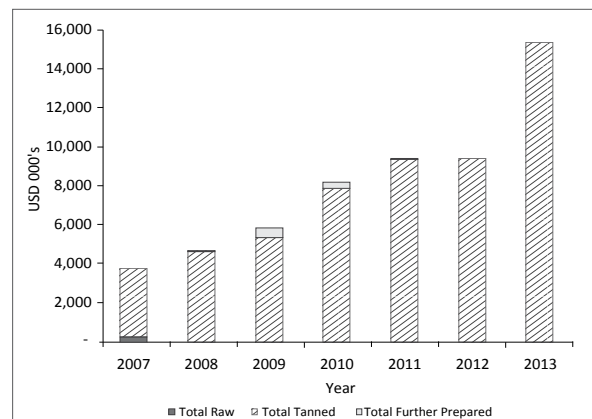
Globally, demand for leather products is growing much faster than supply. Most African nations, including Kenya, are essentially exporters of raw hides and skins and wet blue leather, and maintain a low production capacity for finished leather. Chinese tanneries face increasingly stringent environmental regulations, which affords new opportunities for exporting Kenyan-produced semi-processed leather to China.

Figure 4: Value of Chinese imports of raw leather (2007-2013)



Source: UN Comtrade

Figure 5: Chinese imports of raw leather from Kenya (2007-2013)



Source: UN Comtrade

¹⁹ The number of Kenyans working for wage jobs grew gradually over the last few decades, and since the year 2009, has exceeded self-employment. The nature of employment is in transition as well, as more people are moving away from traditional family-owned farming to higher value-added jobs.

²⁰ At the same time, there exists an ever present challenge for Kenyan manufactures to reclaim market share in their own home market (particularly for footwear), where Chinese producers remain extremely aggressive price-wise and are apparently committed to preserving their dominant market position.

The near and medium-term outlook described in the previous section necessitates a successful revitalization of the entire Kenyan leather sector. Already, Kenya is benefiting from recent price increases for wet salted hides and goatskins (such that buying skins, processing them into blue leather, and exporting semi-finished leathers has become a lucrative business for established tanneries).

Competitiveness analyses for Kenya in terms of its value-added leather products suggest that additional investment in downstream processes, as well as improved quality control, policies designed to encourage Foreign Direct Investment (FDI), and up-scaling of product designs and manufacturing processes are needed (and make good economic sense). These analyses are detailed in Chapter 4 of this report.

Furthermore, the leather sector itself merits restructuring, notably in the manner of both formal and informal network clusters to reduce input costs and accelerate capacity. A private

sector developer might be targeted in leading the development of a leather industry park. The government can broaden local procurement opportunities to Kenya leather producers. The entire local leather value chain can collaborate to enhance its competitiveness vis-à-vis Kenya's second-hand markets and imported new footwear. These strategies (and others) are discussed at length in Chapter 5.

An important mechanism for achieving the basic goal of value addition and product quality enhancement is the adoption of sustainable, clean technologies. Discriminating buyers, particularly in the developed world, value green leather and are willing to pay a premium for it. It follows that adhering to international best practices²¹ for limiting pollutants and remediating their impact on the environment is not only a socially responsible strategy for industry development but one which can help position the Kenyan industry for the production and sale of higher-value products. Developing a 'clean', uniquely Kenyan brand will help in this regard.

²¹ Kenya lacks systematic conformity to international standards at present, so these need to be adopted not only at the discretionary level of individual firms but also at the compulsory level of the entire leather industry.

KENYAN LEATHER PRODUCTS AND MARKETS

In developing a strategy for Kenya's leather industry, the starting place for analysis begins with an understanding of Kenya's existing leather products and markets. This chapter identifies Kenya's most important leather products and highlights the most significant segments and trends of domestic and export markets.

2.1 KENYA'S LEATHER PRODUCTS

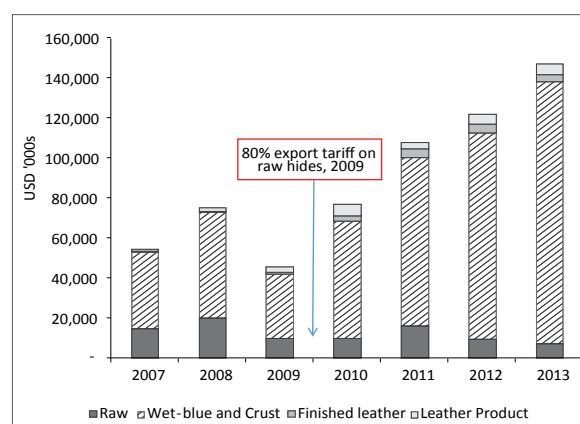
Kenya's leather production consists mainly (89 percent) of semi-processed tanned "wet blue" and some crust leather. The remaining production consists of finished leather (2 percent), leather footwear and handbags, travel ware, and other leather products (4 percent), and raw hides and skins (5 percent). This section profiles the size and relative advantages of Kenya's main leather products.²³

"Wet Blue" Production and Exports Dominate Kenya's Leather Industry

Over the last few years and including 2013, the size of the leather export market as a whole has been showing an upward trend. Currently, semi-

processed tanned "wet blue" leather is Kenya's leading leather industry export, accounting for 89 percent (US\$131 million) of the value of total leather exports in 2012-13. As shown in Figure 6, raw hides and skins accounted for 27 percent of total leather exports in 2007, until the government began imposing duties. Since the imposition of an 80 percent export tariff on raw hides and skins in 2009, official statistics show that exports of raw hides and skins dropped to 3 percent of leather exports, with the share of tanned leather product exports increasing substantially.²⁴

Figure 6: Kenya's leather industry exports (2007-2013)



Source: UN Comtrade

Table 2: Exports of Kenyan leather and leather products (2007-2013) (thousands of US\$)

| Kenyan leather/leather products | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | CAGR |
|---------------------------------|---------------|---------------|---------------|---------------|----------------|----------------|----------------|------------|
| Raw hides and skins | 14,337 | 19,830 | 9,374 | 9,603 | 15,538 | 9,154 | 6,652 | -12% |
| Wet blue/crust | 38,477 | 52,505 | 32,467 | 58,355 | 84,309 | 102,888 | 130,905 | 23% |
| Finished leather | 456 | 524 | 843 | 2,987 | 4,206 | 4,439 | 3,542 | 41% |
| Finished leather products | 717 | 1,647 | 2,521 | 5,545 | 3,030 | 5,078 | 5,632 | 41% |
| Total | 53,987 | 74,507 | 45,206 | 76,491 | 107,082 | 121,560 | 146,731 | 18% |

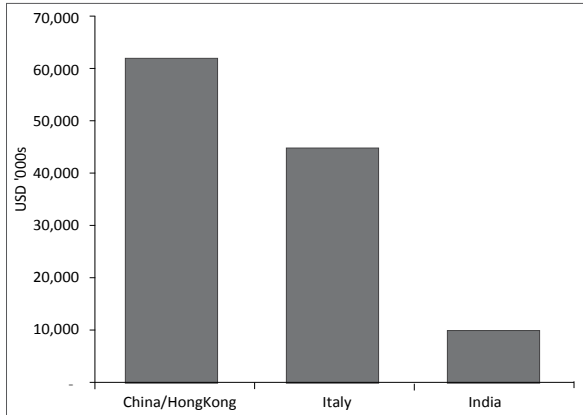
Source: UN Comtrade

²² UN Comtrad.

²³ UN Comtrad.

The following trade data shows that India, Italy, and China/Hong Kong were the biggest importers of Kenya's wet blue leather in 2013. China tops the list with US\$63 million, followed by Italy and India with US\$45 million and US\$10 million, respectively (Figure 7).

Figure 7: Kenya's wet blue export markets, 2013



Source: UN Comtrade

It is important to examine the state of the leather industry in the countries importing Kenya's wet blue. All three of Kenya's biggest wet blue importers are major leather good producers in the global market. China is by far the most dominant leather good producer in the world in terms of production and export volume. Italy is considered as the leading and most advanced country in high-end leather products. India has also risen to be a major force, backed by its cheap and abundant labor, and concerted government policies. The major difference between Kenya and these three countries is that Kenya's leather industry is not only small in size, but it is only capturing a marginal share in the global value chain. Greater wealth and jobs are created in countries that are focused

on downstream manufacturing. In order for Kenya to move into greater value addition and job creation, Kenya must produce more finished leather and finished leather products.

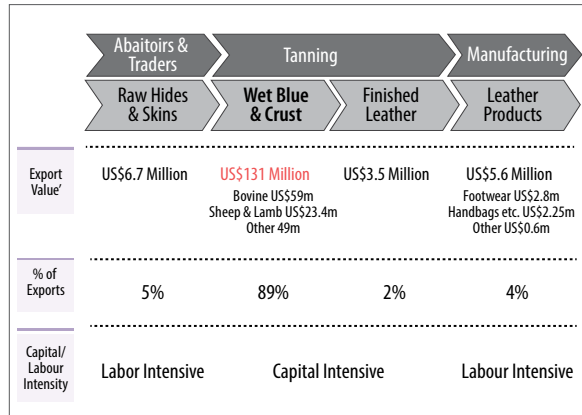
Furthermore, leather good producers and industry experts in Kenya claim that high quality hides and skins are more likely to fall in the hands of foreign leather good producers, which are able to pay higher prices for leather products, while the domestic market is left with low-quality finished leather. A natural explanation is that a lot of small leather good producers cannot afford to purchase high quality leather due to their lack of capital. As the majority of leather good producers in Kenya are competing in the low-end market, purchasing high quality leather for more will render their products uncompetitive in the market. A number of leather good producers also claim that some tanneries cut corners to minimize their tanning costs. The relationship between tanneries and manufacturers was more balanced when more sizable manufacturers existed in Kenya.

Kenya's vision to move up the value chain

According to UN Comtrade, in 2013, wet blue and crust accounted for 89 percent of total leather exports in Kenya while finished leather and finished leather products together only accounted for around 6 percent.²⁴ Experts emphasize that crust only makes up a fraction within the 89 percent share and they estimate that wet blue leather must be responsible for at least 80 percent of total Kenyan leather exports. Figure 8 summarizes the value chain and exports of leather products in 2013.

²⁴ There is concern among industry leaders that official sources of data underrepresent actual leather exports. A significant quantity of raw hides and skins are being smuggled out from Kenya without being taxed. At the leather processing level, a key tannery owner reports that Alpharama tannery alone exports over US\$6 million worth of finished leather and the industry total is estimated to be around US\$10 million. Finished leather product exports also appear to be undervalued. Bata is estimated to export around US\$4 million worth of leather shoes. Also, a large share of leather sandals and other goods are leaving the country without declaration. Based upon interviews and analysis of the official data, in our judgment, the share of each stage of the value chain in figure 8 portrays a relatively accurate picture of reality.

Figure 8: Total export value of Kenyan leather products (2013)



Source: UN Comtrade, 2014 Kenya Statistical Abstract, ETG Primary Research

Value is added when an industry moves right in the above value-chain diagram, indicating that Kenya is not currently capturing significant earnings in the global value chain. Also, moving to the right will mean that more jobs will be created as the downstream (manufacturing) of the leather industry is the more labor-intensive sector. Kenya exports mostly semi-processed wet blue, and a big share of value addition is thus captured in other countries that have vibrant leather product manufacturing industries such as China, India, and Vietnam. As the aforementioned data indicates, Kenya has made notable strides in moving away from exporting raw hides and skins to processed wet blue. The goal is to leverage the current momentum and move into more value added products, further down the leather value-chain.

The Government of Kenya (GoK) envisions the leather and leather industrial sector playing a crucial role in the development of its economy. On the leather processing side, the goal is to move away from wet blue and into crust, finished leather, and leather product exports. On the leather product production

side, the goal is to capture an increased supply of finished leather available in local markets and produce more final leather goods such as shoes, belts, and bags for the local and export markets.

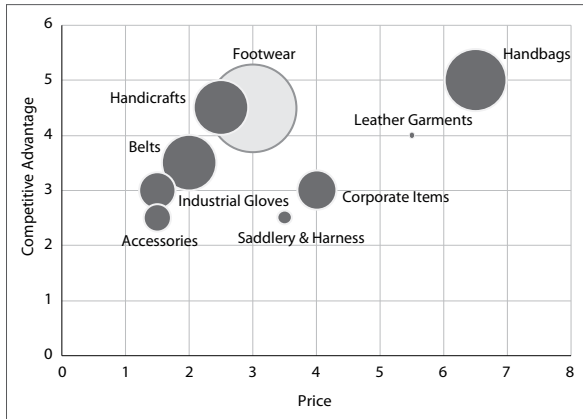
However, it is important to note that once leather reaches the finished stage in its particular color, texture and pattern, the local market has a limited number of buyers for finished leather. Most international buyers prefer leather in crust form as they still have room to manipulate hides and skins according to their preference. Tanneries must have a good idea about which buyer or market their finished leather is heading before undergoing the finishing process. Because of international buyers' preferences of buying leather in crust form, finished leathers are generally consumed by local producers. In this light, our report investigates whether the Kenyan market has the capacity to absorb the potential surplus of finished leather as well as whether Kenya can increase its final leather products export market, particularly to the East African Community (EAC) regional market.

Kenya's final leather products

In the absence of statistical information about the volume of production of different leather products in Kenya, we approached local leather experts and key players in the industry to estimate the relative size and competitiveness of Kenya's various leather products, using a modified Delphi approach.²⁵ According to the data gathered, Kenyan producers are currently producing various leather products that range from low-end leather footwear to high-end leather bags.

²⁵ Chia-Chien Hsu, and Brian A. Sandford, (2007), "The Delphi Technique: Making Sense Of Consensus," Practical Assessment, Research and Evaluation, vol 12, No. 10. <http://pareonline.net/pdf/v12n10.pdf>

Figure 9: Kenya’s final leather products, dominated by footwear²⁶



Source: ETG based on modified Delphi method; bubble size indicates relative production volume.

The consensus estimate by leather experts indicates that footwear is Kenya’s largest finished product subsector, followed by handbags, handicrafts, and belts. Bags earn the highest selling price, with leather garments in close second, followed by corporate items. The “other” leather goods subsector along with industrial gloves collectively have the lowest selling points and production volumes, and also offer the lowest competitive advantage. “Other” leather goods include items such as sports balls, knife cases, etc.

While the footwear subsector has the biggest production volume, leather bags have the highest competitive advantage in Kenya. The reason for leather footwear’s low competitive advantage, despite its dominance in production volume, derives from the varying level of competitiveness among different types of footwear. This variance is illustrated in Figure 10. Contrary to the varied differences among leather footwear’s competitive advantages, many leather bags produced in Kenya are considered high quality and high-end, and they naturally receive higher prices in the market.

Types of leather footwear

As Figure 10 indicates, there is a wide range of leather goods currently being produced in Kenya. Kenya produces a range of leather footwear, most prominently men’s dress shoes, school shoes, safari boots, military/security boots, and sandals.

Figure 10: Types of leather footwear produced in Kenya



Source: ETG based on modified Delphi method; bubble size indicates relative production volume

Many formal and informal producers are engaged in the production of school shoes, sandals, military/security boots, and men’s shoes for two reasons: First, there is a high demand. A significant share of the Kenyan population is in school and in the working age bracket. Also, rising security concerns due to terrorism and other factors has led to an increased demand of military/security boots over the last few years; Second, these items are considered more as “uniform” products that do not require advanced design capacity or sophistication. These Kenyan-made products seldom have high variety and the ones from the informal sector share a similar rudimentary design. This explains the reason behind the meager production of women’s shoes, which tend to be highly trendy

²⁶ We asked the industry experts to scale (from 1 to 10: 1 being the lowest and 10 being the highest) each subsector by production volume (indicated by the size of bubbles), competitive advantage (how competitive each domestic subsector is perceived to be in comparison to other counterparts in the market), and price (how much value each product from each subsector commands in the market).

and require sophisticated design. The following section further explores trends in the leather footwear market, which as mentioned, accounts for the biggest production volume and thus, requires further exploration.

2.2 KENYA'S EXPORT AND IMPORT OF LEATHER FOOTWEAR

Kenya's export of leather footwear is relatively small, totaling only US\$2.8 million in 2013.

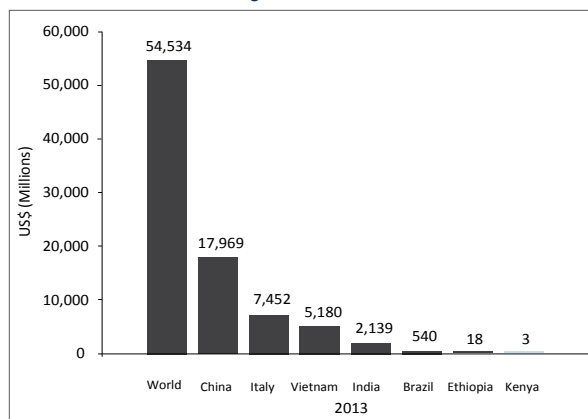
There has been an overall positive upward trend of Kenyan leather exports since 2007, with a spike in the year 2010. Kenyan leather footwear exports have increased significantly (by a factor of 31.4) from a negligible US\$88,000 in 2007 and US\$555,000 in 2008, to US\$2.8 million in 2013.²² According to interviews with experts, most exports are Bata's exports of military/industrial and safari boots to the regional market (Uganda, Tanzania, Zambia). However, it is important to note that the number reflects official trade data, which is always highly underestimated. Many are exported or smuggled through Kenya's porous borders to neighboring countries. There is also export of belts, handicrafts, and sandals

to the regional market by local producers from the informal (*Jua Kali*) sector.

Figure 11 highlights the 2013 value of leather footwear exports of some of the key countries with a vibrant leather production industry. The total export value in 2013 was US\$54.5 billion of which China accounted for over 33 percent, followed by Italy and Vietnam with 13.7 percent and 9.5 percent, respectively. Although Ethiopia, Kenya's regional competitor, only accounts for mere 0.03 percent, it shows promise with a near quadruple increase in the world leather footwear export share since 2011. Kenya currently contributes an insignificant amount to the global leather footwear market.

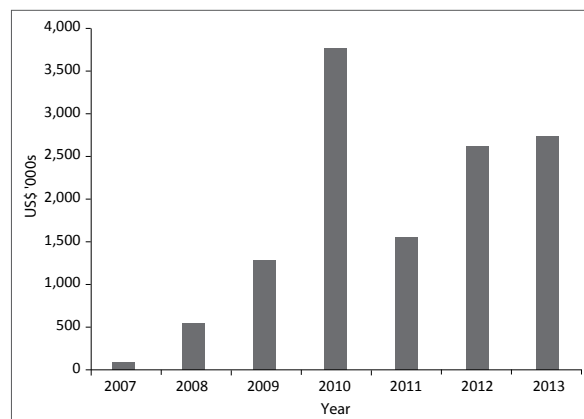
Table 3 shows that the biggest buyers of Kenyan leather footwear are mostly located in Africa. East African Community (EAC) countries such as Uganda and Tanzania are the top markets for Kenya's leather footwear. Although the top 10 markets include countries from various continents, export values are insignificant except to a few African countries.

Figure 11: Value of leather footwear exports by leading countries (2013)



Source: UN Comtrade

Figure 12: Kenyan leather footwear exports (2007-2013)



Source: UN Comtrade

²⁷ UN Comtrad.

Table 3: Top 10 destinations for Kenyan leather footwear exports, 2009-2013 (US\$ '000s)

| | 2009 | | 2010 | | 2011 | | 2012 | | 2013 | |
|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| 1. | Uganda | 460 | Zambia | 1,575 | Uganda | 360 | Zambia | 743 | Uganda | 827.87 |
| 2. | Tanzania | 241 | Uganda | 1,292 | Tanzania | 313 | Uganda | 558 | Zambia | 735.86 |
| 3. | U.K | 182 | Tanzania | 294 | Zambia | 189 | U.S | 207 | Tanzania | 322.9 |
| 4. | Malawi | 122 | U.K | 251 | South Africa | 134 | Japan | 196 | Zimbabwe | 156.22 |
| 5. | Israel | 64 | Malawi | 108 | Japan | 131 | Tanzania | 196 | Malawi | 143.21 |
| 6. | South Africa | 41 | U.S | 93 | U.S | 112 | South Africa | 155 | U.S | 113.78 |
| 7. | U.S | 37 | South Africa | 45 | U.K | 109 | Turkey | 148 | Japan | 99.364 |
| 8. | Rwanda | 34 | Australia | 31 | Rwanda | 37 | U.K | 112 | Italy | 71.045 |
| 9. | Germany | 29 | Austria | 21 | Spain | 26 | Zimbabwe | 95 | U.K | 54.849 |
| 10. | Italy | 25 | Germany | 19 | Austria | 25 | Rwanda | 41 | South Africa | 36.742 |
| Total | | 1,233 | | 3,729 | | 1,436 | | 2,452 | | 2,562 |

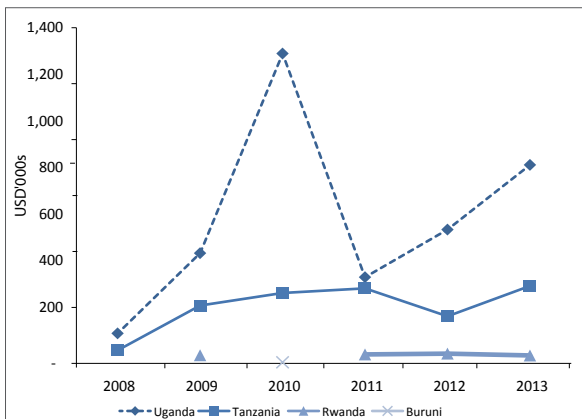
Source: UN Comtrade

The upward trend of the leather footwear export to EAC countries from 2007 through 2013 is consistent with the global export trend. This suggests that the main export destinations for increased Kenyan leather products will be the regional market, through the EAC countries.

Kenya leather footwear imports

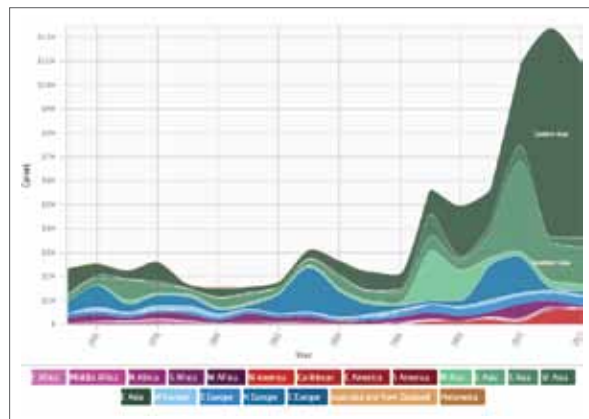
Although the majority of new footwear imported into Kenya consists of plastic/non-leather shoes, imported leather footwear has grown rapidly in recent years, from US\$2.4 million in 1995 to US\$5.5 million in 2007, and reached US\$12.3 million in 2011 and US\$11 million in 2012, as indicated in Figure 14.

Figure 13: Leather footwear export to EAC countries



Source: UN Comtrade

Figure 14: Growth of leather footwear imports in Kenya (1996-2012)

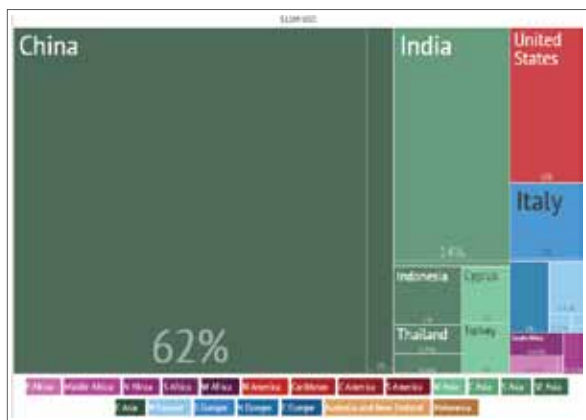


Source: The Atlas of Economic Complexity

²⁷ Beatrice E. Imo, and Rael C. Maiyo, (2012), "Lessons from Thriving Second-Hand Clothing Businesses for Kenya's Fashion Industry," Journal of Emerging Trends in Economics and Management Sciences. 3 (1): 32-37.

The above diagram shows that China is the biggest exporter of leather footwear to Kenyan market, followed by India. The total amount sums up to US\$11 million.²⁸ However, similar to other official trade data in Kenya, pundits claim that this number is greatly undervalued. The market suspects that a significant amount of imported products, especially from China, are brought into Kenya via Uganda without formal declaration.

Figure 15: Sources of Kenyan leather footwear imports (2013)



Source: The Atlas of Economic Complexity

In addition, although the Kenya Bureau of Standards (KEBS) has implemented guidelines called the Pre-Export Verification of Conformity (PVoC) to Standards Programme for exports to Kenya to assure Kenyan consumers of the safety and quality of the imported goods they buy, and to protect Kenyan manufacturers from unfair competition, many believe these are not rigorously implemented.

Comparison of exports and imports of leather footwear

Despite the fact that footwear takes up the biggest share of final leather products produced in Kenya, the country still imports

more than it exports. In 2012, the value of Kenya’s total export of leather footwear was US\$2.7 million, while import value was US\$11 million. The data available demonstrates that Kenya is a net importer (US\$8.3 million)²⁹ of leather footwear and many experts estimate the true value of leather footwear imports to be greater than US\$8.3 million.

2.3 KENYA’S EXPORT AND IMPORT OF LEATHER BAGS, TRAVEL WARE, CORPORATE ITEMS

After footwear, leather bags make up the second biggest leather subsector in Kenya. There are many small and medium size players involved.³⁰ The trend of Kenya’s export of leather bags, travelware, and corporate items mirrors that of the Kenyan footwear sector. Although small in absolute value, there has been an overall upward trend of exports since 2007. Kenyan leather handbag, travelware, and corporate item exports have increased significantly from a negligible US\$383,000 in 2007 to around US\$2.3 million in 2013,³¹ showing potential for future growth.

Figure 16: Exports of Kenyan leather bags, travelware and corporate items



Source: UN Comtrade

²⁸ The Atlas of Economic Complexity, Center for International Development, Harvard University. www.atlas.cid.harvard.edu

²⁹ Ibid.

³⁰ This will be discussed more in detail in Chapter 3.

³¹ UN Comtrade

2.4 DOMESTIC FOOTWEAR MARKET

In the absence of data about the size of Kenya’s domestic market for footwear, the team conducted interviews with experts to obtain consensus estimations based on a modified Delphi Approach. The findings indicate that the second hand market (*Mitumba*) accounts for around 63 percent of footwear sold in Kenya. Around 26.5 million pairs of Kenyan footwear are sold per year in second-hand *Mitumba* markets as illustrated in Figure 17.

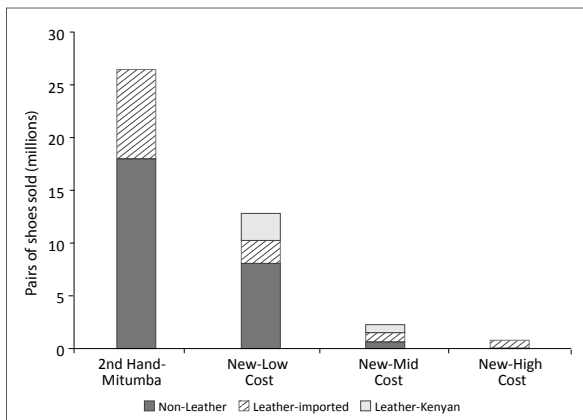
Among new shoes, the majority of purchased shoes are in the low-cost category, with an insignificant amount of shoes in the high-cost category. This trend hints at the purchasing power of the Kenyan population as well as the distribution of economic class in Kenya.

Non-leather shoes dominate in both the *Mitumba* and lower price range footwear, which dominate the Kenyan footwear market. Out of an estimated 42 million pairs of shoes that are being purchased in Kenya annually, 15 million pairs (36 percent) are leather shoes. According to experts’ estimations, domestic producers only supply low-price and mid-price leather shoes into the market. Around 2.6 million

low-price leather shoes are being produced and this is the only category that Kenya is more competitive vis-à-vis international footwear importers. Experts emphasize that in the low-price leather shoe market, there are still vibrant local producers, mainly the informal (*Jua Kali*) sector, competing against cheap imports from China and Ethiopia. In the mid-price category, only about 0.8 million leather shoes are made in Kenya, with the other 1 million pairs imported. Shoes in this category are mainly attributable to Bata Shoe production. Again, there are currently no local producers of high-end leather footwear.

This estimation indicates that 11.7 million leather shoes are imported from overseas while only about 3.3 million pairs (including 2.6 million low-price shoes and 0.7 million mid-price shoes) are being made domestically. The majority of imported leather shoes arrive via the second hand *Mitumba* market (8.5 million) while the majority of Kenyan-made leather shoes come in the form of low-price shoes produced mainly by the informal sector. In order for Kenyan leather footwear producers to grow and capture increased market share, it is critical to understand the trends of both Kenya’s informal sector and the *Mitumba* market and what makes them competitive in the Kenyan market.

Figure 17: Kenyan market share of footwear by point of distribution/price



Source: ETG’s based on Modified Delphi Method

Table 4: Sales of all footwear in Kenya, 2014 (millions of pairs)

| Type of footwear | Total pairs sold (millions) | Non-leather | Leather-imported | Leather-Kenyan |
|----------------------------|-----------------------------|-------------|------------------|----------------|
| Second hand <i>mitumba</i> | 26.5 | 18.0 | 8.5 | 0.0 |
| New-low price | 12.8 | 8.1 | 2.2 | 2.6 |
| New-mid price | 2.5 | 0.6 | 0.9 | 0.7 |
| New-high price | 0.2 | 0.0 | 0.2 | 0.0 |
| Total | 42 | 26.7 | 11.7 | 3.3 |

Source: ETG based on Modified Delphi Method

2.5 THE SECOND-HAND MITUMBA MARKET

Kenyan leather footwear producers are facing steep competition in the domestic market from the second-hand leather footwear market, known in Kiswahili as “Mitumba,” which imports footwear from overseas. In fact, the majority of footwear purchased in Kenya comes from these second-hand *Mitumba* markets. The *Mitumba* markets are highly popular across the entire Kenyan socio-economic spectrum due to the relatively high-quality, low-cost goods that can be obtained. Experts point out that locally produced leather goods, particularly shoes, carry a stigma of being high priced, low-quality products with a generally plain design. *Mitumba* is thus the market of preference for many Kenyans, because it grants access to low-cost, good-quality products to the poorer populations, while at the same time, allows the upper class to enjoy stylish trends and designer brands that the Kenyan domestic leather producers lack. Because of the prominence of *Mitumba* in the leather sector and its direct competition with domestically produced leather goods, it is critical to analyze this informal, thriving sector market. Our research indicates that the *Mitumba* market accounts for some 57 percent of the total leather shoes purchased in Kenya, while new, low-cost leather footwear accounts for 32 percent, and Kenyan produced, low-cost leather shoes only account for 17 percent. An understanding of the *Mitumba* market and how it holds a strategic advantage in the competition for low-cost goods will allow for an informed approach to increasing growth in sales of new, low-cost goods and making them more competitive with second-hand goods.

Brief History of Kenya’s *Mitumba* Market—the creation of the *Mitumba* market has an

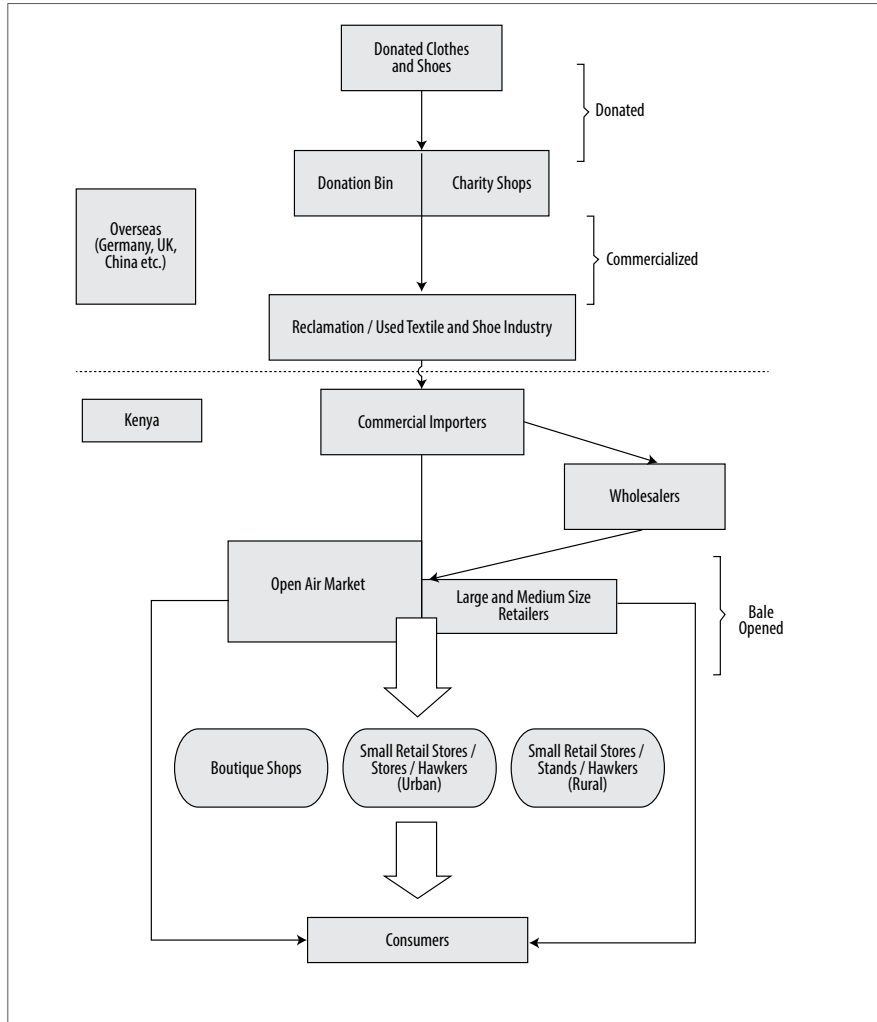
interesting historical context, embedded in humanitarian relief. Second-hand products started to flow into Kenya in the 1970s and ‘80s, when many NGOs and humanitarian organizations began sending donated clothes to the refugees from neighboring warring states.³² Initially, the GoK imposed a stringent tariff to limit their entry and protect its manufacturing industries. The inflow reached new heights, however, when the IMF and the World Bank imposed a structural adjustment program to the Kenyan government, which further liberalized the market to the outside world. Many manufacturers operating in Kenya struggled to compete with the low cost, second-hand influx of shoes (and clothing) that followed. This market liberalization, combined with the low purchasing power of its general population, has made many Sub-Saharan African countries like Kenya fertile grounds for the flourishing of second-hand product markets. Started as a charitable act, the trade of second-hand products has now become a lucrative business in the world. UN Comtrade statistics indicate that the global second-hand clothing trade has increased from US\$1.4 billion in 1990 to US\$5.9 billion in 2011.³³ Many experts even claim this number to be a major underestimation, as a big share of second-hand products are also being smuggled through the borders undeclared. The informality of this market segment makes precise economic calculations difficult.

***Mitumba* Market Import Process—Most of the second-hand shoes that arrive in Kenya are donated by people in Europe, North America, and Asia to charity shops and donation bins that NGOs manage.** NGOs, such as the Salvation Army, then sell their collection to commercial companies that sort the products by type and degree of quality before exporting them to

³² Beatrice E. Imo, and Rael C. Maiyo, (2012), “Lessons from Thriving Second-Hand Clothing Businesses for Kenya’s Fashion Industry,” *Journal of Emerging Trends in Economics and Management Sciences*. 3 (1): 32-37.

³³ A. Hoogerbrugge, (2012), *Trust in Mitumba: Trade relationships in the Kenyan second-hand clothing market* (Master’s Thesis). Leiden University.

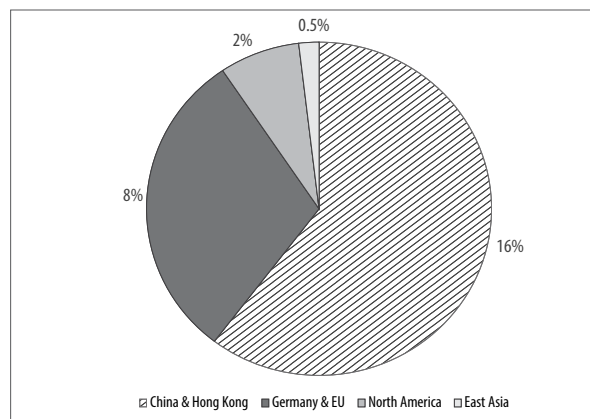
Figure 18: The *mitumba* market product flow chart



Source: ETG

Kenya upon order from the Kenyan market. Commercial importers in Kenya purchase bags of shoes and clothes by weight (kg) and when containers reach the port of Mombasa they pay 16 percent VAT and import duties depending on their value. Wholesalers buy bales of shoes and clothes from the commercial importers and sell them to their corresponding retailers all across Kenya. Small retailers, in both urban and rural areas, who cannot afford to purchase in bales purchase goods in smaller quantities (pairs of shoes and/or pieces of clothing). One can see individuals without retail stores selling *Mitumba* shoes and clothes on the streets in Kenya.

Figure 19: Origin of second-hand footwear in Kenya

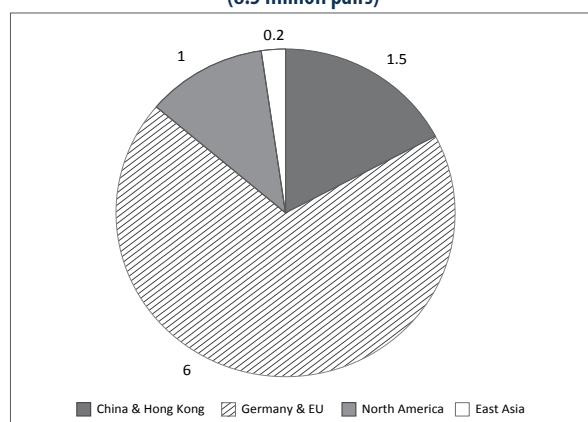


Source: ETG

A notable commercial importer claims that the second-hand footwear market is much smaller than the clothes market. Our primary research estimates that around 26.5 million pairs of shoes are being purchased annually via second-hand markets in Kenya. Among these 26.5 million pairs, one industry expert estimates that around 16 million pairs (60 percent) come from China/Hong Kong, 7.5 million (30 percent) from Europe, with the rest coming from countries in North America and East Asia.

A bale of second-hand footwear from China contains around 10 percent leather shoes, while around 80 percent of the shoes that come from Europe are made of leather. As shown in the figure below, the total number of leather shoes bought from the second-hand *Mitumba* market is estimated to be around 8.5 million pairs. Europe, despite contributing to a smaller share of footwear than China, remains the main source for second-hand leather footwear for Kenya, with an estimated 6 million pairs. China/Hong Kong rank second with 1.5 million pairs, while the rest is provided by North America and East Asian countries.

Figure 20: Origin of second-hand leather footwear in Kenya (8.5 million pairs)



Source: ETG

While the origin of second-hand shoes in Kenya has been dominated by European countries such as Germany and the UK, second-hand

products originating from China and Hong Kong have been increasing gradually due to their low price, as commercial exporters in China and Hong Kong charge lower fees. On average, a bale of second-hand shoes from Germany costs approximately double of a bale coming from China. As is the case in other low-cost manufacturing markets, in the *Mitumba* market we are witnessing a gradual gravitation towards cheaper products from China/Hong Kong. From an economic perspective, this gravitation allows wholesalers and retailers to pursue larger profit margins by lowering their costs through the purchase of cheaper bales.

The distribution of these higher cost European shoes and lower cost Chinese/Hong Kong shoes varies by income level and quality needs. In general, cheaper and more diverse second-hand footwear bales of Chinese origin are sold better in urban areas where there is a higher concentration of low-income Kenyans. Bales of durable and higher quality second-hand shoes from Europe are sold to rural areas where there is a higher concentration of people walking long distances and therefore, in need of higher-quality shoes. However, the high-end designer shoes are normally sorted and sold in boutique shops in the cities where people can afford such luxury products and prices.

Employment in the *Mitumba* Market—Second-hand markets have been controversial across Sub-Saharan Africa, and Kenya is no exception. The robustness of this informal sector has had dramatic implications for the formal sector of the manufacturing economy, and a number of policy ideas have been generated for limiting the supply of second-hand goods and their prevalence in the market. Many industrialists have argued that the influx of cheap products drove a number of Kenyan textile and leather footwear manufacturers out of business and

also took away employment opportunities from the population. To this end, countries such as Nigeria, Ethiopia, and South Africa have banned the import of second-hand products. On the other hand, studies have found that the *Mitumba* market generates great employment opportunities for the low-skilled population.³⁴

Although it is hard to measure the precise number of people involved in the informal sector, Nairobi City Council estimates that over 65,000 people work in the Gikomba market alone, Kenya's biggest second-hand market in Nairobi. This figure is likely to go up to hundreds of thousands when official estimates are conducted nationally.³⁵ This estimation far exceeds the number of people employed in the leather industry (which is estimated at 16,000 workers—see Chapter 3). Thus, the second-hand *Mitumba* market not only brings low-cost, good-quality, stylish clothes and shoes to Kenya, but it also serves as a critical source of much needed employment opportunities across Kenya.

Implications of the *Mitumba* Market for the Local Industry—One important implication of the growth of the *Mitumba* market is that as Chinese non-leather shoe imports continue to make up a larger share of the second-hand footwear market, there will be a gradual reduction in the availability of second-hand leather shoes in the Kenyan *Mitumba* market. As noted, bales that originate from China/Hong Kong contain mostly synthetic, plastic, and canvas shoes. Global trends indicate that the demand of leather goods is growing faster than the supply. Therefore, in developing economies with growing populations, and especially among the younger cohorts, the demand for leather

goods such as school shoes will rise. Projected economic growth rates and the expansion of the middle class in countries like Kenya indicate that there is an increasing market opportunity for Kenyan leather products. Decreasing supply of leather goods from countries like China, in conjunction with increased demand for leather products in emerging economies, presents a unique opportunity for Kenya to capitalize on this supply gap.

It will be highly unlikely for local manufacturers to replace the high-end, designer leather shoes that arrive from European countries, at least for the foreseeable future. However, high-end, second-hand leather shoes are only a small fraction of the entire 8.5 million *Mitumba* leather footwear market. By far, the largest share belongs to low and mid-cost shoes, which appeal to the majority of the Kenyan population. This presents an opportunity for local leather footwear producers to fill this gap. The *Mitumba* market contains a rich web of activity in the leather industry, from buyers, suppliers, manufacturers, and skilled artisans (see Chapter 3). However, there are a number of areas in which the leather value chain must be improved in order for low-cost, new goods to be able to compete with second hand products coming into the market. This includes improved finishing techniques, standardization throughout production for reliably consistent goods, and light use of mechanization. The key is to retain the low cost of production of these goods while improving the quality and finish. Reduced competition from Chinese leather goods also creates an opportunity for Kenyan leather goods to compete on a regional scale, in other East African markets.

³⁴ Philip K. Rono, (1998) "Women's and Men's Second-hand Clothes Businesses in Two Secondary Towns in Kenya" IDS Working PaperNo. 521, Institute for Development Studies, University of Nairobi.

³⁵ Business Insider, (2014), "Nairobi's Gikomba Market Is Like Fifth Avenue, Except Everything's Secondhand", October 15. <http://www.businessinsider.com/r-the-global-business-of-secondhand-clothes-thrives-in-kenya-2014-10>

2.6 KEY FINDINGS OF CHAPTER 2

This chapter investigated the principal leather products, markets, market dynamics, and influence of second-hand products in Kenya.

Currently, Kenya fails to capture much of the potential value inherent in the global leather product value chain. Almost 90 percent of leather products are exported in the semi-processed, wet blue form and only a small amount of finished leather goods are being exported. Even worse, unofficial estimates of exports of raw skins and hides and semi-processed leather are speculated to be much higher than official statistics.

Our estimates of leather products production (using our modified Delphi method) indicate that the handbag subsector is the most competitive, while footwear is the biggest leather goods subsector in Kenya. There is also a range of other leather products produced such as belts and industrial boots; however, the scale and competitiveness of production in

these more diverse subsectors is very low and almost insignificant. The failure of the leather sector to test and diversify new processes, markets, and products is a major obstacle to discovering sources of competitive advantage. Failure to formally integrate the formal and informal sector and to create incentives for quality differentiation between the agricultural and the manufacturing sectors are the most significant. However, many other factors also hinder growth. This chapter identified the inflow of cheap, new and second-hand products into the *Mitumba* market as among the major challenges to greater value addition for Kenyan leather made goods.

The following chapter describes in detail the strategies and market approaches of specific Kenyan companies. It is intended to add context and texture to the findings presented in Chapter 2, and to describe the structure, key stakeholders, and dynamics within Kenya's leather industry.

KENYA'S LEATHER SECTOR

This chapter maps the structure and organization of Kenya's leather sector. It deals separately with leather and leather products production in the formal and informal sectors because, as noted in the previous chapter, the two sectors of activities are strategically autonomous. Participants in both sectors are linked only through arms-length transactional relationships, if at all.

3.1 OVERALL STRUCTURE OF KENYA'S LEATHER SECTOR

Kenya's leather sector has been on a rollercoaster in recent decades. Due to its abundant livestock population, Kenya has been a net exporter of meat as well as hides and skins for decades. As hides and skins have traditionally been perceived only as by products of meat, leather export predominantly took place in the form of raw hides and skins. Between 1979 and 1980, approximately 75 percent of total leather export was in raw hides.³⁶ As the Kenyan government recognized that higher value resided in processing and in finished products, they experimented with the idea of banning export of raw hides and skins in 1980. Although the ban was reversed quickly, this initiative encouraged the rise of the tanning industry in Kenya.³⁷ With support from the government, a number of tanneries and manufacturers appeared. The leather footwear sector, spearheaded by Bata, Kenya's leading footwear company, made an impressive stride in the market.

The heyday of the Kenya leather industry did not last long, however. Market liberalization combined with abolishment of 22 percent export compensation to local manufacturers upended the state of the Kenyan leather industry. Many manufacturers were no longer competitive and were forced to close. As the number and capacity of leather good producers decreased, tanneries also faced a significantly reduced market capacity to absorb further processed leather. Few tanneries and manufacturers made proper adjustments and few survived to this day.

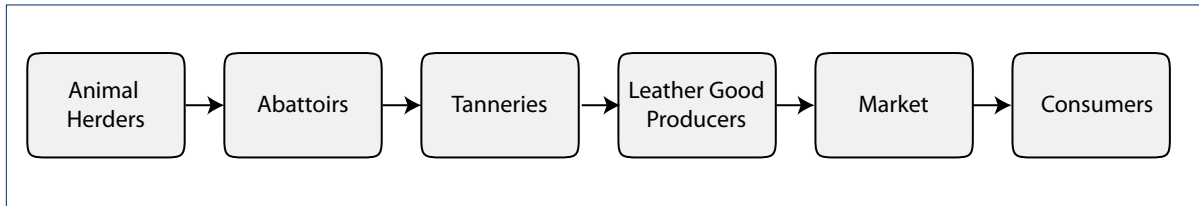
Today, Kenya's leather sector is composed of suppliers of raw hides and skins, abattoirs, traders, tanneries, and producers of leather products in varying sizes. Broadly, the sector is divided into the formal and informal sector. Total employment in the leather industry is estimated to be around 14,000 during peak times. As shown in Chapter 2, according to official trade statistics, the total value of leather and leather products exports was US\$122 million in 2012 and US\$147 million in 2013. Almost all leather goods manufacturers that operate in Kenya today are considered small and micro enterprises. Only a few constitute medium enterprises.³⁸ Among small and micro scale producers, the majority prefer to be in the informal sector in order to avoid the tax burden.

³⁶ USAID, (c.1987), "Leather Industries of Kenya: Direct Loan Case Study," PRE Project Number 940-0002.12, unpublished manuscript, Available online: http://pdf.usaid.gov/pdf_docs/PNAAY145.pdf

³⁷ Ibid.

³⁸ The Micro and Small Enterprises Act defines micro and small enterprises as those who employ no more than 50 employees, with annual turnover of less than 5 million Ksh, while medium enterprise are those who employ between 51 and 100 employees.

Figure 21: Simplified leather industry value chain



Source: ETG

The industry is constrained on the supply side by the quality of raw hides and skins,³⁹ the limited focus of tanneries on exporting “wet blue”, and the limited capacity for producing finished leather products. On the demand side, the industry faces extremely intense competition due to imports of shoes and leather products for the second-hand (*Mitumba*) market, and low price footwear imports, particularly from China, India, and Ethiopia.

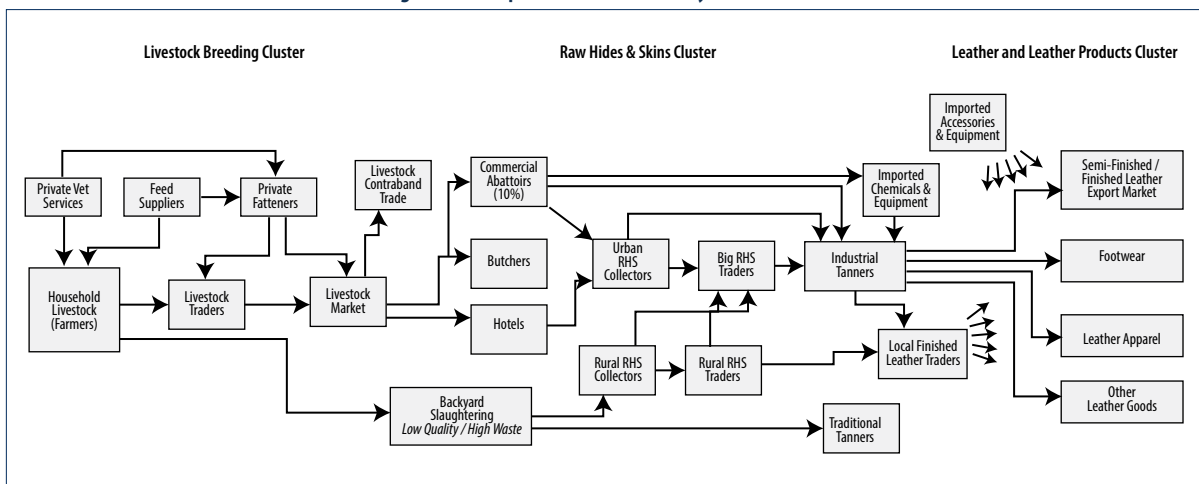
The below diagram illustrates the leather value chain from herders to leather footwear manufacturers. It is an industry that generally involves three subclusters: livestock breeding, raw hides and skins, and leather and leather products. Production efficiency and quality in the previous stages of the value chain directly affect the success of the players in the later stage. Thus, for an industry which involves a wide

range of players such as the leather industry, it is critical to have sophisticated infrastructure, linkage, and communication.

For the purpose of this investigation, the report will treat the supply of crust and finished leather as a starting point. It is by no means to undermine the importance the earlier stage of the leather value chain, but to highlight the inter-linkage of players that are directly responsible for the value added products and their markets.

Kenya's leather product sector is a complex network of various stakeholders playing different roles. On the supply end, only a few tanneries supply crust and finished leather and Alpharama is the major supplier to the local market. Currently, there are several wholesalers in between tanneries, and there are leather

Figure 22: Simplified leather industry value chain⁴⁰



Source: ETG

³⁹ Funding for veterinary support for cattle dipping and animal husbandry has decreased, partially contributing to the poor quality of hides and skins.

⁴⁰ RHS = Raw Hides & Skins Cluster.

middleman that even make deliveries to Mombasa. Many leather middlemen are located in Kariokor Market in Nairobi where small scale leather product producers from as far as Thika come to purchase leather sheets and other key inputs for their products.

The leather product sector is divided into low-end and high-end producers.

Low-end: Most of the small-scale, low-end product producers source their inputs from Kariokor Market (KM) where you normally find low quality finished leather. Because of the high concentration of cheap inputs and labor force, *Jua Kali's* that belong to this group are found in KM. Retail shop owners from all over Kenya and wholesalers from neighboring countries visit KM to purchase leather products.

High-end: Producers involved in high-end leather products tend to purchase directly from tanneries for higher quality finished leather. Due to the lack of machinery and artisans with skills that could transform designs into a product, many designers outsource actual production to leather workshops that have capacity to do it. Once the product is finished, the designers and brands themselves market their products via various channels.

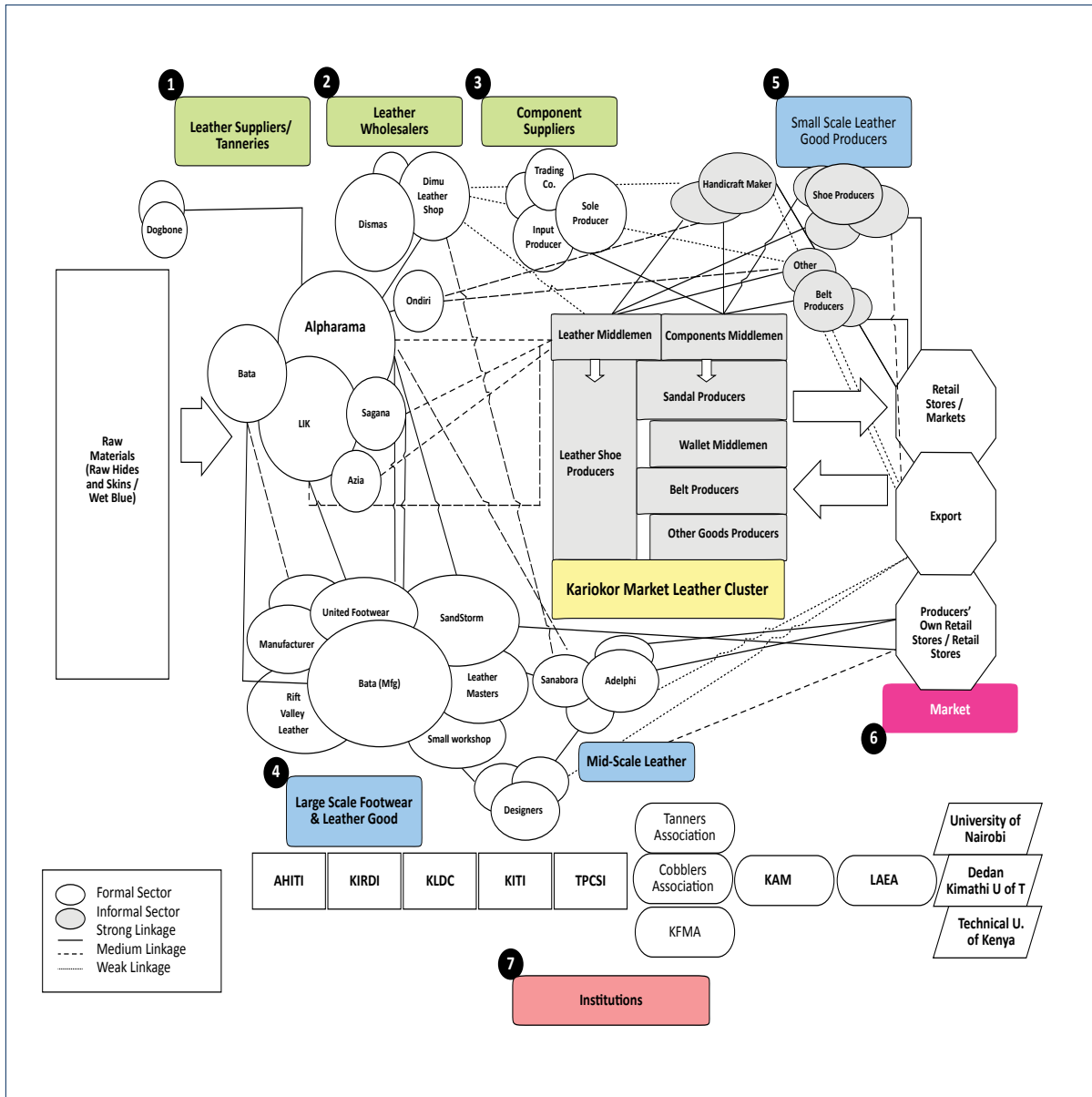
The following Kenyan leather sector profile describes the structure of the sector and inter-linkages of various players in different part of the supply chain in more detail.

Kenyan leather cluster

The cluster map in Figure 23 highlights the main activities and stakeholders in Kenya's leather industry in Nairobi and its surrounding areas, and indicates the many interwoven and complex linkages between stakeholders. It is somewhat difficult to discern between the formal and the informal market, which play complementary roles along the same value chain but throughout different stages of production. Formal registration of facilities and leather companies requires fees and taxes that are prohibitive for small-scale producers. At the center of the cluster map is the heart of Kenya's informal leather cluster—the Kariokor Market—which is a primary informal center of leather production in Kenya. The size of the bubbles in the cluster map indicate the relative size of their production and/or supply. Empty bubbles are placed to indicate that there are additional, but less important, players involved in each sector that, for the purposes of space and efficiency, are not included in Figure 23.

The KM forms a large part of the informal market and contains about 300 workshops and stores, with products ranging from shoes, belts, wallets, bags, and more. Due to their smaller size and limited financial capabilities, some 10-20 stores in the market purchase leather bundles from the tanneries, as opposed to buying leather sheets in bulk from these tanneries. The formal leather market includes the large tanneries, wholesale producers, large-scale producers, some component suppliers, and institutions and formal market avenues such as retail stores.

Figure 23: Kenyan leather cluster map (Nairobi and its surrounding region)



Source: ETG

Starting from the top left portion of the cluster map and proceeding clockwise, the elements of the cluster map are explained as follows:

1. **Leather suppliers:** These are the tanneries in Kenya that are providing finished leather in different quantities (bulk supply versus smaller amounts of leather sheets), both

directly to vendors at KM as well as to large scale producers, wholesale producers, and smaller vendors. Tanneries include Alpharama, the biggest of the tanneries, Bata, LIK, Aziz, Sagana, and smaller tanneries such as Dogbone, which provides wet blue leather to Alpharama.

2. **Wholesale leather suppliers:** Located just to the right of this is the subcluster of wholesale leather suppliers, which also procure leather from the tanneries. This cluster includes Dismas, Balozi, and Dimu Leather Shop. Alpharama and other tanneries provide the leather for Dimu and Dismas. These wholesale producers buy leather in large bundles and sells it to various players in the industry.
3. **Component suppliers:** These provide pieces and accessories such as buckles, soles, thread and glue, which are sourced locally as well as internationally from China, India, and other countries. Large scale leather good producers may purchase directly from the supplier, while many small-scale producers go to small retail stores in town or the middlemen at the KM for the purchase.
4. **Large-scale producers:** These are leather factories and workshops that include Bata, United Footwear, Sandstorm, and Leather Masters. Because of their larger size, these producers have enough capital to go directly to the tanneries to obtain leather bundles and are thus likely to receive higher-quality leather products from the tanneries. Of these companies, Leather Masters is among the biggest of the East African workshops contracting production of leather goods for other designers due to their large scale and access to machinery and skilled staff. Leather Masters produces bags, wallets, champagne cases, and most leather items except for shoe production, which they do not partake in.
5. **Small-scale, low-cost producers:** These are small-scale producers that are considered part of the informal market (since many are not officially fully registered), but do not specifically sell at the KM. They include shoe producers, belt producers, and handicraft makers. They might, for example, be located outside of the city center and sell their goods at small shops or stands.
6. **Market:** The market constituents outside KM include retail stores and leather products being exported. Higher quality leather products are often exported to European, North American, and Asian markets.
7. **Institutions:** Institutions include both governmental and non-governmental institutions. The Animal Health and Training Institute (AHITI), Kenya Industrial Research and Development Institute (KIRDI), Kenya Leather Development Center (KLDC), Kenya Industrial Training Institute (KITI) and Training and Production Center for the Shoe Industry (TPSCI) are all public government institutions that, by definition, provide training, support, and tech transfer services to the leather sector.⁴¹ In reality, these institutions are underutilized and underfunded, and currently offer little support to the leather sector, leaving vast room for improvements in their operations. The other institutions include the Kenya Association of Manufacturers (KAM), which is also underutilized and requires membership, the Leather Articles Entrepreneurs Association (LAEA), a new movement in the leather sector, and universities (which include leather training institutions).

⁴¹ Leather institutions and associations will be discussed in more detail in Chapter 3.3.

In the cluster map, just to the right of the larger scale producer companies, we see “designers” who do not own workshops and often contract out their production to the larger factories/workshops such as Leather Masters. Alternatively, they might contract out their production to smaller-scale workshops such as Adelphi and Sanabora, which are further to the right.

Adelphi and Sanabora are designers who, as mentioned, own smaller-scale workshops. Normally, they produce for their own brand but at times receive orders from small designers that do not own workshops. Occasionally, they receive orders from designers or retail store owners operating overseas. In these cases, the designer will put in an order for a certain amount of unlabeled product (as opposed to putting the Sanabora brand name on it) and the company will then put its own name on the product.

Some local designers and producers approach the Training and Production Center for the Shoe Industry (TPCSI), an institute whose main objective is to train artisans. Brands and designers without workshop facilities outsource their production to TPCSI with a service charge. Occasionally, some small-scale producers with their own workshops, such as Palm Prints and Adelphi, also reach out to TPCSI to access certain machinery or in instances when their workshop is out of capacity to meet orders.

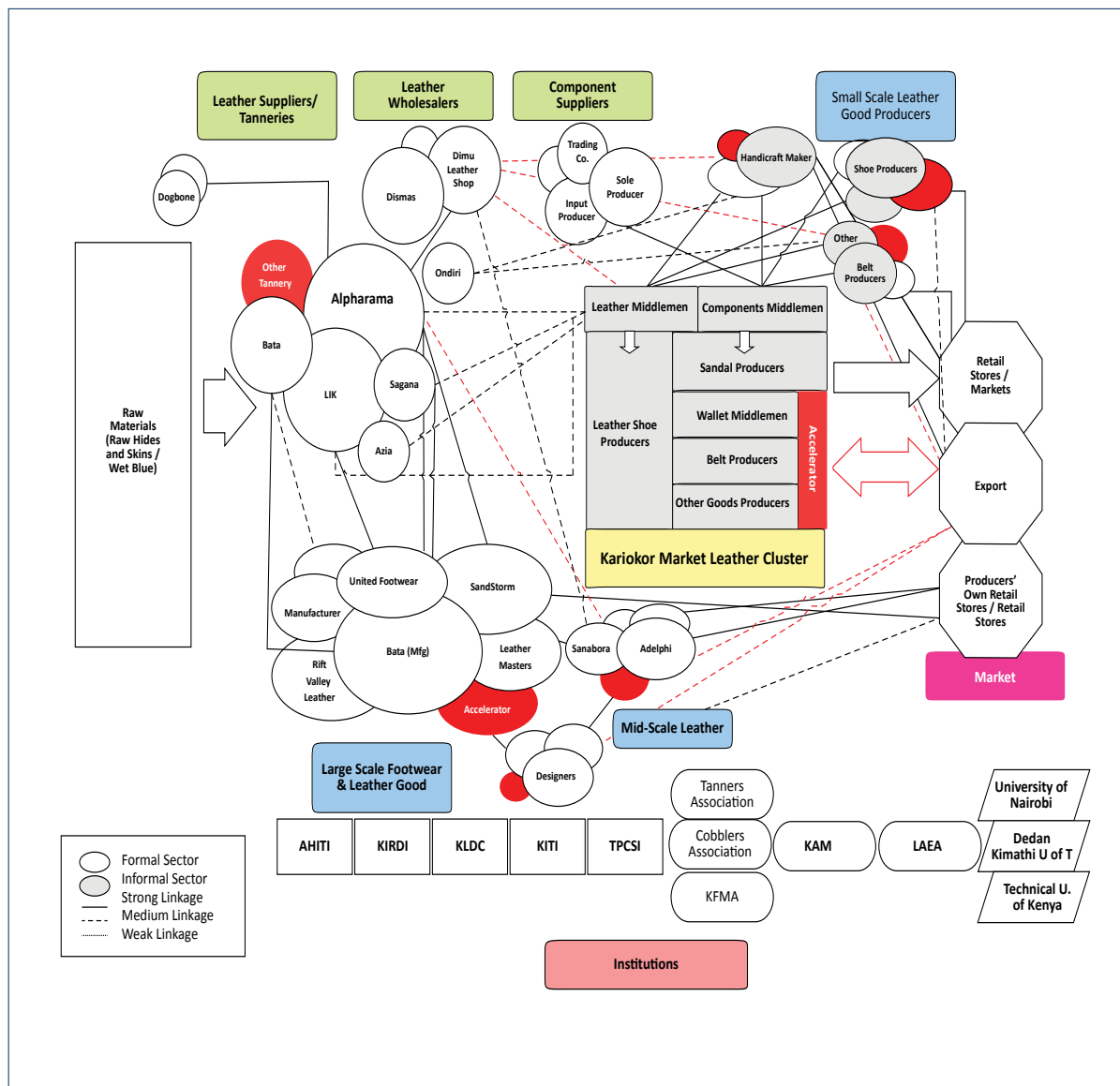
In general, linkages within the Kenya leather cluster are extremely weak. The distinction that is frequently made between the formal and informal production sectors is a distinction that relates to the minimal exchange of products,

credit, information, and personnel across organizational barriers (e.g. formal and informal sectors), which can be described as nearly impermeable. Other weak links in the cluster involve vertical linkages between manufacturers of leather products, and wholesaler/retailer linkages between leather producers and leather product manufacturers, and indeed, even linkages between abattoirs and tanneries. The relationships which predominate in each of these instances are trading relationships, more tactical than strategic, more short term than long term, and lacking in opportunities to transfer risks among value chain partners. Strengthening these linkages and transforming them into effective conduits through which products, information, credit, and key personnel can flow and in which risks can be jointly shared needs to become an overriding objective of government policy.

The figure below builds upon Figure 23 and illustrates strategic linkages that can and should be strengthened within the cluster by adopting initiatives that: (i) enhance communication and trust among cluster stakeholders; (ii) develop cluster accelerators/common manufacturing facilities;⁴² and (iii) attract key companies to densify the cluster (see recommendation in Chapter 5). Overall, the bubbles are bigger in size to indicate general growth in the Kenyan leather industry. The highlighted (red) parts indicate the transformation. Weak linkages are strengthened by more balanced relationships among various actors. The informal KM plays a bigger role in the industry and their marketing channel is expanded. New red bubbles indicate the appearance of new players in each subsector.

⁴² The accelerators and common manufacturing facilities will be further explained in Chapter

Figure 24: Strengthened Kenyan leather cluster map (Nairobi and its surrounding region)



Source: ETG

Leather industry employment

In 2013, Kenya's leather industry employed 14,000 workers during peak times, a number based on combining official formal sector employment data with expert consensus estimations of informal sector employment,⁴³ as shown in the Table 5. The diverging trend between the formal and informal sector is

noteworthy. The employment figures for the formal sector have steadily remained around 4,000 while figures of the informal sector have increased from 7,000 to 10,000 over the past five years. Importantly, these are not full-time equivalent workers, given that labor in the informal sector is transient, and varies during peak times.

⁴³ Chia-Chien Hsu, and Brian A. Sandford, (2007), "The Delphi Technique: Making Sense Of Consensus." <http://pareonline.net/pdf/v12n10.pdf>

Table 5: Employment in Kenya's leather industry (2009-2013)

| | 2009 | 2010 | 2011 | 2012 | 2013 |
|--|--------|--------|--------|--------|--------|
| Tanning | 995 | 1,002 | 1,064 | 1,047 | 1,077 |
| Footwear | 1,691 | 1,695 | 1,799 | 1,800 | 1,859 |
| Handbags, luggage, etc. | 906 | 984 | 1,007 | 1,032 | 1,075 |
| Sub-total-formal sector* | 3,592 | 3,681 | 3,870 | 3,879 | 4,011 |
| Sub-total-informal sector (jua kali)** | 7,000 | 7,500 | 8,000 | 9,000 | 10,000 |
| Total | 10,592 | 11,181 | 11,870 | 12,879 | 14,011 |

Sources: *2014 Kenya Statistical Abstract

** ETG primary research,

3.2 LEATHER PRODUCT MANUFACTURERS IN THE FORMAL SECTOR

Footwear manufacturing

Kenya's once vibrant footwear manufacturing industry experienced a downward trend when the government opened the door to more cost-competitive footwear from Asian countries during the 1990s. At the time, a number of major players closed down their operations, having failed to adapt to the highly competitive market. Blueys, a company that was big enough to export its footwear, for example, has disappeared from the industry. Other companies that weathered the storm were forced to adapt by focusing on more niche markets. The stories of Bata and United Footwear reflect the history of the industry.

BATA—Kenya's biggest player

The biggest player in Kenya's formal footwear sector is Bata Shoes. It is the largest buyer of raw leather in the country today. Bata has been in business in Kenya since 1932 and it produces the country's only globally recognized brand of footwear. The company's reputation has been built around the shoes it produces which are

comfortable and durable. Its brand proposition is "good shoes that last in difficult working environments." Bata's work boots, work shoes, and its children's footwear lines are its most popular. Its "Safari Boot" design is a particular favorite purchase for tourists visiting East Africa. Bata produces a full set of rugged footwear and related products, including military boots, safety boots, children's school shoes and safety belts and gloves.

Bata supports a work force of 3,000. In addition to its well-maintained and modern facilities, it supports a housing campus near its factory in Limuru where employees and their families live. The company has been acclaimed in several surveys as one of the best companies to work for in Kenya. Many leather industry managers of small and medium Enterprises are ex-Bata employees.

Bata is a multinational company but remarkably it is also family-owned. Recently, Mr. Bata set up a Kenyan Entrepreneur Award, which provides US\$25,000 to a Kenyan entrepreneur who distinguishes him or herself by the creativity of the business model which they champion.⁴⁴

⁴⁴ Bata Blog, (2014), "Bata Shoe Foundation Announces US\$25,000 in Award Funding for Young Entrepreneurs Using Business to Make a Difference in East Africa," September 17. <http://batalegacy.org/bata-shoe-foundation-announces-25000-in-award-funding-for-young-entrepreneurs-using-business-to-make-a-difference-in-east-africa/>

Because Bata is privately owned, the long vision and the social development agenda of the owners has a more significant impact on Bata's strategy than is the case of other multinationals. Bata appreciates access to a large tourist pool visiting Kenya whose demographics—middle income, working class—map nicely into Bata's target market. The company fully expects that Kenya's tourism industry will rejuvenate and that when it does, additional demand will arise for its products.

The single biggest challenge that Bata faces in Kenya is an insufficient supply of quality leather. The company is the largest purchaser of leathers in the country—larger than any domestic or international buyer. Bata buys leather from more than 250 abattoirs and from most of the tanneries in Kenya. Its procurement methods involve sending its trained technicians into the plants of its suppliers, physically inspecting each piece, and hand picking those hides and skins that meet its standards. Since it has been in business in Kenya, Bata has witnessed a progressive reduction in the size of hides and skins as well as a reduction in their thickness. This is the direct result of inbreeding within herds and the failure of the Ministry of Agriculture's Artificial Insemination (AI) program to be sustained. Other issues that adversely affect the availability of quality leather include the increasing prevalence of tick marks on locally produced skins and the mottling effect that these have on finished leather.⁴⁵ Formerly, the Ministry of Agriculture provided dipping ponds, which constrained astringents and were effective in countering ticks. However, when the ministry terminated its support of ponds, farmers fell back to hand spraying, which is not nearly as effective a counter measure.

At the same time, government support of veterinary services receded with the result that many farmers simply went without veterinary support when their animals fell ill or contracted disfiguring dermatological diseases. These two factors, together with the progressively diminishing size of cattle, sheep and goats in Kenya, which result in smaller and less valuable hides and skins, are the primary reasons why the supply of quality inputs has decreased. On the demand side, interest in purchasing raw hides and semi-finished products, particularly from China, has increased significantly over the past five years.

Bata is fully integrated: It processes wet blue leather, which it purchases into finished leather in its own facilities. However, in recent years it has not been able to secure enough quality leather to operate at target capacity utilization levels and as a result, the company has had to import in order to satisfy its requirements. Bata has purchased intermediate products from Uganda and Egypt and from as far away as New Zealand.

The second biggest challenge the company faces involves the failure of the GoK to enforce its own trade regulatory standards. The Kenyan Bureau of Standards sets the design and construction standards that apply to footwear imported into the country. These standards relate to the minimum flexibility and minimum leather grade that imported shoes must attain. However, the company believes that these standards are not effectively enforced, and as a result, Bata and other local producers face unfair competition from overseas manufacturers who dump substandard shoes into the Kenyan market.

⁴⁵ Mottling results from tick infestation.

A third challenge faced by Bata is the lack of a business environment that effectively supports value addition to leather. Bata, as noted above, is fully integrated—operating its own tanneries, manufacturing facilities, and retail outlets. However, it is not self-sufficient. The company is part of a global corporate network, which supports the Kenyan operation with expertise in cutting edge leather technology, machinery maintenance and replacement, technical training and best management practices. However, within the local business ecosystem, Bata lacks effective support. The regulation of the meat industry, for example, falls under the Kenyan Meat Commission which takes little interest in hides and skins. Most workers in abattoirs are paid on a piecework basis and lack incentives to assure quality removal of hides and skins from carcasses.

Bata recently engaged a consulting firm to conduct a study of the primary market challenges that the company faces in Kenya. The study found that Bata's primary challengers—which account for 60 percent of its lost sales—were offshore, low-cost footwear manufacturers and not the second hand shoe market. The second hand market accounts for 40 percent of Bata's lost sales. In response to this competition, Bata has been able to secure a niche for specialty work shoes and rugged casual footwear with a simple but distinctive design. Bata's brand and its distinct position in the East African market is well supported by its retail distribution network. As of October 2014, Bata owns and operates over 130 retail stores in Kenya and the number is growing fast. It opened 34 stores in the year 2013 alone.⁴⁶ Bata also operates retail stores regionally in countries such as Rwanda, Uganda, Tanzania, Burundi, and South Sudan. However, it is not the low-cost producer and the company prices its

products aggressively (significantly above low quality, imported products) in order to assure a profit. The study conducted by the consulting firm estimated that Bata sales could increase by as much as 90 percent if competition in the informal sector were curbed.

The company is more sanguine regarding the competitive challenges that it faces on the supply side of its chain. It favorably views both the federal decentralization and the transfer of more budgetary authority to the county level in Kenya. One result of this decentralization of political power may be the re-institution of farmers training centers, which support increased experimentation with good animal husbandry methods, and enhance quality of skinning at local abattoirs. A reliable supply of wet blue leather is Bata's primary requirement and the company is positive about the prospect of increased export duties on wet blue. Currently, Uganda imposes 80 percent duty on its wet blue exports and there is increasing pressure on Kenyan policy makers to follow suit, albeit at a lower duty rate.

United footwear

United Footwear was established 35 years ago as a family business. It was once a burgeoning company, which hired over 360 employees and produced over 2,000 pairs of shoes daily. The scope of its production was diverse, ranging from boots to women's shoes. Then came the global competition. As with most footwear manufacturers in Kenya, they found it difficult to compete against footwear produced by international companies that were more competitive. Open competition forced them to adjust and the solution was to limit their range of products to boots. Women's shoes proved to be too trendy and it was impossible for a medium-

⁴⁶ Business Daily, (2014), "Bata set to open its largest Africa store in Nairobi," May 14. <http://www.businessdailyafrica.com/Corporate-News/-/539550/2314826/-/item/1/-/inm4at/-/index.html>

scale company like United Footwear to keep up with the ever-changing styles. Currently, United Footwear focuses its production on security, military, and industrial boots. In one corner of the factory, one can still observe boxes of shoe lasts⁴⁷ that are no longer being used. Although the number employees decreased from 360 to 60 and though the company now produces 200 pairs of boots per day, the managing director of the company is hopeful of the prospects that the "Buy Kenya" initiative could bring to the company.

Handbags, travelware, corporate items

At first glance, the growth of the Kenyan leather bag industry does not appear to be very promising as it is constrained by numerous challenges. There are few players, if any, in the leather bag sector that can match the tradition or the longevity of some of the leather footwear producers in Kenya. Currently, there are no big scale producers operating in Kenya that possess the capacity to engage in mass production or to undertake exports on a consistent basis. Instead of Kenyan producers exporting in containers, most of the products that reach the European or North American market go through retail store owners or designers that visit Kenya. Leather Masters, one of the biggest leather product workshops in Kenya, employs between 30 and 45 staff members, depending on the market demand. According to several craftsmen who operate their own workshops, many young designers aspire to participate in the field, but find the lack of skilled craftsmen an insurmountable entrance barrier.

Despite the existence of such prevalent constraints, the leather handbag market has grown by a factor of 5.5 over the last six years and has potential for further expansion. UN

Comtrade shows that Kenya has witnessed a gradual increase in export of leather suitcases/ handbags from around US\$400,000 in 2007 to US\$2.2 million in 2013. While the total export value remains relatively small compared to other sectors, the rate of growth is noteworthy. It is also important to note that these numbers may not reflect the true amount of handbag exports, as an increasing amount of leather bags and cases are crossing the border without declaration. Only a small portion of production takes the official route, paralleling the vibrancy of the informal market for other leather goods throughout Kenya.

The reason for the growth in the leather handbag sector can be traced to the rise in the number of talented designers and producers participating in the sector. In addition to some of the traditional players such as Leather Masters and Adelphi, many small and medium scale workshops such as Sandstorm Kenya, Rift Valley Leather, Sanabora Design House, and Gonzala Leathers have established themselves in the last decade.

Sandstorm Kenya – Kenya's key and growing player in leather bags

Sandstorm Kenya, a brand that used to produce luxury safari tents, has transformed itself into one of the leading leather bag producers in Kenya under the management of Mark Stephenson. Initially, the management envisioned targeting the international market, with Kenya as a manufacturing base. However, they learned that the inroads to overseas markets are difficult without abundant capital and scale. At the same time, they acknowledged that the growth in the Kenyan middle class elicited growth in demand for high quality leather products, presenting an opportunity

⁴⁷ Artificial foot that is inserted into the shoe to maintain its shape.

for the company to scale production for the domestic market. Although Sandstorm's main clients continue to be expats and tourists, they have witnessed local demand surge in the last 12 months. Sandstorm's vision is to build a strong local base endorsed by the growing creative class in Kenya prior to focusing on expanding to the global market.

Sandstorm purchases most of the finished leather from Bata, Alpharama, and Sagana depending on availability of finished leather in each tannery. While canvas and zippers are imported from overseas, the rest of the components such as glue, brass, and buckles are mostly sourced locally.

The state of the labor pool reflects the general trend of the Kenyan leather industry. The majority of Sandstorm's newly hired workers lack experience and training in making leather products. Even those who have prior knowledge in production and machinery from technical universities lack experience working specifically with leather and canvas and generally require additional on-the-job training.

Sandstorm's production ranges from leather bags, canvas bags, travelware and brief cases to wallets and car seats. The majority of their finished products are distributed via their own retail channel: six stores in Kenya, one in Tanzania, and an online store for the UK market. Sandstorm expects to add an additional two retail stores within the next year. Currently, their workshop, which is located in Karen, just outside Nairobi, hires over 35 craftsmen who produce around 600 bags per month. Around 90 percent of the sales occur locally and 10 percent in Europe.

One of the biggest challenges Sandstorm faces today is the inconsistency in the quality of the finished leather that they procure from local

tanneries. A single order containing a batch of the same kind of leather can vary considerably in color and texture. This kind of inconsistency in leather quality presents a potential barrier for manufacturers such as Sandstorm to scale reliable production and build high-end brand recognition and brand loyalty. The majority of leather good producers interviewed for this study also echoed this particular constraint.

The second challenge, equally shared by companies that produce high quality leather bags, is the lack of a marketing channel or platform to increase the international prominence of Kenya as a quality leather bag producer. There are a number of international fairs in Kenya that have been created in order to promote local brands and increase interest in the market. Sandstorm and others have participated in several of these high level international fairs for leather products, often receiving generous subsidies from institutions such as KLDC, but many Kenyan based fairs fail to attract a substantial crowd. The high expense incurred from traveling, booth rental, and accommodation at the international fairs, however, undermines companies' ability to participate. Due to lack of accessibility to the global market, Kenyan brand recognition is insignificant, despite the increasing quality and scale of companies like Sandstorm.

Belts, leather garments, industrial gloves, and others

There are only a few formal sector producers of belts, leather garments, and industrial gloves in Kenya, with more producers being found in Kariokor market. East African Tanneries is one formal sector company that has a small production line for producing industrial gloves, primarily making use of hides scraps from its security boots workshop.

3.3 LEATHER PRODUCT MANUFACTURERS IN THE INFORMAL (JUA KALI) SECTOR - KARIOKOR MARKET (KM)

There are informal *fundis* (“artisans” in Kiswahili) and markets that produce and sell leather products in every county across Kenya.

However, none matches the number and the degree of concentration of KM. The KM is a big, open-air market located on the Race Course Road, just outside the city center, where one can find the largest range of leather inputs and products in Kenya. More importantly, it is home to the biggest informal (*Jua Kali*) leather good producers in Kenya, loosely governed by the county government. Out of the 300 plus stores (at least 200 within the walled boundary and 100 outside), over 80 percent are estimated to be involved in leather products, either directly or indirectly. Joseph Wairiuko, an executive at the Kenya Association of Manufacturers who has worked in KM for five years, suspects that the number of stores in Kariokor has increased since he began working. It is not only a bustling market, but also a growing one and many firmly believe in its untapped potential for further growth. As you walk in, you can see rows of stores full of producers making shoes, belts, wallets, handicrafts, etc.

Leather middlemen

There are about 10-20 leather middlemen in KM who buy crust and finished leather directly from tanneries or leather wholesalers and sell it to footwear/leather good producers.

The leather middlemen buy the leather from a few tanneries such as Alpharama, LIK, and Sagana because of the availability of finished leather. The biggest leather supplier to the *Jua Kali* market is Alpharama. To ensure fair supply distribution, Alpharama assigns each middleman a designated day of the week to visit the tannery to make purchases.

As middlemen can only visit tanneries on designated days of the week, they can also pre-order future purchases in case they cannot make it the following week. The price and the process of purchase is mostly dictated by tanneries. As there are only a small number of tanneries (mostly Alpharama) monopolizing the production of finished leather, small-scale individual middlemen have no bargaining power over price or quality.

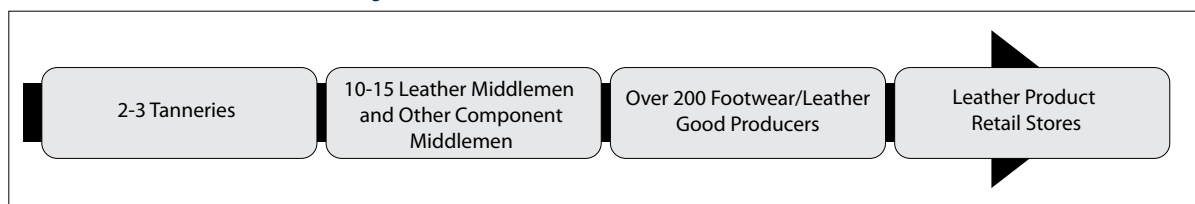
Leather middlemen generally buy leather in rolls of around 160 sq. ft.. The price of a roll varies, depending on the type and quality of leather. Leather good producers then buy these rolls per sheet (1 roll has many sheets), with 1 sq. ft. of leather selling for KSh 150, or 1kg of leather selling for KSh 800.

Leather footwear producers

Currently there are over 200 small shops/stalls that produce and sell footwear and a range of other hand-made leather products in KM.

- *The number of employees working in each shop fluctuates depending on orders they receive (it could range from 10 to 200 pairs*

Figure 25: Structure of the Kariokor market leather cluster



Source: ETG

of shoes). At times, a shop could have 30-40 employees working, with each employee specializing in making different parts of the shoe. The most labor-intensive work is making beads for sandals; 10 employees will be required per day to make flower beads for 50 pairs of shoes. Thus, some shops buy ready-made beads from factories in Mombasa).

- **Most leather good producers at KM have never received training in any formal institution, as it is perceived to be expensive and impractical.** They come to KM and learn on the job. Producers learn about new designs and technology from the Internet.
- **No use machinery is observed in the shops: the products are handmade.** According to the artisans, handmade shoes are unique and more durable than the Chinese/Ethiopian shoes that are machine-made. However, they acknowledge that the lack of machinery and tools is a significant constraint in producing products with high quality finishing. People in KM also take pride in providing jobs and are therefore worried of job losses if the process is mechanized. They believe around 10,000 people are economically dependent on this informal leather market.

Production estimation of Kariokor Market

As a key supplier of low-cost leather shoes in Kenya, leather products from KM are dominated by shoes followed by sandals, wallets, belts, and others. Other products include leather balls, accessories, and African ornaments.

- **One leather footwear stall produces between 40 and 50 pairs a day.** One larger store with six employees has a capacity of making up to 300 pairs of shoes a day. However, not many stores are operating in full capacity unless it is peak season. On average, one sandal-producing stall receives an order of 1,000 to 1,200 pairs of leather sandals per month.
- **For our simplified estimation, we post the following assumption, based upon our interviews and inspections at the KM:**
 - o 60 percent of 300 stores are engaged in producing leather footwear 300×60 percent = 180 stores
 - o each stall works for 300 days per year
 - o each stall produces 50 pairs of leather shoes per day
 - o $50 \times 180 \times 300$ days (excluding Sundays and holidays) = 2.7 million pairs are produced in one year
 - o Suppose the average value of a pair of leather shoes is KSh 600, the value created in leather shoes from KM alone is about KSh 1.6 billion.
- **The leather shoe market is very seasonal.** **The demand for school shoes**, for example, increases rapidly during the beginning of the school semester that buyers wait as shoe producers finish each pair. During November and December, leather shoe producers gear up for the biggest season of the year.

Table 5: Types of leather footwear produced in Kenya

| | |
|-------------------|---|
| Sandals | <ul style="list-style-type: none"> • Mostly with leather bottom, leather strings (with beads), and rubber soles • Sandals for adults sell for KSh 400-500, sandals for children sell for KSh 200 • West African countries, Tanzania, and Uganda are big buyers • 1 sq. ft. of leather produces around 1.5 sandals |
| Men’s Dress Shoes | <ul style="list-style-type: none"> • Men’s dress shoes sell for KSh 800-1000 • Soles are mostly imported from China |
| School Shoes | <ul style="list-style-type: none"> • School shoes sell for KSh 400-500 • Demand tends to exceed supply just before the beginning of the school semester |
| Security Boots | <ul style="list-style-type: none"> • Security boots sell for KSh 1,600 • Security companies usually come and place bulk orders |
| Safari Boots | <ul style="list-style-type: none"> • Safari boots are sold for KSh 500-600 • Leather required for safari boots is cheaper than men’s dress shoes • Soles used for safari boots are produced locally, thus cheaper than imported soles |

There is more variety in terms of goods being produced in Kariokor Market. Production volumes of other leather products, however, are much smaller than leather footwear. They include:

| | |
|--------------|---|
| Wallets | <ul style="list-style-type: none"> • Few stores are specializing in making leather wallets |
| Belts | <ul style="list-style-type: none"> • Mostly sold to Tanzania |
| Phone Cases | <ul style="list-style-type: none"> • Mostly sold to Tanzania |
| Sports Balls | <ul style="list-style-type: none"> • Very few produced |

Key buyers at Kariokor market

According to our primary research, the majority of buyers of products made in Kariokor are retail storeowners who visit the market to place orders that may range from 20 to 100 pairs of shoes. The retail storeowners then bring Kariokor Market-made shoes to their respective stores in different parts of Kenya and sell them directly to consumers. Many producers in Kariokor Market are not aware of what happens outside of their walls once the shoes leave the market.

Most men’s dress shoes, school shoes, and security boots are sold locally while sandals are popular in neighboring countries. Shoe sellers estimate that 90-95 percent of leather shoes produced are sold locally and the remaining are sold in neighboring countries. Among the sandal buyers that visit Kariokor, around 20 percent are Kenyans and 80 percent come from East/Central Africa, and also Western African countries such as Nigeria, Sierra Leone, and Ghana.

Kenyan clients—although individual customers often visit the market, the majority of Kenyan clients are retail storeowners. Leather shoes and other leather products are then distributed and sold across the country.

Regional Clients—The biggest foreign buyers, who purchase footwear and other leather products at Kariokor Market, come from neighboring Uganda and Tanzania. Due to the spread of Ebola and following the travel restrictions, the number of buyers traveling from Western Africa has declined significantly, if not completely.

Competition with Mitumba

Footwear producers in Kariokor Market face considerable competition from the second-hand (*Mitumba*) market. Our initial hypothesis was that, "People buy more leather shoes from *Mitumba* market because it is cheaper." However, this hypothesis turned out to be questionable after speaking with producers and sellers in Kariokor Market. Men's shoes, school shoes, and sandals constitute the largest share of leather shoes in Kenya. According to producers/sellers in Kariokor Market, the price of a new pair of men's leather dress shoes (KSh 800) and school shoes (KSh 400-500) in Kariokor Market is cheaper than many of the leather shoes found in *Mitumba*. Although one can encounter an old pair of men's leather shoes for KSh 400 or 500, a pair of good quality men's dress shoes, for example, may cost over KSh 2,000 in *Mitumba* market. Also, school shoes and leather sandals are not widely available in *Mitumba* market. Even if school shoes do exist in the second hand *Mitumba* market, many parents who can afford it prefer to purchase a new pair for their children. In light of this trend, many storeowners in Kariokor identify Ethiopia and China, not *Mitumba*, as the biggest competitors for their low-cost leather products.

The majority of Kenyans own one or two pairs of leather shoes for going-out or special occasions. A significant proportion of the unemployed or people involved in informal sector, however, do not necessarily purchase leather shoes on a regular basis. The majority of people who require and buy leather shoes on a regular basis are the ones that are formally employed and work in offices and schools. The middle class, in general, purchase leather shoes in retail stores located in the town/city center where a significant share of the shoes displayed are supplied by *Jua Kali's* in Kariokor Market.

For those who purchase comfortable shoes or sneakers, *Mitumba* appears to be the popular marketplace. Many of the leather shoe producers working in Kariokor Market also wear shoes from *Mitumba* because: (i) they don't need to wear leather shoes; and (ii) one can find more fashionable/better finished shoes made of other materials.

Challenges faced by the Jua Kali sector

1. **The cost** of some inputs such as shoe lasts, soles, etc. are high as they are mostly imported. Local soles are sourced and used in KM, but the quality is poor.
2. **Lack of recognition:** None of the stalls that operate within KM have a brand name. Also, producers/sellers claim that the average Kenyan is not aware of how many leather products are being supplied by KM. Even those who purchase leather shoes in a city retail store, supplied by KM, are not aware of where the shoes come from.
3. **There is no distribution or marketing channel for the producers.** The products are sold mostly through retail storeowners that visit KM.
4. **Leather good producers in KM have no connection with end users.** They are therefore not aware of design trends.
5. **Producers are aware of the growth of the finished leather industry in Ethiopia under the auspices of the government.** They believe it is becoming more difficult to compete against the products imported from Ethiopia.

As discussed, KM is an integral part of Kenya's leather market and as such, there is a prime opportunity for improving and expanding this industry to promote economic growth and take hold of emerging opportunities in the leather

industry. Global trends indicate that there is a growing need for supply of leather goods, and Kenya has the resources in place to capitalize on the opportunities in the leather market, both for internal needs such as the increasing demand for school shoes, as well as external markets such as those of the East African Community. The linkages that we see in the cluster map (Figure 23) are important for understanding points of potential linkage strengthening. Crust and finished leather manufacturing is one very important element, and has shown increased and improved levels in recent years.

Analysis of the Kenyan leather industry shows that there are skilled, large-scale producers in operation and skilled artisans operating in the informal sector through KM. KM can be expanded through targeted approaches that will improve leather output and quality. As it stands, KM is receiving lower quality leather inputs from tanneries, as higher quality leather products are reserved for formal market participants that are larger in size and have the capital available for these higher quality products. The benefit of receiving lower quality imports is that the KM can continue to provide lower cost goods to the market, which is fitting for this informal, low-cost sector.

Thus, the opportunity for improvement lies in improving the finished products coming out of KM. This can be achieved through light mechanization, standardization, training, and improved finishing techniques. Some examples include, machine cutting of leather sheets as opposed to hand cutting, the use of shoe lasts, and common facilities that would provide the resources and standardization tools for leather workers. The majority of Ethiopian and Chinese shoes imported into this market are machine-

finished, which results in higher quality products. By contrast, it is estimated that over 90 percent of KM leather artisans finish their products by hand, evident in minor details as visible glue marks, uneven threading, wrinkled leather, etc.

Improvement in the quality of leather products in KM can help to increase the percentage of new, low-cost goods in the Kenyan leather market. This will lead to increased penetration of these goods into the second hand *Mitumba* markets. Standardizing and improving these low-cost leather products can also lead to a number of other market opportunities for KM. One example of this is customization capabilities, where small, informal leather artisans, such as those operating in KM, can achieve higher output volumes and qualities that may lead to requests for customizable orders, such as for military boots or niche leather products.

3.4 TANNERIES

The number of tanneries that operate in Kenya has fluctuated over the last couple of decades. Currently, there are 14 operating tanneries of varying size and capacity. However, only a handful of these tanneries process crust and finished leather and the rest focus on exporting wet blue. Some tanneries are mainly engaged in subcontract tanning in which small-scale tanneries supply wet blue to large-scale tanneries such as Alpharama.

Traditionally, three or four tanneries have been major players in supplying finished leather to the Kenyan domestic market. Currently, some of the major players are either undergoing financial difficulties or reducing their output. Alpharama has grown into a dominant force in tanning and most local leather good producers source finished leather from them.

⁴² Kenya Industrial Research and Development Institute, "Leather Division." <http://www.kirdi.go.ke/kirdi-departments/rtdi-department/leather-division>

It is important to note that most of the tanneries are located around Nairobi. Experts point out that this is because of the high concentration of producers and manufacturers in that area. At the same time, this trend may discourage other regions from developing even a quasi-leather-cluster that resembles Kariokor Market.

Alpharama: The key tannery in Kenya

Alpharama Limited has been moving up the market since its establishment as a tannery in 1996. With a US\$15,000 investment, it began producing wet blue leather. Since then, the company has moved into the production of crusted and finished leather. Recently, it has experimented with the production of women's slippers using its own fine leather as an input.

Alpharama is the largest and most dominant tannery as well as a force of innovation in

the Kenyan leather industry. Its management believes in building technology and management capacity. They are not afraid to experiment with new products, processes, and business models. Alpharama has tried to find ways around what its management refers to as the triad of misdirected practices—drying, salting and flaying—which create a ceiling over the value of Kenyan leather and lead to its reputation as being low quality among many importers. Alpharama invests in alternative business processes, which remove the value limitations of the leathers, which it produces. Distinctively, it also invests in skills development, win-win partnerships with chain partners and technology transfer. The company has invested, for example, in the installation of hide pulling and skin rollup equipment, which it has helped install in partners' abattoirs and it has tried to create incentives for its supply partners to

Table 6: Details of tanneries operating in Kenya

| Tannery | Quantity of wet salted hides per month | Goat and sheep skin (pieces per month) | Capacity utilization (%) | Level of production | | |
|---|--|--|--------------------------|---------------------|-------|----------|
| | | | | Wet blue | Crust | Finished |
| Bata Shoe Limited (Limuru Town) | Crust / Finished 600,000 sq. ft. | N/A | 100 | X | X | X |
| Alpharama Ltd. (Athi River) | 650 tons | 400,000 | 100 | X | X | X |
| Leather Industries of Kenya (Thika) | 300 tons | 100,000 | 50 | X | X | X |
| Aziz Tanneries Ltd. (Njiru Market) | 300 tons | 200,000 | N/A | X | X | X |
| Sagana Tanneries Ltd. (Sagana Town) | 200 tons | 50,000 | N/A | X | X | X |
| Nakuru Tanneries Ltd. (Nakuru Town) | 200 tons | 150,000 | N/A | X | | |
| Dogbones Ltd. (Nairobi) | 300 tons | N/A | N/A | X | | |
| Nairobi Tanneries Ltd. (Nairobi) | 50 Tons | 50,000 | 70 | X | | |
| East Africa Tanneries Ltd. (Njiru Market) | N/A | 250,000 | 85 | X | X | X |
| Faaso Import and Export (Nairobi) | 100 tons | 50,000 | N/A | X | | |
| Athi River Tanneries (Athi River) | 250 tons | 100,000 | N/A | X | | |
| MAS Trading Company (Nairobi) | 200 tons | N/A | 100 | X | | |
| Zingo Tanneries (Nairobi) | 300 tons | 200,000 | 80 | X | | |
| Ondiri Tannery (Kikuyu) | Insignificant | Insignificant | N/A | X | X | X |
| Abdulwadood Tanners Ltd. | Not in operation | Not in operation | N/A | X | | |

Source: Alpharama

⁴³ International Trade Center, "Leatherline: Kenya Country Information." <http://www.intracem.org/leatherline-portal/african-platform/kenya/#footwear>

⁴⁴ Kenya Industrial Training Institute, "Leatherwork and Tannery Department Background Information." <http://kiti.ac.ke/node/102>

change their own business processes and move away from flaying for instance. It allows the abattoirs with whom it works to pay back this investment over time and it pays a handsome premium (20 percent) for the high quality hides and skins, which its partners are able to produce with this equipment.

The company has tried to distinguish itself with respect to the environmental impact of its operations. Alpharama is the only tannery in Africa that is certified under the environmental sustainability certification regime, the Leather Working Group (LWG), advanced by the British Leather Corporation. It operates a closed water system, which enables it to recycle 70 percent of its process water. Another important part of the LWG quality process involves leather traceability. Accordingly, the company tracks each production batch, which it produces from abattoir through its own in-house processing, and maintains a tracking profile for every pallet of product that it sells. The result of these and related efforts has been a growing market for the company-crested leather and the development of an increasing number of committed buyer accounts in China, Italy, Turkey and Malaysia. Recently, the company began selling semi-finished leather to a supplier of cell phone cases to Samsung.

In spite of its growing success, the company faces several severe competitive challenges. Not only is the quality of local raw hides and skins declining but also their sizes are diminishing at the same time. Ten years ago raw hides in Kenya had an average size of 30 sq. feet. Today, the average size of a cowhide is just 25 sq. ft. Although the government has restarted its artificial insemination (AI) program, the company estimates that it will take five to six years to have some impact on the size of available raw leather pieces and perhaps

as many as seven generations of breeding to reclaim the size which formerly characterized the national herd.

Another problem which adversely affects Alpharama's cash flow is the loss of VAT exemption. At the insistence of the IMF, VAT was reinstated for the industry in September 2013. The result is a great deal of additional working capital requirements associated with fine leather production. Even when it is exporting its products the company's competitiveness is compromised. This is because VAT refund and duty drawback programs in Kenya are slow and inefficient. Tanners based in Uganda, for example, can expect to receive rebates within four months. In Kenya a comparable payback time is two years. This poses a real problem for a company like Alpharama which turns over its inventory six times per year and which has a cash-to-cash cycle of 60 days.

3.5 INSTITUTIONS SUPPORTING THE LEATHER SECTOR

There are various institutions and associations that underpin the Kenyan leather industry. Unfortunately, there is little communication and cooperation among them. Even worse, a great number of institutions exist only in name and their effectiveness is almost negligible. In this section, we identified some of the key institutions that have a critical role in supporting various subsectors of the leather supply chain.

Kenya Leather Development Council (KLDC)—Lead Policy & Implementation Institution

KLDC is a relatively nascent institution (established in 2010) which has been an information hub for any party interested in learning about or investing in Kenya's leather industry. It was founded under the Ministry of Livestock with a specific mandate to support development of the leather industry.

⁴⁵ Kenya Association of Manufacturers, "About Us," <http://www.kam.co.ke/index.php/about-us>

It is a relatively young institute that has been repositioned under the auspices of Ministry of Industrialization to emphasize its focus on supporting leather industry stakeholders.

KLDC envisions itself as being a leading agency in transforming Kenya's leather industry into a globally competitive one. KLDC is in close contact with various leather stakeholders and occasionally coordinates workshops and invites SMEs to participate in various fairs to harmonize and promote activities in the leather industry. KLDC also seeks partnerships with international counterparts in sharing knowledge. As the only leather institution that is uniquely and closely linked to the market and its key players as well as the Ministry of Industrialization, KLDC has a critical role in supporting the industry to grow.

Kenya Industrial Research and Development Institute (KIRDI) – Research Institution

KIRDI falls under the Ministry of Industrialization and Enterprise Development and was established in 1979. It is a multidisciplinary research institute with a wide range of divisions under its Research, Technology and Innovation (RTIC) Department. Leather is one of the key divisions in RTIC. The main objective of the institute is to undertake research into, and development and dissemination of the latest technology in tanning, equipment, quality control etc. The leather division also advocates for establishing mini tanneries in high livestock potential areas of Kenya to add value and boost local employment.⁴⁸ However, there is concern in the industry that the topics KIRDI chooses to research are impractical and fail to address the challenges that industry players face. Even worse, many experts assert that KIRDI has not made any significant research contributions to the industry in recent years. Instead, KIRDI seems more focused on revenue generating

activities such as consulting and business incubation, which possibly overlap with its role and mandate.

Educational Institutions

At the higher education level, University of Nairobi and Dedan Kimathi University of Technology offer degree courses in Leather Science. The Technical University of Kenya also offers a diploma in fashion design and textile technology to support students interested in product designing. However, most students of such programs are not considered experienced enough to make significant contributions to the industry immediately upon graduation. Equipment and curriculum require an overhaul. Also, as addressed in the narrative of Sandstorm Kenya, the majority of graduates from technical universities require additional training when hired to produce leather goods. There needs to be improved communication between Kenyan educational institutions and industry stakeholders to better prepare students joining the labor force.

Training Institutions

Some of the notable training institutions in Kenya include:

Training and Production Center for the Shoe Industry (TPCSI)–TPCSI was established in Thika in 1994 under UNIDO's initiative to support the Kenyan leather industry. The institution has a critical role in boosting the industry's competitiveness. Its objective is to provide intensive training on multiple aspects of leather goods production, ranging from designing to costing. Since its inception, TPCSI has trained over 250 people from other countries and over 400 trainees in Kenya. The current facility consists of 16-18 skilled and capable staff members. TPCSI is equipped with relatively modern machinery that many SMEs can only dream of.

⁴⁸ Kenya Industrial Research and Development Institute, "Leather Division." <http://www.kirdi.go.ke/kirdi-departments/rti-department/leather-division>

Almost all machines are currently functional: however, the very important CAD/CAM machine which uses computer and graphics software for designing and grading shoe patterns and for manufacturing cutting dyes, shoe lasts and sole moulds, requires repair.

TPCSI, the facility with great potential, is currently being underutilized. Many staff are left idle if they are not producing leather goods outsourced by Kenyan SMEs. Currently, the facility is more of a production outsourcing workshop rather than a training institute. Group training occurs only when there is external funding. In previous years, multilateral organizations such as UNDP have funded training sessions for poverty reduction and vocational training purposes for a group of around 30 trainees. In 2014, however, there has not been any group training and only a few individuals who could afford KSh 20,000 for a two week training have been able to take advantage of the facility. Furthermore, the majority of leather good artisans are not aware of the existence of such training institute. If they

are, the high training fee hinders them from enrolling. TPCSI furthermore lacks the incentive to advertise and promote training.

Animal Health and Training Institute (AHITI) – A training institute which was established in 1965 by the Food and Agriculture Organization (FAO) provides training on leather manufacture and leather craft. AHITI offers two year certificate courses in leather manufacture and leather craft.⁴³

Kenya Industrial Training Institute (KITI) – KITI was established in 1965 with help from the Japan International Cooperation Agency (JICA). The purpose of KITI is to provide practical and technical skills as well as entrepreneurial skills to trainees. The leather department, headed by Mr. Peter Kanyuru, was created under KITI in the same year to specifically promote leather production skills.⁵⁰

Table 7 summarizes leather industry related training courses offered by AHITI, TPCSI, and KITI.

Table 7: Training courses offered by AHITI, TPCSI, and KITI

| | AHITI | TPCSI | KITI |
|------------------------|---|--|---|
| Training offered | - Hides and skins inspector - Leather technologist | Practical skills: leather product designing, assembling, costing cutting, etc. | Leather tanning; Footwear producing skills; Other leather work |
| Courses offered | - Leather technology - Hides and skins improvement | Shoe making; Handbag making | Leather craft-skill upgrading; Shoemaking; Leather tanning; Entrepreneurship; Leather artisan; Craft-long term course |
| Certification | - AHITI certificate | TPCSI certificate | Kenya National Examinations Council certificate; Grade test certificate; KITI certificate |
| Entry requirements | - Kenya Certificate of Secondary Education mean grade C, with relevant subjects | Employees from industry; High school graduate | Kenya Certificate of Secondary Education mean grade D and above; Employees from leather organizations and industry; Jua Kali artisans, etc.; High school graduate |
| Target group | - School leavers | Leather craftsmen; Shoe makers | Leather craftsmen; Tanners; Entrepreneurs in leather trade; Shoe makers |
| Sponsorship | - Partial funding from government | Partial funding from government | Partial funding from government |
| Duration of courses | - 2 years | 2 weeks to 2 months | Skill upgrading: 3 months; Artisan: 1 year; Craft: 2 years |
| Number trained in 2014 | N/A | No group training offered; Few individual trainees | 32 trainees |

Source: Alpharama

⁴⁹ International Trade Center, "Leatherline: Kenya Country Information." <http://www.intracen.org/leatherline-portal/african-platform/kenya/#footwear>

Associations

LAEA (Leather Articles Entrepreneurs Association) – In the past many small and medium enterprises involved in leather goods production in Kenya felt underrepresented and needed a platform to channel their concerns. Their movement gained momentum as many producers began aggregating around international trade fairs and exhibitions to promote their respective leather products. Consequently, a number of SME owners came together and formed an association called LAEA. The association, chaired by Mr. Morris, is a membership driven association that brings together players in the production and commercialization of leather articles made in Kenya. LAEA currently consists of over 100 members from all over Kenya and is open to any player that has a role in the leather industry, regardless of their size or location. Through mobilization of the leather articles subsector, capacity building, and incubation, the mission is to promote global competitiveness of Kenyan-made leather articles.

Kenya Association of Manufacturers (KAM) – Established in 1959 as a private entity, KAM is a representative organization for all types of value-added manufacturers in Kenya. Its objective is to support the local manufacturing industry to become more competitive and promote trade with other African countries. To this end, KAM plays a vital intermediary role between manufacturers and the Ministry of Industrialization in addressing concerns of its 800 members. KAM also provides technical advice on trade tariffs, taxation, and business information to facilitate its members' operation.⁵¹

Prior to the establishment of KLDC, Kenya did not have an institute whose mission was specifically dedicated to the leather

industry. Associations representing footwear manufacturers, cobblers, and tanneries existed, as did a number of training and research institutions such as KIRDI, TPCSI, AHITI, etc. However, no institution possessed the capacity or mandate to explore the wide range of the leather supply chain from a macro-level perspective. As evidenced by the above list, this resulted in several institutes with overlapping roles and functions and even with the emergence of KLDC, the roles of institutions are highly blurred. For example, the leather department of KIRDI, an institute designated primarily for research and development, also engages in capacity building and business incubation. The distinction between its role and the role of KITI and TPCSI is unclear at best. Too many institutes with overlapping functions creates a significant amount of red tape for the implementation of initiatives and breeds inefficiency in Kenya's leather sector.

3.6 KEY FINDINGS FROM CHAPTER 3

In this chapter we endeavored to examine the Kenyan leather industry and map the structure and organization of some of the leading enterprises and associations which drive it. We sought to map the interactive commercial activities that determine the cluster competitiveness of the industry, and we discovered relatively little cooperation and mutual alignment of strategies, business processes or investments. The cluster mapping presented in this chapter confirmed that most commercial interactions within the cluster are arms length transactions. Little structural accommodation has been made between enterprises in an effort to create business synergies or to test new markets, products, or process technologies. Other key findings include:

⁵¹ Kenya Association of Manufacturers, "About Us," <http://www.kam.co.ke/index.php/about-us>

- Kenya has a complicated and intricate set of leather firms and institutions, which comprise the leather sector. However, due to the limited linkages, cooperation, and collaboration among the stakeholders, Kenya's leather sector needs to increase the trust, collaboration, and exchanges of information, products, technologies, and personnel to become a more dynamic and competitive industrial cluster.
- Employment in the leather industry is small (estimated at 14,100) and the informal sector is the bigger employer accounting for up to 10,000 workers during peak times.
- Most of the leather good producers are small or medium enterprises and many prefer to stay in the informal sector to avoid paying taxes and to minimize interaction with government authorities.
- There is a mutually beneficial linkage between formal and informal sectors, based primarily on the flow of intermediate products. However, the exchange of management, skilled workers, and investment capital is weak and unbalanced.
- Only a few tanneries process finished leather for sale in the domestic market. Kenya's finished leather market is tightly controlled and asymmetric with regard to market information and access to working capital. It is primarily a "seller's market." Kenya's largest and most modern tannery, Alpharama, dominates the production and commands a great influence over the market.
- There is a vibrant and competitive informal sector in Kariokor Market cluster that produces low-cost leather goods for Kenya and the region.
- Many institutes and associations exist to support the industry, but few play a significant role due to lack of coordination, funding, and industry acknowledged authority.

In Chapters 2 and 3, the report described different markets, key industry players and their scope of production, and market dynamics in order to form a better understanding of Kenya's leather industry.

Chapter 4 moves from a descriptive to a normative or prescriptive mode. It applies several analytic tools to begin to formulate strategies for moving the sector from its prevailing low-level equilibrium to a much higher equilibrium. It discusses the strengths, weaknesses, potential, and competitiveness of the Kenyan leather industry in comparison to other major leather producing countries. It also assesses potential ways forward based on the successful experience of developing countries which have recently made progress toward this same goal.

COMPETITIVENESS ANALYSIS

Previous chapters described the key trends and structure of Kenya's leather sector. This chapter employs four analytical tools to assess the competitiveness of the leather industry in Kenya.

1. SWOT analysis of the leather industry in Kenya
2. Benchmarking and gap analysis
3. Value chain analysis
4. Competitive positioning analysis

4.1 SWOT ANALYSIS OF KENYA'S LEATHER INDUSTRY

The Strengths/Weaknesses/Opportunities/Threats (SWOT) analysis presented below allows us to examine the current competitive state of the Kenyan leather industry. It assesses the industry's competitive strengths and weaknesses in both local and international markets, and identifies pending opportunities and threats, which the industry must be able to respond to, in order to improve its current competitive position.

Our analysis reveals that despite having abundant livestock, a significant number of established tanneries, and a young and growing workforce, a long list of weaknesses and threats is hampering the Kenyan leather industry from fulfilling its potential. Most of the strengths of the industry relate to its potential to produce low-cost leather as a tradable commodity. The markets in which Kenyan firms compete are global commodity markets, and commodity markets in which renewable natural resources are traded pose several limitations

on the industrial development of nations that depend on them.

The limitations of competing in these low-cost, low-quality leather markets are explained below:

- a. Prices are competed down to the cost of production for the marginal market entrant because typically, no barriers to entry exist in commodity markets;
- b. Because no natural resource production is strictly renewable, precisely how marginal production costs are determined varies from one national venue to another depending on the policies and mechanisms deployed to internalize external costs; Commodity markets are prone to wide swings in demand, supply, and price. The factors which determine the inherent profitability of sectors, based on natural resource extraction, fall, for the most part, outside the purview of individual firms and sectors which extract and sell these resources.
- c. For the above reasons, private investments in these sectors are risky and participants prefer to invest in assets with short economic lives, such as working capital and trading capacities, rather than in more productive assets with longer economic lives.

In spite of these weaknesses, demand for leather products appears very likely to exceed supply both regionally and worldwide. As a result, the core strengths of the Kenyan leather sector (e.g., abundant animal herds

and abundant low cost unskilled labor) will likely continue to sustain the sector, if only at a level of low equilibrium, as a producer for commoditized, intermediate products, which other more developed economies will continue to depend on as inputs in their own value adding manufacturing processes.

In order to transition from competing on a low-cost basis to competing on the basis of competitive advantages of its intermediate product quality and market differentiating channels, the Kenyan leather industry requires increased entrepreneurship, greater dynamism based on demonstrated non-traditional undertakings, and stronger linkages—both backward from herdsman, and forward to niche markets.

The most significant constraints, which continue to restrain the development of the sector, relate to its structure and industrial organization. In the Kenyan leather sector of today, no effective incentives exist for combining the capabilities of different participants along supply chains in ways which create value, increase the size of the competitive space in which individual participants can operate, and thus, stimulate additional commercial experimentation. The industry's atomized structure effectively locks current participant into a short term or "trading" mode of business operation. In order to move beyond the low-level equilibrium that currently prevails, incentive systems need to be created. Incentive systems are required, for example, to affect "quality" incentives in each link of the chain, stimulating structural changes within the industry, through joint ventures, mergers, and new foreign direct investments, and assisting with the development of new institutions,

including business incubators, structured markets, and new modes of technology transfer and of skills development.

With all of that said a number of favorable opportunities are emerging both locally and globally, which should assist efforts to restructure the leather industry. Demand for leather goods is currently high and it is expected to grow globally. In the midterm, demand is expected to be even greater in Africa than in the rest of the world. In order to serve these regional markets, Kenya's strategic location affords its producers a significant distribution cost advantage. By leveraging its rich pool of livestock and labor, while mitigating some of the identified challenges, the leather industry could grow and become a competitive player, not only in the region, but also in the world in the long run.

Table 8 lists the strengths, weaknesses, opportunities, and threats of the entire range of the Kenyan leather supply chain. A myriad of challenges is identified here. Throughout the supply chain, Kenya currently lacks equipment, technology, awareness, and knowledge to produce quality hides and skins as well as finished leather products. Efficacy of both private and public institutions with mandates to support and develop the industry is severely limited due to incapacity. Although these problems have been identified in numerous studies, insufficient funding, investment, and incentives have curtailed the industry's ability to address them. As a result, many formal sector manufacturers have terminated their operations. Due to Kenya's unfriendly business climate and the presence of a strong second-hand market, there are only a few, if not any, new investments entering Kenya.

Table 8: SWOT analysis of the leather industry in Kenya

| | | INTERNAL | | | |
|----------|---|--|------------|--|----------|
| | | STRENGTHS | WEAKNESSES | | |
| POSITIVE | <ul style="list-style-type: none"> • Abundant livestock • Tradition in leather industry • A number of functioning tanneries • Creative and resilient workforce • Abundant labour • Self-organized cluster in Kariokor Market | <ul style="list-style-type: none"> • Low quality hides & skins due to diseases, branding and scratches • Poor husbandry practices • Poor equipment and fraying in abaitois • Low awareness for the value of hides / skins among general population • Poor finishing due to lack of machinery • High electricity cost and tarrif on importing inputs • Lack of quality finished leather available locally • Lack of quality standard • Lack of skilled artisans and training programs • Lack of capacity to meet bulk order • Lack of funding, investment and R&D • Lack of Kenyan leather brand recognition globally • Lack of marketing channel / platform • Unfriendly business climate - Electricity / Tariffs / Corruption • High concentration of tanneries near Nairobi area and poor infrastructure hindering the industry to take advantage of rich livestock pool in rural areas | | | NEGATIVE |
| | | OPPORTUNITIES | THREATS | | |
| | <ul style="list-style-type: none"> • Big pool of willing young labour • Growing informal sector • Growing number of designers • Rising middle class • Increasing Government support • Enforcement of environmental standard in China requiring more processed leather import • Expected job loss in China's manufacturing due to the weakening competitiveness in manufacturing sector • Lack of vibrant leather product industry in neighboring countries • Strengthening trade among EAC | <ul style="list-style-type: none"> • Growing competition coming from Ethiopia and China • High dependency on imported components • Spread of Ebola virus hindering regional buyers from travelling to Kenya • Market share and power concentrated in one tannery promoting imbalance and monopoly • Strong presence of second hand products • Increase in negative externality (environment) • The biggest, long standing shoe manufactures gradually decreasing leather shoe production in Kenya • Lack of communication, collaboration, and knowledge sharing among industry stakeholders • Lack of communication/cooperation among diferent government institutions • Lack of capacity and funding in leather industry institutions | | | |
| | | EXTERNAL | | | |

On the contrary, some niche markets have developed in the midst of the growing operation cost and competition. A number of new generation, small-scale enterprises producing high-end leather bags have sprung up as described in Chapter 3. Also, spearheaded by large pool of experienced informal sector leather good producers, the informal sector (*Jua Kali*) has demonstrated a strong prospect for growth (will be discussed in more detail below).

Furthermore, as described in the “Opportunities” section of the SWOT table, a number of favorable domestic and international factors create a window of opportunity for the Kenyan leather industry. It is important to note that no country has developed its leather industry into globally a competitive one without dealing with multiple constraints. The rapidly developing leather

sectors of Vietnam, India, and Ethiopia have all shared challenges similar to the ones Kenya is currently facing. Kenya has the significant advantage, however, of being able to learn from their experiences.

SWOT analysis of informal sector (*Jua Kali*)

A SWOT Analysis of the informal sector in Kenya reveals additional weaknesses but also additional strengths. The primary challenge facing the informal sector is its limited capacity to access markets. This burgeoning, self-organized, informal leather products cluster, which is *Jua Kali*, already supplies a great amount of leather products both locally and regionally. However, the distribution channels through which it markets its products are myopic, limited in market range, and ineffective in transferring information about the needs

and requirements of broader markets and potential customers with specific needs back to producers. Leveraging existing distribution channels, already operating in the formal sector, and building new distribution channels based on internet market methods are strategic priorities for realizing the enormous untapped potential of the *Jua Kali* sector.

Kenya has a vibrant informal, leather products sector mainly concentrated in Kariokor Market in Nairobi, as described in detail in Chapter 3. In spite of its internal constraints and industry-wide challenges, the informal sector has demonstrated a high degree of resilience. It remains competitive and continues to export a great amount of finished leather products to regional countries.

Three priority issues must be addressed in order to unlock its greater potential:

- a. **Artisans in the informal sector need access to fundamental machinery** to improve product quality and production efficiency.
- b. **The informal sector is in need of representation.** A number of small groups exist but the current arrangement lacks scale, leadership, management, and a concerted voice to have any bargaining power against other players in the leather supply chain. As a result, other leather industry players often take advantage of them. They struggle to procure high quality leather and are often left with rejects that tanneries failed to export. Having representation will thus allow them to build a stronger and balanced linkage with formal sector players.

Table 9: SWOT analysis of the informal (*Jua Kali*) leather sector in Kenya

| | | INTERNAL | | | |
|----------|--|--|--|---|----------|
| | | STRENGTHS | | WEAKNESSES | |
| POSITIVE | | <ul style="list-style-type: none"> • Big labor pool • Experienced and creative labor force • Self-organized cluster (Kariokor Market) • One-stop leather product market • Affordable products / Cost competitive • Fluid labor sharing among informal sector artisans / stores • Kariokor Market recognized by many regional stakeholders | | <ul style="list-style-type: none"> • Lack of proper training and technology • Lack of design capacity and slow in adapting to new designs • Lack of highly skilled artisans • Poor finishing due to the lack of machinery • Lack of differentiations in products • Poor tools / equipments • Unorganized and limited space • Poor working environment • Lack of distribution channel • Lack of marketing • Lack of brand | NEGATIVE |
| | | OPPORTUNITIES | | THREATS | |
| | | <ul style="list-style-type: none"> • Growing pool of willing young labor • Lack of vibrant leather shoe industry in neighboring countries • Strengthening trade among EAC members • Great potential to become a strong and competitive cluster | | <ul style="list-style-type: none"> • Growing competition from Ethiopia and China • Many shoe components imported • Spread of Ebola Virus hindering regional buyers from traveling to Kenya • Strong presence of secondhand products • Weak linkage with formal leather industry • Lack of representation & association • No bargaining power over tanneries | |
| | | EXTERNAL | | | |

c. **Lastly, an external push in terms of marketing and business management skills will allow the informal sector to expand its reach and grow in size.** Informal sector producers lack the capacity to expand their marketing and distribution channels. While the finished products from the informal sector are competitive, and the name of the Kariokor Market is widely known, average Kenyans are not familiar with its products. Expanding its reach will allow this subsector to grow drastically. Some of its high performing producers could even graduate from the informal sector and move into the formal sector.

Addressing these three small challenges could enable the already vibrant informal sector to capture a bigger market share, generate higher income, and create more employment opportunities. It is critical for the government to acknowledge and support this competitive subsector.

4.2 BENCHMARKING AND GAP ANALYSIS

A benchmarking and gap analysis enables a comparison of Kenya’s competitiveness in leather and leather products with those of key competitors. Our benchmarking exercise focuses on four tiers of global competitors, each represented by one country:

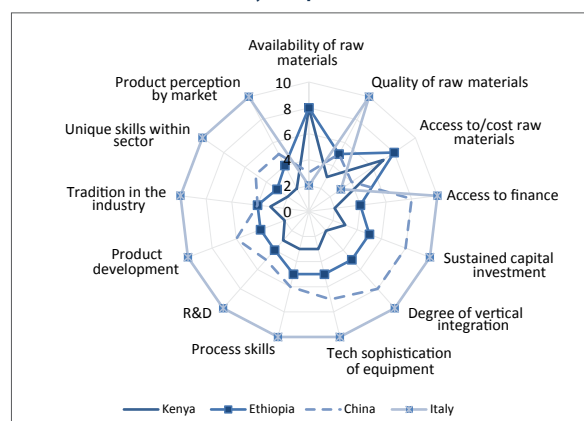
- a. **Italy**—representing global leaders in high quality leather products such as Germany, France, UK;
- b. **China**— the dominant world producer of leather products and representing low-cost producers of leather products such as Vietnam, India, Indonesia;

- c. **Ethiopia**—an emerging global player in leather and African competitor of Kenya;
- d. **Kenya.**

This primary research employed a modified Delphi Approach,⁵² which entailed surveying a number of leather experts, policy makers, and business leaders in the Kenyan leather industry to rate each tier for each category on a scale of 1 to 10 (10 being the most advanced/highest).

Selected experts were asked to compare Kenya’s leather industry performance against that of the three representative countries. Ten competitiveness factors were chosen based on key competitiveness indicators for the leather industry.⁵³ The results are depicted in the following spider diagram.

Figure 26: Spider diagram benchmarking Kenya’s leather industry competitiveness



Source: ETG estimations based on the modified Delphi Method

Kenya’s leather industry, despite having a history of being a major export industry in the past few decades, not only falls behind Italy and China, but also Ethiopia in every category, except availability of raw materials and access

⁵² University of Illinois Extension. "Modified Delphi Technique." <http://www.communitydevelopment.uiuc.edu/sp/Step6/Delphi%20Technique.pdf>

⁵³ World Bank, (2011), "Comparative Value Chain and Economic Analysis of the Leather Shoe Sector (Sheepskin Loafers) in Ethiopia, Tanzania, Zambia, China and Vietnam," Chapter IV in Light Manufacturing in Africa: Focused Policies to Enhance Private Investment and Create Millions of Productive Jobs, Volume II.

to raw materials. While the availability of raw materials is a significant competitive advantage, this advantage is severely reduced because of Kenya's very low quality of raw materials, ranking two points beneath that of Ethiopia. Moreover, Kenya's access to its raw materials is further compromised by the high levels of unreported smuggling of its raw hides and skins. In comparison to more established countries, Kenya significantly lacks sustained investment in both human resources and technology. A number of training facilities in Kenya are currently underutilized due to lack of funding and the majority of Kenyan artisans working in the industry have never received formal training. Access to finance is also limited and hinders the capacity of SMEs to advance to the next level.

Furthermore, this analysis highlights the competitive difference between Kenya and Ethiopia. Ethiopia's leather industry has grown significantly and systematically over

the last decade, and Ethiopia has done an excellent job in creating a platform for foreign investment. For instance, Ethiopia recently successfully attracted a major Chinese shoe manufacturer, the Huajian Group, which built a facility that produced two million pairs of shoes in 2013.⁵⁴ Ethiopia's success is rooted in strong support and investment by the Ethiopian government. For example, Ethiopia's Leather Industry Development Institute (LIDI) has been supporting the industry players in areas such as designing, production, training, marketing, and quality control. Ethio-International Footwear Cluster Co-operative Society, Ltd. (EIFCCOS), which is a footwear cluster consisting of informal sector producers and SMEs, has been working closely with the government and banks to secure loan opportunities for its producers. Ethiopia has distinguished its leather industry from that of Kenya and is now positioning itself as a promising player in the global market.

Table 10: Competitive benchmarking of Kenya's leather industry vs. Ethiopia, China, and Italy (scale of 0-10)

| Competitiveness factors | Kenya | Ethiopia | China | Italy |
|---|-------|----------|-------|-------|
| Availability of raw materials | 8 | 8 | 3 | 2 |
| Quality of raw materials | 3 | 5 | 5 | 10 |
| Access to raw materials | 7 | 8 | 4 | 3 |
| Access to finance | 2 | 4 | 8 | 10 |
| Sustained capital investment | 3 | 5 | 8 | 10 |
| Degree of vertical integration | 2 | 5 | 8 | 10 |
| Technological sophistication of equipment | 3 | 5 | 7 | 10 |
| Process skills | 3 | 5 | 6 | 10 |
| R&D | 3 | 4 | 5 | 10 |
| Product development | 2 | 4 | 6 | 10 |
| Long-standing tradition in the industry | 3 | 4 | 4 | 10 |
| Unique skills within sector | 2 | 3 | 5 | 10 |
| Product perception by market | 2 | 4 | 5 | 10 |

Source: ETG estimations based on the modified Delphi Method

⁵⁴ Bloomberg, (2014), "Ethiopia Becomes China's China in Search for Cheap Labor," July 23. <http://www.bloomberg.com/news/2014-07-22/ethiopia-becomes-china-s-china-in-search-for-cheap-labor.html>

4.3 VALUE CHAIN ANALYSIS

The value chain analysis contained in this section compares the relative competitiveness of Kenya and Ethiopia's leather sectors. It assesses the difference in resource requirements and productivity associated with the processes to transform raw inputs into finished products for consumers or into intermediate inputs used in the manufacturing processes of other producers.

Average costs for different production activities in Kenya are compared with activity costs found in Ethiopia.⁵⁵ Ethiopia was selected for this benchmark analysis because it is currently at a comparable level of industry development and is likely to pose significant competition in regional markets.

By comparing unit activity costs between Kenya and Ethiopia, we can identify critical functions within Kenyan supply chains whose efficiency is either a source or a retardant of competitive advantage. This analysis allows us to identify specific functional constraints that limit the ability of the Kenyan leather industry to compete on a cost basis. The SWOT analysis presented above identified other non-cost constraints, which inhibit value creation within the sector.

Information produced from value chain analysis is critical for the sector stakeholders, as well as the government and its institutions.

Once cost and productivity constraints are identified, policy makers can work with respective stakeholders to address them.

Kenya's leather industry value chain

As identified in Figure 21 in Chapter 2, Kenya's leather industry value chain is depicted according to its three component functions: (i) livestock breeding; (ii) raw hides & skins production; and (iii) leather and leather goods production. Due to the extensive analysis on livestock breeding and raw hides and skins clusters in other reports,⁵⁶ our analysis focuses on the leather tanning and leather products functions.

Tanning subsector

Tanning is a critical subsector in the leather industry. The efficiency and input cost competitiveness of this subsector determines the cost competitiveness of semi-finished and finished leather. Currently 14 tanneries operate in Kenya. However, only four or five produce finished leather.

Table 11 illustrates the relative costs of producing leather in Kenya and Ethiopia. While not precisely comparable, because comparing cattle hide tanning in Kenya is not identical to sheepskin tanning in Ethiopia, this data provides a useful set of metrics for comparing relative input costs in the two countries.

⁵⁵ By having a benchmark we can assess the competitiveness of the current Kenyan leather industry vis-à-vis other global competitors. We chose Ethiopia as our reference point due to its proximity and similarities with Kenya in three areas. First, the strengths and weaknesses of the leather industries in Ethiopia and Kenya bear similarity. Their competitiveness derives primarily from abundant livestock (raw material) and relatively cheap labor cost. Both countries lack advanced technology or productivity. Second, both countries mostly produce low-cost leather products. Third, they are in the same region and are competitors for markets in the region. Also, Kenya could emulate Ethiopian policies and initiatives, which led to the industry's highly successful transformation.

⁵⁶ Alfred M. Muthee, (2008), "Integrated Value Chain Analysis of the Leather Sector in Kenya," MSME Competitiveness Project, Ministry of Trade and Industry, The World Bank.

Table 11: Comparative costs of tanning leather in Kenya and Ethiopia

| Inputs | Kenya (Processing 1 kg of hide) | | Ethiopia (processing 1 sq. ft. of sheep skin)* | |
|----------------------------|------------------------------------|------------|---|------------|
| | Total cost (US\$) | Total (%) | Total cost (US\$) | Total (%) |
| Raw materials | 1.16 | 72 | 0.42 | 59.0 |
| Chemicals | 0.32 | 19 | 0.08 | 11.0 |
| Labor | 0.04 | 2 | 0.02 | 3.3 |
| Electricity | 0.03 | 2 | 0.03 | 1.5 |
| Effluent treatment | 0.04 | 3 | 0.01 | 0.9 |
| Utilities | N/A | N/A | 0.01 | 1.6 |
| Depreciation | N/A | N/A | 0.01 | 1.5 |
| Marketing/ Distribution | N/A | N/A | 0.03 | 4.3 |
| Overhead | 0.02 | 1 | 0.10 | 14 |
| Total | 1.60 | 100 | 0.72 | 100 |

Source: ETG Primary Research for Kenya,
* Ethiopia Value Chain Analysis (2006)

Raw materials (raw hides and skins) represent the highest cost input in the tanning process for both countries. Yet, raw material costs are significantly higher in Kenya at 72 percent, vs. 59 percent in Ethiopia. The second most costly input is chemicals, which represent 19 percent of total costs in Kenya vs. only 11 percent in Ethiopia. Labor accounts for only 2 percent of total cost for Kenya, and is 3.3 percent in Ethiopia. The next most important cost is effluent treatment, which in Kenya accounts for 3 percent of total costs, and is three times higher than in Ethiopia.

The high cost of raw materials and chemicals for leather tanning in Kenya relative to Ethiopia represents the most significant competitive challenge for Kenya. Surface treating agents are available under EAC duty remission for tanneries which export. However, provisions of the EAC Customs Union Protocol erode its usefulness: tanneries which sell to the EAC cannot fully utilize the scheme because they are obligated to cede the EAC market in return. Conversely, in

Ethiopia imported chemical for tanning are said to come in duty-free.

Regarding the high cost of raw materials, many other previous reports have documented the importance of improving incentives for downstream providers of raw materials (from herdsman and abattoirs). Similar policy recommendations are included in Chapter 5 of this report.

Footwear and leather products subsector

Kenya's footwear and leather products cluster was once dominant in East Africa. However, Ethiopia has made tremendous productivity gains in recent years, and now surpasses Kenya in terms of its competitiveness as Table 12 shows. Overall, it is more expensive to produce a pair of low-cost, men's leather shoes in Kenya than in Ethiopia. In Kenya, the cost is US\$9.44 vs. Ethiopia's ability to make a pair of loafers for US\$7.28.

Table 12: Comparative costs of producing a pair of low-cost shoes (Kenya) vs. loafers (Ethiopia)

| | Kenya | | Ethiopia | |
|---------------------|-------------|--------------------|-------------|--------------------|
| | Cost (US\$) | Percentage of cost | Cost (US\$) | Percentage of cost |
| Leather (Sheepskin) | 4.40 | 47 | 3.72 | 51 |
| Other Inputs | 2.75 | 29 | 2.27 | 31 |
| Labor | 1.10 | 12 | 0.55 | 8 |
| Electricity | 0.17 | 2 | 0.03 | 0 |
| Packaging | 0.39 | 4 | 0.31 | 4 |
| Maintenance | 0.09 | 1 | 0.06 | 1 |
| Other Costs | 0.55 | 6 | 0.34 | 5 |
| Total | 9.44 | 100 | 7.28 | 100 |

Source: ETG Primary Research for Kenya data and Global Development Solutions, LLC for Ethiopia data

Kenya's lack of cost competitiveness results from several factors. Our data reveals that three major constraints disadvantage Kenyan producers:

- **Cost of leather inputs:** The procurement of finished sheepskin account for almost 50 percent of the total cost in both countries. However, it is more expensive in Kenya than in Ethiopia. First, industry leaders point to smuggling as a key reason for the cost driver. Local tanneries have to compete against smugglers and end up paying extra to raw hide and skin traders. Second, there are many inputs such as chemicals and even machinery that are imported and subject to tariffs. Third, tanning is a subsector that requires a great amount of water and electricity. Kenya has a reputation for an unfriendly business climate due to its high electricity cost.
 - **Cost of Labor:** Although Kenya has a relatively competitive labor cost compared to more developed countries such as China, it still is higher than its regional competitor. The current state of high wages is not driven by shortage of labor. In fact, Kenya has an unemployment rate that goes beyond 40 percent. Neither is the higher wage driven by higher productivity. Industry pundits blame ceremonial wage increments for driving up the wage cost and thus, making light manufacturing industries uncompetitive.⁵⁷ Kenya's current average wage cost is US\$150 compared to between US\$40 and US\$60 in other Sub-Saharan African countries. Ethiopia's labor costs are one third of that of Kenya.⁵⁸ Also, lack of modern machinery and facilities severely limits efficiency and productivity.
 - **Productivity:** Despite Kenya having an average wage cost of US\$150, compared to US\$50 in Ethiopia, Table 12's costs comparison shows that on average, the Kenyan labor cost is twice as high as that of Ethiopia in making a pair of men's leather shoes. This indicates a higher productivity level among Kenyan leather shoemakers. However, given the insignificant level of formal training and knowledge dissemination observed in the Kenyan leather industry, Ethiopia is likely to close the gap in the near future. Ethiopian LIDI trains hundreds of students every year in their facility. Foreign investors operating in Ethiopia are also investing heavily to boost productivity. Huajian, for example, has been sending a number of workers to China not only for technical trainings, but also for managerial trainings.⁵⁹ Thus, Kenya's advantage in productivity is likely to diminish in the near future, if it has not declined already.
- In comparison to other international and regional players (China and Tanzania), another report indicates that Ethiopia's cost competitiveness is primarily due to its low cost of labor and the low cost of locally available sheepskin.** As shown in Table 13, the cost of raw material inputs in Ethiopia for producing a pair of loafers is only US\$3.72, compared to US\$4.00 in Tanzania and US\$5.85 in China.⁶⁰

⁵⁷ The Kenyatta government has repeatedly raised minimum wage by 14 percent to support its constituents in times of increasing living costs in Kenya. Manufacturing stakeholders, including the Kenya Association of Manufacturers, argue that this critically damages competitiveness of the already constrained Kenyan manufacturing industry. <http://www.kam.co.ke/index.php/opinion-pieces/439-industry-says-yes-to-productivity-based-wage-increments>

⁵⁸ Daily Nation, (2015), "High energy, labour costs bane of industrial growth," January 19. <http://www.nation.co.ke/lifestyle/smartcompany/High-energy-labour-costs-bane-of-industrial-growth/-/1226/2594554/-/qtaot5/-/index.html>

⁵⁹ China Daily, (2014), "Puttin its Best Foot Forward", December 9. http://africa.chinadaily.com.cn/weekly/2014-09/12/content_18587359.htm

Table 13: Comparisons of raw material inputs for producing a pair of loafers in Ethiopia, Tanzania, and China

| | Ethiopia | | Tanzania | | China | |
|---|----------|------------------|----------|------------------|----------|------------------|
| Raw material as a percentage of the value chain | 51% | | 72% | | 36% | |
| Total cost of raw material inputs/pair | US\$5.99 | % of Total Input | \$7.19 | % of Total Input | US\$9.22 | % of Total Input |
| Sheepskin (cost/pair) | US\$3.72 | 62% | \$4.00 | 56% | US\$5.85 | 63% |
| Other inputs (cost/pair) | US\$2.27 | 38% | \$3.19 | 44% | US\$3.36 | 36% |

Source: Global Development Solutions, LLC (2011)

Kenya can strive to achieve key competitiveness advantages that Ethiopia has achieved with respect to low labor and input material costs, and quality in relation to formidable international players in the leather footwear market such as China and Vietnam. Ethiopia has relatively low labor costs (skilled: US\$41–US\$96/month; unskilled: US\$16 – US\$33/month), which is two to three times lower for skilled labor and 14 times lower for unskilled labor when compared to China. Ethiopia’s low cost of locally available sheepskin also plays an important role in contributing to the low unit production cost of loafers in Ethiopia. The cost of sheepskin is only US\$3.72/pair (62 percent of total cost of shoe), vs. US\$4 in Tanzania, and US\$5.85 in China.

Cost of production for other leather footwear products in Kenya

For Kenya’s footwear and leather products cluster, recent cost estimates for the production of boots—military, security, and industrial—by producers in the formal sector are shown below. In boot production, leather is the most costly input accounting for 57 percent and 56 percent in military and security boots, and 45 percent for industrial boots, for which the quality of leather can be lower. Other boot input components—soles, insoles, laces, glue, and metal—are the next most costly inputs, accounting for 29 percent in the case of military and security boots, and 41 percent for industrial

boots, due to the high cost of metal toe inputs. Labor inputs account for 8 percent of total production costs, and electricity costs range between 2-3 percent.

Table 14: Breakdown of costs involved in producing boots in Kenya (Formal sector)

| | Military boots | | Security boots | | Industrial boots | |
|-------------|----------------------|-----|----------------------|-----|--------------------|-----|
| | Cost (KSh) | % | Cost (KSh) | % | Cost (KSh) | % |
| Leather | 725 | 57 | 695 | 56 | 550 | 45 |
| Soles | 280 | 22 | 280 | 22 | 280 | 23 |
| Insoles | 15 | 1 | 15 | 1 | 15 | 1 |
| Thread | 10 | 1 | 10 | 1 | 8 | 1 |
| Laces | 10 | 1 | 10 | 1 | 8 | 1 |
| Glue | 48 | 4 | 48 | 4 | 48 | 4 |
| Labor | 100 | 8 | 100 | 8 | 100 | 8 |
| Electricity | 32 | 2 | 32 | 3 | 32 | 3 |
| Metal | 0 | 0 | 0 | 0 | 130 | 11 |
| Other | 62 | 5 | 62 | 5 | 62 | 5 |
| TOTAL | 1,282 (US\$14.10) | 100 | 1,252 (US\$13.77) | 100 | 1,233 (\$13.56) | 100 |

Source: ETG Primary Research

Costs of production in the informal sector (Jua Kali)

The cost of making a pair of men’s dress shoes that is sold for KSh 800 (US\$8.80) in Nairobi’s Kariokor Market is KSh 600 (US\$6.60). As shown in Table 15, leather inputs account for 47 percent, other material inputs for 37 percent, and labor accounts for 17 percent (US\$1.10).

⁶⁰ Global Development Solutions LLC (2011).

Table 15: Breakdown of costs involved in producing men's dress shoes in Kenya (Informal sector)

| Components | Cost (KSh) | Cost (%) |
|------------------------------|------------|------------|
| Leather (2 sq. ft. required) | 280 | 47 |
| Buckle (imported) | 10 | 2 |
| Soles (imported) | 200 | 33 |
| Lining | 10 | 2 |
| Labor | 100 | 17 |
| Total | 600 | 100 |

Source: ETG Primary Research

The costs of making a pair of Safari Boots that sells for KSh 500-550 is shown in Table 16. The cost of leather inputs (simple tanned and finished split hide) is significantly less than that for industrial boots in the formal sector, and for men's dress shoes in the informal sector. The cost of labor in making men's safari boots is slightly lower than for making men's dress shoes. Producers point out that men's safari boots are relatively easier to make.

Table 16: Breakdown of costs involved in producing men's safari boot in Kenya (Informal sector)

| Components | Cost (KSh) | Cost (%) |
|------------------|------------|------------|
| Leather (0.5 kg) | 100 | 25 |
| Soles (Kenyan) | 170 | 43 |
| Lining | 10 | 3 |
| Welt | 20 | 5 |
| Strings & eyelet | 15 | 4 |
| Labor | 80 | 20 |
| Total | 395 | 100 |

Source: ETG Primary Research

One of the reasons that KM (informal sector) has continued to engage in such a high level production of leather footwear (estimated to produce more than 2 million pairs/year) is due to the profit margins obtained in producing school shoes, sandals, and belts. As shown in Table 17, profit margins for school shoes are estimated at the US dollar equivalent of US\$1.10 for a pair of school shoes, US\$1.93 for a pair of sandals, and US\$0.83 for a belt.

Table 17: Profit margins for producing school shoes, sandals, and belts (Informal sector)

| | School shoes (KSh) | Sandals (KSh) | Belts (KSh) |
|--------|--------------------|---------------|-------------|
| Cost | 300 | 275 | 85 |
| Sale | 400 | 450 | 150 |
| Profit | 100 | 175 | 75 |

Source: ETG Primary Research

4.4 COMPETITIVE POSITIONING ANALYSIS OF KENYA'S LEATHER PRODUCTS

Kenya's relative competitiveness in leather products has declined substantially since it won preeminence as East Africa's leading footwear producer during the 1980s. It is important to assess Kenya's position today relative to other competitors and identify opportunities to reposition the nation's leather product industry in order for it to move into higher value-added markets and to increase its share in those markets.

No African countries are significant players in either the fine leather or the footwear markets. Despite owning a fifth of the global livestock population, African countries account for only 4 percent of world production and 3.31 percent of value addition. Most African countries, including Kenya, are basically exporters of raw hides and skins and of wet blue leather. With that said, several African countries, including Tunisia, Morocco, Egypt, and Ethiopia, have been positioning themselves for what observers agree will be a significant supply shortage of leather based footwear and other leather products by the end of the next decade. Several strategies have emerged among African countries vying to capture this large footwear market. They all involve creating incentives, investing in human capital, and creating new value chain building institutions and trade policies designed to push and pull private manufacturers to add more

skilled labor content to their abundant livestock resource base, thus moving up the value chain.

Men's footwear

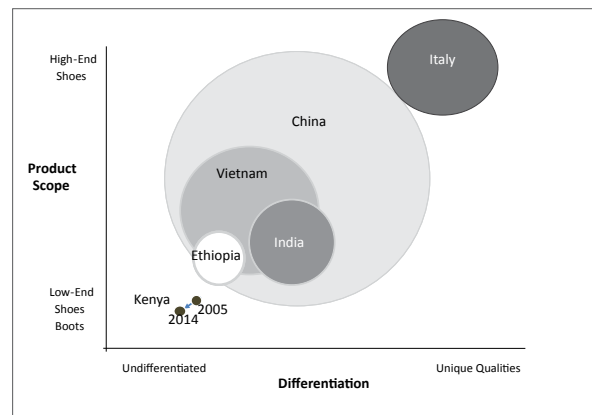
In the global context of footwear exports, Kenya's position is negligible with only US\$2.8 million in sales in 2013 (up from US\$0.5 million in 2008). Compared with the world's largest players, China (US\$50.8 billion), Italy (US\$11.8 billion), Vietnam (US\$11.6 billion), Kenya does not even appear on the same radar screen. Even in comparison with its African neighbor Ethiopia (US\$23.5 million), Kenya's production base is minimal.⁶¹

Men's footwear markets are highly price sensitive and the enormous economies of scale realized in China, Italy and Vietnam allow manufacturers in these countries to realize significant production cost advantages, not only from lower input costs, but also from large production learning costs. One shoe manufacturing center in China, for example, produces more shoes for export than all manufacturers manage to produce in all of Sub-Saharan Africa. In addition to low production costs, however, three additional factors are essential for repositioning Kenyan producers in global markets: (i) market responsive product designs; (ii) highly skilled labor inputs; and (iii) access to efficient distribution channels which preserve margins for producers selling into specific target markets.

Figure 28 depicts Kenya's starting position as a producer of leather footwear for the current period, 2014. The size of the bubbles in the diagram correspond to the scale of production among global market leading countries. Kenya is a minor player with respect to the leading producers and exporters of leather footwear.

China is the dominant world producer of leather footwear, accounting for more than 60 percent of world production and 40 percent of world exports (US\$50.8 billion). Italy and Vietnam are the second and third largest exporters, exporting US\$11.8 billion and US\$11.6 billion respectively. In contrast, Ethiopia exported US\$23 million, and Kenya only US\$1.2 million in 2013.⁶² Italy by far produces the most sophisticated, high-end shoes, and has high levels of product differentiation, with unique qualities, branding, etc. China occupies the middle of the diagram and dominates in all but the high-end where Italy and other European producers have competitive advantage. Vietnam is rapidly conquering the competitive space in low-end to mid-level quality footwear, especially as a low-cost contractor for brands. Ethiopia is emerging as a new world player, due to low cost labor and stable business climate. It has also been attracting an increasing number of foreign investors as a production site to enter into the EU market and the US market through the AGOA program. Kenya has been a relatively small player since 2005. As Bata's production of low-end men's leather shoes for the domestic market have decreased in the last few years, and its export of leather shoes into the East African

Figure 27: Competitive position of Kenyan leather footwear (2014)



Source: ETG

⁶¹ World's Richest Countries, http://www.worldsrichestcountries.com/top_footwear_exporters.html

⁶² Ibid.

market has declined, Kenya's competitive position has been driven to low-cost producer of undifferentiated low-end shoes and boots.

Kenya's position depends on three critical success factors: market relevant design, skilled labor, and efficient distribution channels, as well as representing the kinds of economies of production that result from large volume. What can be inferred from this diagram is that the most successful strategy for growing Kenya's position in the low-end shoes and boots market is to concentrate on developing markets and to grow corresponding distribution channels within Eastern and Southern Africa. Prospects are most attractive in those segments where market responsive product designs already exist. Work boots, African-style safari footwear, and school-age children's shoes, for example, meet this description. This strategy needs to be based on the realization of economies of scale and economies of scope.

Economies of scale are realized when average production costs are lowered as production volume increases. There are two types of economies of scale: (i) Internal economies which result from cost savings that accrue to individual companies. Learning curve related cost reductions fall into this category; and (ii) External economies which benefit individual companies because of the way in which the larger industry is organized around individual companies. External economies of scale are created, for example, when overhead costs are shared among multiple producers. They are realized when water treatment costs are shared and when design and development are shared. Mergers between leather tanneries, as well as the outsourcing of specific functions within integrated supply chains are viable sources of economies of scale.

Economies of scope are realized when multiple products are sold into the same target markets via single multiproduct distribution channels.

Economies of scope make it cheaper to produce a range of products together rather than to produce each one of them on its own. For example, if leather wallet producer X expands the scope of his production into leather bags, folders, and other corporate items, he can diversify his products and reach a larger audience by utilizing the same equipment, similar input, and the same distribution and logistics channel. As a result, producer X can now market himself as a leather goods producer rather than merely a leather wallet producer. This will likely reduce the costs per unit.

Such economies can also be realized from cooperative interrelationships created within supply chains and from other forms of commercial partnering, such as cross-selling one product alongside another, or using the outputs of one business as the inputs for another. Economies of scope are best realized through strategic cooperation among and between competitors, which result in win-win outcomes.

In the context of global footwear markets, enormous economies of scale and of scope have already been realized in China, India and Vietnam, and these will be difficult for Kenyan manufacturers to match. In order to achieve low cost parity, Kenyan production costs need to be lowered significantly—achievable through a combination of internal and external improvements—at the same time that product quality is increased measurably.

In order to serve markets in which competitive advantage can best be secured for a resurgent Kenyan footwear industry, Eastern and Southern Africa footwear markets need to be

become the industry's primary focus. To this end, new products need to be designed for these markets and new distribution channels developed into them. Currently, only one Kenyan shoe manufacturer, Bata Shoes, has access to a broad network of shoe distribution outlets through its own affiliated stores located all over East and South Africa.

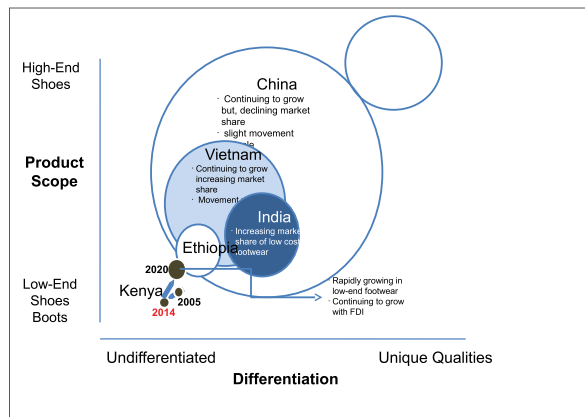
Figure 29 reflects Kenya's changing competitive position in world footwear, projecting into 2020. Most of the dominant world players have grown and shifted upward and to the right, reflecting improvements in quality, differentiation, and product scope. Italy is further consolidating its position in the upscale footwear market. Meanwhile, China, due to rising labor costs, faces increasing competitive pressures particularly from Vietnam, and is forced to move upscale. Ethiopia continues to grow rapidly as a strong base for FDI-driven low-end footwear. Kenya continues to grow and compete vigorously with Ethiopia for market share in both its own domestic market and the East African market.

Specialty leather products

The market for personal leather products, other than shoes, encompasses an extremely large number of product categories, includes a wide diversity of styles and designs and is accessible via a diverse set of distribution channels serving an equally diverse set of micro-niches. Kenya currently exports less than US\$2.2 million worth of these leather products. By way of comparison, global leaders China and Italy exported handbags and other leather products, worth US\$26.7 billion and US\$6.5 billion, respectively in 2013.⁶³ Vietnam and India export US\$2 billion and US\$1 billion, respectively.

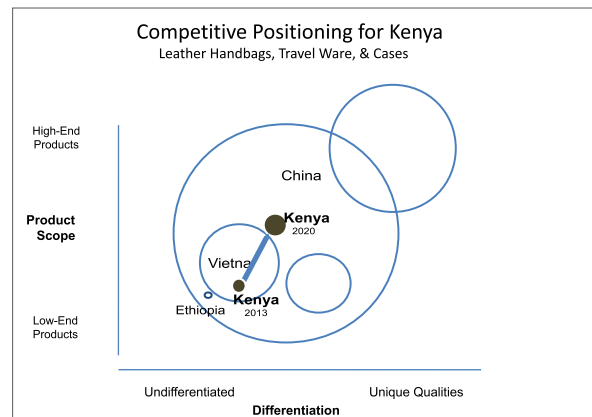
Whereas Kenya's initial competitive position in the handbag and other specialty leather products market is similar to that of footwear market (competitively disadvantaged in cost, quality and design, because of the enormous diversity and complexity of this niche), the country's strategy can be different. And indeed, Kenyan producers can compete better in this market once appropriate channels are developed.

Figure 28: Projections of future global competition of leather footwear



Source: ETG

Figure 29: Projections of future global competition in other leather products



Source: ETG

⁶³ UN Comtrade, 2013.

The quality reputation and name recognition of local producers of handbags, travel ware, and cases is low. With that said, handmade, distinctive African designs produced by small-scale manufacturers is growing in the safari tourism niche. Sandstorm Kenya and Rift Valley, for example, have carved out places in this market niche with its distinctive brand. The sources of competitive advantage that Kenya possesses include a strong tradition of craft ware design and handcrafted manufacture production.

Analysis suggests that unlike the leather footwear sector, where Ethiopia commands dominant global market presence over Kenya, in the case of leather handbags, travel ware, and cases, Kenyan products (US\$2.2 million) were almost quadruple the export size of that of Ethiopia (US\$0.57 million) in 2013. As discussed in Chapter 3, many new leather bag brands have appeared, targeting a large tourist base in Kenya over the last decade. Despite decreases in the number of tourists visiting Kenya due to the rising insecurity, the reputation of its products allows Kenya to continue to outperform Ethiopia. High numbers of expats and tourists in previous years have helped to establish Kenya's reputation and enabled it to reach a sufficient scale to continue to produce high quality handbags. Players such as Sandstorm Kenya and Rift Valley Leather, although small, show strong potential.

The potential exists to build on these successes and to double or triple exports of hand bags, travel ware, and cases by 2020 by improving quality and building the "made in Kenya" brand distinction. This strategy would entail the following steps: (i) create a mass customization delivery capacity; (ii) invest in advanced leather

product design skills and capacities; (iii) link up ICT companies which can facilitate internet sales with artisan producers of leather goods located in the EU and USA; and (iv) facilitate cross-selling between the tourism industry and the specialized leather manufacturing sector.

4.5 KEY FINDINGS FROM CHAPTER 4

The main findings of the competitiveness analysis presented in Chapter 4 include the following:

- Kenya, despite having a history of leather as one of its major export industries, is currently a minor exporter of leather and leather products (only US\$95 million in 2013). Kenya is also significantly less competitive than global leaders including Italy, China, and Vietnam in all competitiveness indicators, except availability of raw materials and access to raw materials, but also lags behind neighboring Ethiopia in access to raw materials.
- The most significant competitive disadvantage, which Kenya producers have is their lack of market access and sophisticated marketing capabilities. These disadvantages manifest themselves in several ways: (i) a failure to understand the product design preferences of target markets; (ii) the lack of proprietary brands; (iii) the lack of dedicated distribution channels; (iv) a failure to engage internet based modes of marketing; and most importantly, (v) a failure to invest in quality inputs and quality processing technology with which to open high-end markets. Most of these issues transcend the parameters of traditional leather producers and require industry restructuring, strategic cooperation, and/or industry group action.

- For the tanning subsector of the leather value chain, the high cost of raw materials and chemicals in Kenya relative to Ethiopia, represents the most significant competitiveness challenge for Kenya.
 - In the footwear subsector, Kenya has been a relatively small player since 2005. As Bata's production of low-end, men's leather shoes for the domestic market have decreased in the last few years, and its export of leather shoes into the East African market has declined, Kenya is now characterized a low-cost producer of undifferentiated low-end shoes and boots.
 - In the footwear subsector, Kenya's lack of cost competitiveness results from three major constraints disadvantage Kenyan producers: (i) high cost of leather inputs; (ii) high cost of labor; and (ii) high cost of electricity.
 - Ethiopia is emerging as a new world-class player, due to its low cost skilled labor and its stable business climate. It is attracting an increasing number of foreign investors who are using Ethiopia as a production site especially to enter into the EU and US markets, the latter through the AGOA program.
 - In the case of leather handbags, travel ware, and cases, Kenya's exports in 2013 (US\$2.2 million) were almost quadruple the export size of that of Ethiopia (US\$0.57 million). Kenya can build on its previous reputation for quality hand bags, travel ware, and cases by improving quality, building the "made in Kenya" brand distinction, and creating a mass customization delivery capacity.
- Chapter 5 provides a number of strategic responses to the obstacles and constraints to value addition and competitiveness enhancement identified in this chapter.** It builds on assessments and analyses presented in the first four chapters to recommend strategies which fall into one of three areas appropriate to moving Kenya's leather sector from its current low level equilibrium to a higher equilibrium.

IMPLEMENTATION RECOMMENDATIONS AND ACTION PLAN

Based on the analysis and findings of the state of Kenya's leather industry and the competitiveness challenges and opportunities it faces, this chapter provides recommendations for strategic targeting of key products and markets, and puts forward actions to strengthen the competitiveness of the industry. The chapter concludes with a reflection of the risks and benefits of pursuing the targets and implementing the suggested actions.

5.1 STRATEGIC TARGETING OF LEATHER PRODUCTS AND MARKETS

As indicated in the analysis of market opportunities (Chapter 2) and competitiveness positioning analysis (chapter 4), the most promising targets for Kenya's leather industry include the following three key products, with corresponding market thrusts (Table 18).

To increase the competitiveness of the leather industry and accomplish these targeted product-market objectives, strategies and actions are recommended. They have been grouped according to the following framework, which consists of three key strategies, each including several supportive initiatives. Table 18 also matches action initiatives to the three key product/market competitiveness strategies.

The overall strategy and each of these recommended action initiatives address critical binding constraints on the competitiveness of the leather industry. Each recommended action initiative is outlined below. The chapter concludes with projections regarding the number of leather sector jobs that would be created were the recommendations to be implemented. In the Annex a proposed action plan includes a suggested timeline and identifies responsible stakeholders for the implementation and achievement of tangible results.

Table 18: Strategic targeting of Kenyan leather products and markets

| Strategic Products | Strategic Markets |
|-------------------------------------|---|
| Low value added leather footwear | <ul style="list-style-type: none"> • Domestic Market—increase share of domestic leather footwear market, particularly with low-cost men's shoes, low-cost school shoes, and boots. • Regional Market—increase exports to EACs of low cost-men's shoes and boots. |
| High value added specialty products | <ul style="list-style-type: none"> • EU and US Markets—increase exports of specialty leather products, leather handbags, travel ware, and cases, with a focus on EU and US markets. • Domestic and EAC Markets—increase domestic and regional sales, especially safari-type products sold to tourists in Kenya and EAC. |
| Finished leather | <ul style="list-style-type: none"> • China and EU Markets—Increase exports of higher value added finished leather (and crust leather), especially to China and EU. |

Table 18: Leather industry strategy & actions

| | Recommendations to improve the competitiveness of: | | |
|---|--|-------------------------------------|------------------|
| | Low value-added leather footwear | High value-added specialty products | Finished leather |
| Strategy 1: Promote the dynamic restructuring of the leather industry | X | X | X |
| 1.1 Establish a collaborative, stakeholder-driven leather industry strategy implementation process | X | X | X |
| 1.2 Strengthen the Kenya Leather Development Council (KLDC) | X | X | X |
| 1.3 Improve the regulatory framework to reduce production costs and safeguard the environment | X | X | X |
| Strategy 2: Increase access to markets and induce greater demand for Kenyan leather & leather products | | | |
| 2.1 Develop a leather marketing entity to increase awareness, coordinate branding and promote exports | X | X | X |
| 2.2 Design a transparent public procurement policy | X | X | X |
| Strategy 3: Build quality and standards | | | |
| 3.1 Improve the production process, technology and machinery | | | |
| 3.1.1 Establish leather product development accelerators (or “leather wealth creation centers”) | | | |
| i. Nairobi leather accelerator (for formal sector) | X | X | X |
| ii. Kariokor market satellite leather accelerator | X | | |
| 3.1.2 Develop a leather industry park | X | X | X |
| 3.2 Improve Skills | | | |
| 3.2.1 Restructure and upgrade the Training and Production Center for the Shoe Industry (TPCSI) | X | X | |
| 3.2.2 Strengthen university leather design, technology, and marketing capacities | | X | X |
| 3.2.3 Enhance human resource placement services for the leather industry | | X | X |
| 3.3 Encourage quality and enforce standards | | | |
| 3.3.1 Align incentives for quality and promote quality certification systems | X | X | X |
| 3.3.2 Develop leather award and recognition programs | X | X | X |
| 3.3.3 Initiate regional branding of the leather industry to promote specialization | | X | X |
| 3.3.4 Increase enforcement of quality standards for imported leather products | X | X | |

5.2 PROMOTE THE DYNAMIC RESTRUCTURING OF THE LEATHER INDUSTRY BY IMPROVING GOVERNANCE AND STRENGTHENING COLLABORATION (STRATEGY 1)

Due to the highly fragmented structure of the leather industry, the limited linkages among stakeholders, and lack of a coherent and shared competitiveness strategy by the private sector, government, and other institutions, the primary strategy is to consolidate the leather cluster and promote its dynamic restructuring. Several important initiatives are designed to bring this about. These include:

- **Establishing** a leather cluster working group and strategy implementation process;
- **Strengthening** KLDC to orchestrate interventions to accelerate the restructuring of the industry; and
- **Improving** the regulatory framework to reduce production costs and safeguard the environment.

A critical cornerstone for improving of the competitiveness of the leather industry is a well-functioning set of institutions to support the industry, coupled with a strong legal framework and business climate. This strategy recommends that it is critical to strengthen and position KLDC as a driving institutional vehicle to enhance the leather industry's competitiveness.

Establish a collaborative, stakeholder-driven leather industry strategy implementation process

In order to foster linkages and collaboration across the leather industry, it is recommended that Kenya establish a collaborative, stakeholder-driven leather industry strategy

implementation process with a **Leather Cluster Working Group**, composed of about 100 stakeholders across the industry, to participate in the short and long-term development of the industry. The activities of the Working Group are to be implemented as a collaborative, action-oriented clustering process, which while developing a shared vision and strategy and identifying and implementing concrete action initiatives, also builds trust and social capital throughout the cluster.⁶⁴

This strategy implementation process is seen as complementary to the **Leather Task Force**, which can serve as a central steering group for a much larger group of industry stakeholders. In developing this process, the following activities will be carried out:

- **Conduct interviews and meetings** with leaders and develop a comprehensive list of industry leaders and stakeholders to join the Leather Cluster Working Group;
- **Conduct a series of meetings to develop a shared analysis**, vision, strategy, and action plan for the leather cluster using the current analysis and preliminary recommendations report as a starting point for discussion;
- **In the cluster meetings, identify and develop 20-30 concrete action initiatives**, both top-down and bottom-up, with business plan and leadership; and
- **Identify priority initiatives and begin initial implementation**, with preliminary financing support from a Leather Cluster Action Fund (US\$50,000-US\$100,000) to support initial implementation projects/tasks (e.g., feasibility studies, benchmarking trips, etc.).

⁶⁴ Clustering is internationally recognized as the best way to pro-actively address sector development and stimulate economic development (e.g., World Bank, African Development Bank, InterAmerican Development Bank). Clustering is effective because it doesn't only deal with individual companies; instead, it engages entire networks of entrepreneurs, companies, research and educational institutions, government, and other institutions in a coordinated fashion to accelerate competitiveness. Competitiveness is accelerated by supporting the entire value chain to develop, based on knowledge and value added, rather than compete on low costs. Clustering is especially important for small economies like Kenya where the critical mass of individual companies is too small to effectively compete in domestic and international markets.

Clustering should lead to the following important results for Kenya's leather industry:

- a. *It will position Kenya's leather industry subsectors in higher value-added market segments* (shift from low-value export of intermediate wet blue leather to development of higher value-added finished leather, footwear and handbags for domestic and export markets, and shift to knowledge-based development and collaboration with universities, international and domestic sector specialists, etc.).
- b. *It will support collaboration, learning, common production facilities*, joint purchasing, and joint marketing of low-cost footwear manufacturers.
- c. *Within proposed priority pilot sectors (e.g., footwear and handbags)*, industry leaders will get acquainted with market trends and competitiveness requirements and get support to export higher value-added products and services.
- d. *It will accelerate development of incentives for improving linkages and optimizing synergies along the value chain* (such as opportunities for cluster-based sector development in sustainable animal husbandry, sustainable tanneries, competitive footwear industry, artisanal leather products, etc.)

For the private sector, the Government of Kenya, and other institutions and development agencies, the initial clustering process will result in the following:

1. *Support to accelerate both bottom-up and top-down implementation of priority action initiatives.* Clustering will also lead to strong buy-in and ownership of leather industry stakeholders in implementing the strategy and priority action initiatives.

2. *Within pilot subclusters, the private sector and government will get a clear picture about which subsectors to support and invest in* because of leadership readiness, product attractiveness, potential international markets, and other company and sector capabilities.

These processes and activities related to clustering, along with their expected results, are detailed further in the Annex.

Strengthen the Kenya Leather Development Council (KLDC)

As described in Chapter 3, Kenya currently has many institutions—KLDC, KIRDI, TPSCI, AHITI, KITI—playing different roles in supporting the development of the leather industry. However, there is limited communication and cooperation among the different institutions, and there is no appropriate forum to address such issues. Most of the institutions are also underfunded, and if not, they are out of touch with the private players that drive the industry.

In this light, the Ministry should reinforce KLDC with sufficient funding and authority to fulfill its potential. In particular, KLDC should be given more responsibility and power for coordinating all leather institutions (TPSCI, the leather department of KIRDI, and AHITI, among others).

The Ministry should allocate more financial resources to enable KLDC to execute its various mandates which include: (i) coordinating leather sector activities and stakeholders; (ii) supporting accelerators and common manufacturing; (iii) coordinating policy development and implementation; (iv) capacity building; and (v) market development.

The Ministry must work with institutions to streamline the delegation of responsibilities and roles. KLDC should be able to fully leverage its close relationship with the industry stakeholders and it must be the medium for the industry players to address challenges. KLDC will then recommend practical research topics for KIRDI to focus upon. KLDC must also mobilize leather goods producers and collaborate with training institutions to create appropriate curriculum to address technical skill gaps. In sum, KLDC must be the prime institute overseeing all the activities, policies, and initiatives for the leather industry.

Furthermore, KLDC needs to internally restructure its current four-department system, reducing it to two departments to make the institute less top-heavy. KLDC is an institute in charge of big responsibilities but limited in staff size. Having fewer department directors but more mid-level members will allow for better management of the institution, both financially and operationally.

Improve the regulatory framework to reduce production costs and safeguard the environment

Kenya should improve its regulatory framework as it relates to leather on two important fronts. Firstly, import duties on leather tanning and footwear production inputs should decrease from 25 percent to the more common 10 percent. This could apply to chemicals, dyes, shoe making supplies and components, shoe lasts, soles, shoe lace ringlets, and buckles, among others.

Second, international leather-related environmental standards should be adopted and enforced, particularly at the tannery level.

At present, Kenya lacks systematic conformity to such standards. These need to be adopted not only at the discretionary level of individual firms but also at the compulsory level of the entire leather industry. If this is successfully done, green and clean leather can become an attractive part of the Kenyan leather value proposition.

Historically, leather producing countries have imposed tariffs on the export of raw hides—as Kenya does today—and have gradually imposed tariffs on the export of wet blue.

The rationale for this has been to encourage domestic manufacturing by artificially lowering the cost of inputs. This strategy worked favorably for countries such as Ethiopia: At the time when Ethiopia imposed a tax on the export of wet blue, many foreign investors had already entered or were about to enter Ethiopia. In addition, domestic capacity in the leather sector had increased due to the support of international donors and two sectoral institutions—LIDI and TIDI—which had built reasonable capacity in terms of testing, quality standards, and training, among others. Ethiopia had also implemented generous measures to encourage exports of leather products, which allowed the country to domestically absorb much of the semi-finished or finished leather. Additional information on the experience of Ethiopia can be found in the Annex.

However, in some countries, this strategy has backfired, and the World Bank does not recommend this approach be tried in Kenya at this time. Enforcing environmental standards in Kenyan tanneries will already push up the cost base of the tanning sector, and imposing a tax on the export of wet blue could undermine some of the tanneries.

5.3 INCREASE ACCESS TO MARKETS AND INDUCE GREATER DEMAND FOR KENYAN LEATHER AND LEATHER PRODUCTS (STRATEGY 2)

This section offers recommendations about how to increase demand for Kenyan footwear and other leather products. The key problem is that despite a significant supply of livestock and raw material, Kenya remains a minor provider of leather and leather products in world markets. It is currently a very minor exporter of leather and leather products (only US\$140 million, 0.14 percent of the US\$100 billion world leather export market in 2013, and only US\$2.8 million (0.005 percent) of US\$54.5 billion dollar world leather footwear export market). Even in its own domestic market, Kenyan-made leather shoes account for only 3.3 million (7.9 percent) of the 42 million pair of shoes purchased annually. The overall solutions are multi-dimensional, involving improvements in competitiveness, productivity, and access to markets. To increase access to markets and grow the demand for Kenyan leather and leather products, the following actions are suggested:

- **Develop a leather marketing entity** to increase domestic and international awareness of Kenyan leather, coordinate the branding of Kenyan leather, and promote exports; and

- **Facilitate access of local producers** to the domestic market by improving opportunities to succeed with public procurement contracts.

Sub-strategy 2.1: Develop a leather marketing entity to increase awareness, coordinate branding and promote exports

Kenyan leather producers should join forces with the government to strengthen international and domestic awareness about Kenyan leather, coordinate branding, organize international leather fairs, and promote exports. The KLDC currently serves as the central organization to promote Kenya's leather. However, it is important to increase the publicity around Kenyan leather, develop branding campaigns, and organize public awareness events domestically and internationally (i.e. trade fairs, exhibitions, etc). This can be done through a stand-alone leather marketing entity that works in conjunction with KLDC or through a specific department under KLDC.

To develop branding strategies, for instance, lessons can be learned from other countries that have developed such strategies for their high-end leather goods in specific markets. Ethiopia has recently started a campaign to brand its sheep leather in Japan (see Box 1).

Box 1: Branding Ethiopian sheep leather in Japan

Dubbed as a champion product approach, Ethiopia is set to brand its leather and leather products made of sheepskin to Japanese market and beyond.

Sponsored by the Japan International Cooperation Agency (JICA), the champion product approach movement is something which is said to seek and improve Ethiopia's image and brand the country's finest sheep leather and finished leather products abroad.

Noriyuki Nagai, one of the four consultants hired by JICA to undertake the job of championing sheep leather to become a brand product, told The Reporter that the short term target of the champion product approach is to introduce Ethiopia's high-end sheep leather and leather goods to the Japanese market.

Source: <http://allafrica.com/stories/201412011189.html>

Similarly, Kenya can find ways to brand and distinguish its sheep and goat skins and hides to Japan and other countries.

⁶⁵ <http://sunlightfoundation.com/blog/2013/08/12/case-study-public-procurement-in-the-slovak-republic/>

The leather marking entity can promote exports by organizing international match-making and leveraging global business-to-business (B2B) e-commerce platforms. For the former, Kenya could leverage the experience of the Export Promotion Council and the networks of sister leather development councils to promote matchmaking between international buyers of crust and finished leather and Kenyan producers. This could significantly increase the visibility and demand for Kenyan leather. For the latter, Kenya can take advantage of global B2B commercial platforms to access new markets throughout the world. For instance, the recent recapitalization and expansion of Alibaba, the world's largest and most successful global e-commerce market platform, opens up a uniquely valuable opportunity for Kenyan-based leather tanners to sell directly to Chinese leather product manufacturers.

Currently China is the largest footwear and leather goods manufacturer in the world. However, increasingly stringent environmental controls within China are forcing many Chinese tanneries out of business, with the result that Chinese buyers are becoming increasingly active in seeking overseas supplies of raw, semi-finished and finished leather.

Dealing through a global B2B e-commerce platform like Alibaba affords several advantages to Kenyan exporters: (i) Alibaba provides access to tens of thousands of buyers whom Kenyan exporters could not otherwise access. Many of these buyers include SME leather product manufacturers based not only in China but in other parts of the developing world; (ii) Alibaba provides a pre-fabricated end to end supply chain which affords de facto structured trade and third party (Alibaba) guaranteed conformance with product quality standards, shipment and delivery times, and payment; and

(iii) significantly, Alibaba affords a “first move” source of competitive advantage to the African leather production platform, which would be able to interface with it and to mobilize its B2B capabilities quickly and fully.

To this end, a for-profit Alibaba-like leather trading company could be created in Kenya using the skills and internet competences of one or more of the many Nairobi-based ICT companies. This leather trading company could be selected as a preferred trading partner by KLDC or the Minister's Leather Task force and awarded a start-up contract to provide specialized trade and market interface services for Kenyan leather and leather goods exporters. The leather marketing entity could play a role in mentoring the company with the help of the Leather Accelerator suggested in this chapter.

Sub-strategy 2.2: Design a transparent public procurement policy

Public sector procurement presents an important market development opportunity for Kenyan footwear producers to supply specialized boots and shoes to the public sector. Several government agencies, including the military, the police, and the Youth Development Corps, require rugged and durable boots and shoes, which Kenya's largest footwear manufacturer has long specialized in.

Currently, these government agencies develop their own individual specifications and put them out to competitive tender. However, by collaborating with Kenyan based footwear manufacturers to develop, design and functional specifications collaboratively with Kenyan based footwear manufacturers before tendering large orders, and by purchasing orders which correspond to economic lot sizes for local companies, another niche might be

created in which Kenyan manufacturers would be well positioned. In addition, the niche could be consolidated by providing after market support services such as maintaining stand-by inventories of replacement boots and providing warranties against excessive wear.

As outlined by the *Buy Kenya, Build Kenya* policy, government procurement policy could bring great benefits to the manufacturing sector, including the leather and leather good sector. A guaranteed market—conditioned on quality, price, and timeliness—could help the industry reach a certain level of scale and efficiency in producing selected products. Since the knowledge and skills developed could be easily transferable to other products, the spillovers could be greater than the government’s initial intention.

To have a successful program, the Government of Kenya must set up and enforce strict transparency rules with a competitive, open bidding process. The purpose of this policy is to incubate its nascent industry to become competitive and potentially serve as a medium of rewarding innovative entrepreneurs. Lessons can be learned from a case study of Slovakia’s effort to bring transparency in its public procurement process.⁶⁵

5.4 BUILD QUALITY AND STANDARDS (STRATEGY 3)

As described earlier, Kenya trails behind global and regional competitors in the leather industry in terms of productivity, quality, and costs of products. Strategy 3 and its sub-strategies provide mechanisms to enhance the productivity of companies through the following:

- *Establishment of industry accelerators* to support micro, small and medium enterprise (MSME) development and linkage, and improve production processes, technology and machinery;
- *Development of critical infrastructure*, including a potential leather park to develop economies of scale for water treatment and agglomerate markets;
- *Enhancement of training and skill development centers*; and
- *Development of quality and standards.*

Strategies and actions to enhance productivity throughout the leather value chain are vital to Kenya’s ability to compete both within its own domestic market and globally.

Box 2: Case study—Slovakia

Over the years, Slovakia has acquired a reputation for rampant corruption in doing business. However, since the enactment of a new initiative of a procurement portal called EVO, in which the public can access various public procurement information sources, Slovakia has been making an effort to shift away from a deeply entrenched stigma. The recent development has brought a paradigm shift in the role of civil society and media oversight. As more information is available to the public, journalists and civil society can proactively play an analyst and intermediary roles in shedding light on corruption during the public procurement process. Information disseminated via EVO include:

- Name of the contractor who won the contract;
- Number of bids received;
- The monetary value of the contract;
- The criteria used for selection;
- The type of procedure used;
- The committee members who evaluated the bids; and
- Complaint adjudication authority.

⁶¹ InfoDev of the World Bank has undertaken a great deal of work in developing toolkits, case studies, and organizational designs for specialized incubators that are focused on the agribusiness sector. These tools and the knowledge that accompanies them could be used as templates to launch leather industry business accelerators/incubators. Source: The World Bank (2011) ‘Growing food, products, and businesses: applying business incubation to agribusiness SMEs’.

Sub-strategy 3.1: Improve the production process, skills development, technology and machinery

This sub-strategy focuses on how to improve and upgrade the productivity of leather and leather products producers in both the formal and informal sectors. To this end, the creation of two leather product accelerators is recommended: one for the formal sector and a satellite accelerator for the informal sector in Kariokor Market.⁶⁶

Leather Product Development Accelerators (or “Leather Wealth Creation Centers”)

An extremely effective way to populate an emerging industry with a combination of new entrepreneurial firms and highly innovative existing firms involves the creation of sector-focused business accelerators/incubators. Business accelerators/incubators are institutions which are designed to accelerate the growth and success of new and existing entrepreneurial companies through the offer of an array of business support resources and services that include physical space, capital, coaching, common services, and networking connections. Sector-focused accelerators/incubators are particularly effective in filling gaps or weak links in supply chains.⁶⁷

Business accelerators strengthen existing businesses by improving their quality, scale, market focus, and by injecting new businesses into their supply chains, as well as linking new market entrants to other members of the business ecosystem to whom they plan to sell and to serve. The probability of

a successful launch of “pioneering” existing companies and new start-up companies is greatly enhanced when leading members of the sectors into which incubatees are launched sit on oversight and advisory panels and consider the viability and merit of emerging companies from the point of view of strengthening and complementing their own established businesses. Being able to witness firsthand the testing of new services rewards these sector-leading companies and introduces new product concepts and processes, which hold the potential for extending their own market reach. Consultation allows more traditional and slower moving companies to witness firsthand the development of new business models and the maturation of new entrepreneurs and innovating existing “pioneer” companies, and in the process make determinations regarding which emergent companies to affiliate with, buy out, or hire talent away from.

Companies that provide specialized business support services to an entire sector or to several parallel supply chains, such as quality control certification, order fulfillment, packaging, market research, etc., are particularly useful in strengthening the sectors that they serve.⁶⁸ For the leather industry in Kenya in particular, several of the potential areas for “pioneering” existing companies and new enterprises include:

- Leather market information services;
- Internet-based wholesale leather marketing services;
- Leather quality certification services; and
- Specialty services required to support the production of hand-crafted footwear.

⁶⁶ The Shoe Cluster in Addis could be inspiring as an example. There are a couple of successful shoe producers there – small Ethiopian companies—. The cluster provides a facility with machineries to produce various components (soles for instance) but also services like marketers, designers, and trade shows.

⁶⁷ For example, see Linda Knopp (2007) “State of the Business Incubation Industry,” Athens, Ohio: National Business Incubation Association; and R Grimaldi (2005) “Business incubators and new venture creation: an assessment of incubating models,” *Technovation*, February, pp. 111-121.

⁶⁸ InfoDev of the World Bank has undertaken a great deal of work in developing toolkits, case studies, and organizational designs for specialized incubators that are focused on the agribusiness sector. These tools and the knowledge that accompanies them could be used as templates to launch leather industry business accelerators/incubators. Source: The World Bank (2011) ‘Growing food, Products, and Businesses: Applying Business Incubation to Agribusiness SMEs’.

To this end, we recommend that the Ministry of Industrialization and the Leather Task Force proceed as follows:

- a. Develop two proposals for funding leather industry business accelerator/incubators (one for the formal sector and one for the informal sector);
 - b. Identify resources to financially support the launch of a new accelerator/incubator by providing resources for a business plan;
 - c. Offer to provide matching grant support to the deserving incubatees endorsed jointly by independent third parties and the Ministry of Industrialization;
 - d. Create two core accelerator/incubator teams, each with affiliated relationships with technology experts, academics, technical development agencies; and
 - e. Launch the two accelerators/incubators as pay as you go enterprises supported by enterprise grants provided to deserving incubatees.
- Establish a private sector led common prototyping and marketing platform to enable collective generation of competitive leather products and services.
 - Mobilization of space, equipment and finance;
 - Set up a pilot tech center in Nairobi (subsequently replicated in the 8 regions);
 - Undertake joint production and marketing projects through the NLPA; and
 - Through these projects, the NLPA will demonstrate best industry practices, develop a market for skilled designers, industrialists, and service providers, support programs of recognition and award (see “Develop Leather Award and Recognition Programs” below) and build capacity among leather sector stakeholders.

Initial outlines for the development of a Nairobi Leather Products Accelerator (NLPA, for the formal sector) and a Kariokor Market Satellite Accelerator (for the informal sector) are provided below.

Nairobi Leather Products Accelerator (NLPA)

It is recommended that a pilot leather industry accelerator be developed in Nairobi to facilitate manufacturing and marketing collaboration, and support competitiveness within the leather products industry. The NLPA would certify and entitle its graduates and supporters to participate in other programs designed to upgrade the industry. Non-participants would enjoy no such entitlements. To this end, the following actions are recommended:

The strategic importance of the proposed NLPA is to promote technology absorption, greater flow of information, collaboration among firms, and remove binding constraints on the competitiveness of leather products firms. It will offer common machinery for prototyping, training in production, marketing, and business management, and a nurturing environment for leather goods and services start-ups. The recently established Leather Articles Entrepreneurs Association (LAEA) has indicated their interest to co-lead this initiative to establish the NLPA.

Kariokor Market Satellite Leather Accelerator (for informal sector)

The establishment of a common manufacturing facility and business accelerator for micro and small-sized leather businesses in the Kariokor Market (KM) will enhance the market’s performance in serving the low-cost leather goods market. The previously established TPCSI, located in Thika, does not serve the needs

of leather goods producers in KM due to its distance from the KM, its cost of services, lack of funding, and lack of orientation to client needs. Hence, a Kariokor Market Satellite Accelerator (KMSA) is proposed. The proposed KMSA will have many functions similar to the NLPA, but the KMSA will be focused on providing support for existing informal sector leather producers to increase their competitiveness. It is proposed that the KMSA be established as a satellite of the NLPA in Kariokor Market. Establishing the KMSA will include:

- Offering sales, marketing and branding services to increase the market for KM leather goods;
- Establishing a common manufacturing facility with shared production machinery for local businesses, which will enhance the quality of their products ;
- Offering more services tailored to informal sector producers, including cutting and stitching;
- Providing technical support in the creation of shoe designs ;
- Creating linkages to auxiliary suppliers for good quality inputs such as shoe soles, shoelaces, and buckles; and
- Providing business management training support.

It is proposed that the KMSA should charge a small fee for use of the processing, leather cutting, and finishing equipment to ensure sustainability of the accelerator. KM has been able to remain competitive thanks to its low cost products. Toward this end, KMSA will ensure that the producers maintain low costs while upgrading quality. The project also recognizes that although each vendor in KM does not have a specified brand, KM itself is highly recognized not only by Kenyans but also by regional leather stakeholders. The ultimate goal is to

develop the “Kariokor” brand and explore new sales channels under the partnership. The idea of KSMA requires the development of a two pronged initiative, which include a common manufacturing facility, and sales, operations and administration functions. These are explained in detail in the Annex.

Develop a leather industry park

Constraints that limit the competitiveness of the leather industry include its fragmentation and the high costs of water effluent treatment.

The development of a Leather Industry Park can potentially address both of these. The Leather Task Force is already considering the development of a Leather Industry Park as a means to co-locate tanneries and leather products producers in an industrial zone—currently proposed in Athi River, Machakos County. The government will provide water, energy, and an effluent treatment plant and encourage the movement from the export of wet blue to finished leather and leather products. If the Leather Industry Park initiative is to succeed, then it must have a strong market orientation and its development, scale, and strategic role within the industry must be guided by the profit and loss consideration of a private sector developer. Importantly, in Ethiopia the small firms in the leather products sector are grouped in clusters in Addis, while the tanneries are located outside Addis, mostly around the dry port of Modjo—to reduce logistics costs—but also for environmental reasons.

Our primary recommendation is that the idea of a Leather Industry Park be subjected to a market test that includes the following six steps:

- a. ***Prepare a detailed business plan***, including alternative site assessments, analysis of development costs for infrastructure and

financial feasibility analysis. It is critical that a detailed feasibility study be developed to determine the financial sustainability of a Public Private Partnership (PPP) venture, the kinds of incentives and policy supports which would ideally be required to support the provision of water resources on a fee for service basis, the costs of tapping into the Athi River basin, as well as the merits of other alternative locations for the park;

- b. **Conduct pre-market testing**, including demand assessments involving prospective customer surveys, and assessments of demand/willingness to pay for services. To that end, the shared and jointly used facilities that it contains (e.g., water treatment, power, common purchasing of chemicals and other inputs, joint marketing support, etc.) need to be confirmed in the value they provide by the willingness of tenant leather processors to pay for them;
- c. **Conduct economic, technical, and environmental analyses** that determine the costs and benefits of developing the industry park. Will the costs of water supply development and effluent treatment be offset by benefits and revenues?
- d. **Develop a master plan for the leather city/industry park**. Prepare a comprehensive master plan for development of the park;
- e. **Identify private developer**. A PPP venture will serve as the “market test” of the financial sustainability of the park; and
- f. **Find anchor tenants and sources of soft financing**. Identify major partners for the leather park. Lessons can be learned from

the Dongo Kundo Special Economic Zone (SEZ) in Mombasa, whose development has been accelerated by Toyota as a potential anchor tenant and JICA as a strong supporting donor.

The development of the proposed Leather Industry Park can and should afford an opportunity to begin the restructuring of the leather industry. As discussed in previous chapters, the industry suffers from some significant structural disabilities that limit its productivity and its competitiveness. Both economies of scale and economies of scope can be fostered within a new business enclave by lowering barriers to entry for emerging companies—particularly ones which support non traditional business models—, by inviting investment from foreign companies, which can deliver new competitiveness enhancing methods and technologies, and by passing and diversifying risk through the specific assignment of functional responsibilities among tenants. The zone tenancy agreements comports with an overall industry restructuring plan can be developed in ways which foster cooperation, cross fertilization, and the realization of economies of scale and scope.

As a starting point, key lessons learned for developing industry parks both in Kenya and in other developing countries need to be considered and applied to the design of the Kenyan leather park. These lessons are highlighted in Box 4 and an in-depth analysis of their relevance to Kenya is provided in the Annex.

Box 4: Lessons learned in developing industry parks in Kenya and other countries

1. Improvements in the business environment are the primary magnet for attracting private investment into development zones. In particular, zones which succeed in assisting investors overcome service, land, and infrastructure constraints are more likely to succeed than are other zones which afford less conducive investment environments;
2. Industrial zone development projects which are fully funded, led, and managed within the public sector frequently fail to meet project expectations. This is most frequently the result of misalignment of incentives, politically driven and risk adverse decision-making, slow to react and bureaucratic processes, and weak management skills. The Export Processing Zone Authority of Kenya is an example of a public sector organization, which has been responsible for the development of industrial parks in Kenya but whose track record has been mixed.⁶⁹
3. Diversity in institutional and business model arrangements is good. “One size” never suits all businesses, will not work in all zones, nor will it fit all supply chains.
4. In all cases, a private operating company should be engaged to market the zone, negotiate leases and sales terms with tenants, assure the provision of essential ancillary business services, and manage a “one-stop” customs, business permitting and licensing interface with government.
5. Zone investments anchored by joint ventures between local and foreign investors are more likely to result in technology transfer and strong linkages to the local economy than those which are anchored by local investors or foreign investors alone.
6. Zone development projects which are fully funded by private investors frequently attempt to price up until marginal costs and benefits are equal and thus, capture economic rents which projects are otherwise able to provide to tenants and their commercial dependents. As a result, privately managed development zones frequently frustrate efforts to realize external economies because they allow less producer surpluses to accrue for the benefit of tenants suppliers, including poor farmers and aspiring SME’s.
7. Zone development projects, which define clear, balanced, and counter balancing roles for public and private participants, appear to offer the most effective and ultimately, the most successful modes of governance. Issues which frequently require mediated resolution between public and private sector interests include: (i) effective modes for integrating the local economy into zone operations; (ii) equitable terms negotiated between zone tenants and employees and local suppliers; (iii) basis for expanding, maintaining and up-keeping the zone and near zone infrastructure. Examples of successful zones organized to balance the interests of public and private sector stakeholders can be found in Tanzania in the sugar production zones and in Jordan and Gabon in more conventional industrial export zones.
8. Early occupancy and tenancy commitments on the part of large anchor tenants can significantly reduce implementation risk and shrink the time required from initial zone development to full zone occupancy. On the other hand, large anchor tenants are not reluctant to exercise their market dominant position in ways designed to reduce development time and to secure favorable terms for building out infrastructure and providing supportive services.

⁶⁹ “Are economic zones appropriate in the African context? Economic zones can be expensive and risky projects; the margin for error is small, and successful zones take time to develop. They rely on effective state capacity, and their success is tightly intertwined with that of the wider national economy in which they are based. Clearly, they are not for the faint-hearted.” (p. 263). “Kenya’s EPZ program, often held up as an example of African success, looks rather anemic. Even including the single factory units, the program, which has been operating for nearly two decades, accounted for just over US\$400 million in exports in 2008—US\$11 in exports per capita.” (p.80). Thomas Farole. (2011). “Special Economic Zones in Africa: Comparing Performance and Learning from Global Experience”, World Bank.

Sub-strategy 3.2: Improve skills in the leather industry

All successful and competitive industries require a continuous supply of critical skills and new competencies. Kenya's leather sector is no exception. There is a shortage of skill development centers in the country that cater for the needs of the leather sector. In general, the majority of newly hired workers lack experience and training in making leather products. Even graduates from technical universities, who have prior knowledge in production and machinery, lack experience working specifically with leather and generally require additional on-the-job training. The action initiatives developed here include:

- **Restructuring and upgrading** the Training and Production Center for the Shoe Industry (TPCSI), and placing it under the direction of KLDC;
- **Strengthening** leather design, technology, and marketing skills;
- **Creating human resource placement services** for the leather industry; and
- **Improving and extending professional certification programs within the industry** to assure that critical skills and competencies remain current and competitive through post graduate, continuous training.

Restructure and Upgrade the Training and Production Center for the Shoe Industry (TPCSI) and Place it under the Direction of KLDC

The Training and Production Centre for the Shoe Industry (TPCSI), a training institution that was set up by UNIDO, has failed to fulfill its objective. This well-equipped facility is highly under-advertised and underutilized. Only a few artisans in the industry are aware of its existence, and as stated in Chapter 3, only a few individual artisans have actually received training from TPCSI. Most machines and staff

members are left idle and members of the TPCSI identify underfunding as the cause of this state. With no new enrollment, TPCSI continues to struggle financially. However, if a training session is offered at an affordable price with a larger group of trainees, it could offset the vicious cycle.

To this end, we propose restructuring TPCSI, which is currently under KIRDI, a research institute that deals with a wide range of industries. KIRDI is fundamentally oriented to research rather than industry and is out of touch with the market. Instead of having TPCSI under a research institute that lacks strong linkages with leather industry players, the institute will likely become more functional if it is positioned under KLDC. With its extensive network with artisans and manufacturers, KLDC can mobilize and organize training sessions on a regular basis. The demand for training has always been present. However, the current structure did not provide any incentive for either TPCSI or KIRDI to be more proactive. A restructuring and reorienting of TPCSI to be market-oriented will be a key solution in addressing the current lack of skilled labor in the Kenyan leather industry, and in supporting the leather industry to be more competitive.

Furthermore, in order for the TPCSI to be more effective in accommodating trainees, we propose the construction of boarding facilities combined with a basic kitchen facility within the compound. There is a building next to the manufacturing facility that is barely being used in the compound. With a small investment, TPCSI could transform vacant spaces into bedrooms. Many artisans and potential artisans from all over Kenya will visit TPCSI to advance their skills in leather goods production. As training sessions range from two weeks to two months, this will allow trainees from different

Box 5: Case study: Ethiopia Leather Industries Development Institutes (LIDI)

The Government of Ethiopia established the Leather and Leather Product Technology Institute (LLPTI) in 1998. The facility, renamed as Leather Industries Development Institutes (LIDI), became a designated institution that would spearhead capacity building and technology transfer. Since its foundation, LIDI has played a critical role in helping the Ethiopian leather industry in reaching its potential. LIDI not only works on the development and dissemination of technology for the entire range of the leather supply chain but also works closely with key industry players in training and building capacity.

Furthermore, LIDI also supports the leather industry in the following ways:

- **Benchmarking:** The objective is to build capacity and ultimately, to promote greater competitiveness in the Ethiopian leather industry. The government identified globally prominent leather enterprises and sponsored the process of aiding selected Ethiopian counterparts in a wide range of areas such as management, productivity, input supply, marketing, product quality, and human resource development.
- **Twining:** The objective is to establish long term knowledge sharing with globally recognized institutions and advanced counterparts in other countries. For example, a long-term relationship was formed between LIDI and the Indian Leather and Leather Products Technology Institute.
- **Market Research:** LIDI recognizes market entrance as a great challenge to the industry. To facilitate new, international market entrance, LIDI constantly conducts research on trade agreements and markets for the industry manufacturers.
- **Direct Assistance:** By maintaining close relationships with industry players, LIDI also directly assisted leather good producers in production and design. Beyond their conventional role of training, LIDI provided its facilities to leather good producers in order to facilitate their production.

More importantly, LIDI ensured its facility is highly accessible to Ethiopian tanneries and leather good producers by offering its service at a minimal cost.

Implications for the Kenyan leather industry

Factors that allow LIDI to be effective are not only found in sufficient funding and a strong backing from the government. The success also lies in its organizational structure. Unlike Kenya, where responsibilities and roles are dispersed into several institutions, LIDI oversees every facet of the leather industry in Ethiopia. Its close linkage with the market and industry stakeholders allows its training, marketing, technology dissemination, and investment programs to be more effective. Moreover, having all the services and programs under one institution allows a higher level of communication and knowledge sharing among different industry players in the supply chain. It allows LIDI to design programs and services that are catered to the industry's demand.

counties to enjoy the session at a significantly lower cost. Thus, having a boarding space within the compound will provide more incentives for people to access TPCSI.

TPCSI was established through UNIDO at about the same time as Ethiopia's Leather Industries Development Institutes (LIDI). As the Box 5 case study shows, LIDI has been successful in supporting the competitive development and transformation of Ethiopia's leather industry.

Strengthen leather design, technology, and marketing capacities

One of the main bottlenecks in the industry as identified in previous chapters is the

conspicuous lack of design, technology, and marketing capacities by local institutions including universities. In spite of having a number of university programs dedicated to such programs, many leather good producers acknowledge that there is a lack of skilled labor able to contribute to the industry upon graduation. In fact, highly competitive local brands such as Sandstorm and Rift Valley Leather have designers coming from overseas. In the informal footwear sector, one can rarely observe an innovative design or marketing strategy. Identical designs are recycled and handed down to next generations. The development of innovation in marketing is no different.

All successful and competitive industries require a continuous supply of critical skills and new competencies. Kenya's leather sector is no exception. As mentioned, there currently appears to be a short supply in two critical skill areas: (i) leather product fashion design; and (ii) leather product marketing.

Many leather good producers in Kenya have expressed difficulty in accessing global markets. In fact, few players can afford to participate in renowned international leather fairs organized outside of Kenya, while international fairs organized in Kenya generally attract insignificant international traffic. In rare cases where there are opportunities to create linkages with international clients and where generation of product orders occur, producers in Kenya often fail to meet the size and quality requirements of the orders. In the Kariokor Market, a self-organized leather cluster, there is a high level of labor fluidity. Many artisans work in multiple stores depending on each store's need for labor. In the formal sector however, there is a lack of communication and coordination. Seldom do different brands or workshops collaborate to amass the scale the industry lacks.

In order to address these key shortages, it would be advisable to recruit and endow new designing and marketing professorships at one or more of Kenya's business schools and technical universities to international experts to initially fill the chairs provided under these endowments. Not only would such an undertaking help to generate graduates ready for commercial engagement, but it would also, over a number of years, transform an industry weakness into an industry strength. Professors could be expected to consult and advise within the industry and to form clusters of excellence around their practices. The Technical University

of Kenya, which provides a diploma in fashion design and textile technology, could be a good candidate institution to recruit and house a new leather design professorship, and the University of Nairobi and Dedan Kimathi University of Technology, with their degrees in leather science, could be good candidate institutions to recruit and house one or two new leather products marketing professorships.

Enhance human resource placement services for the leather industry

Developing an efficient and well-organized market for technically competent managers, technicians, and workers in the leather industry is extremely important for long term industry growth. To this end, a Human Resources (HR) placement service should be organized either as a function of KLDC or an adjunct function of the business school, in order to serve as the primary platform for learning and knowledge dissemination within the leather industry. Having a centralized HR placement service center dedicated to keeping track of skilled leather artisans will improve the industry in various ways. First, it will lower the possibility of leather good producers missing aforementioned opportunities to expand their market. When a leather enterprise is in need of extra skilled labor, they can reach out to the services to hire per diem workers to meet big orders. Secondly, the human resource placement services will facilitate the process of potential new investors moving into the industry. Instead of scouting talent on their own, new investors can simply advertise their need via the service center. Lastly, the center could aid Kenya in respect to data collection. The biggest obstacle to this study was a lack of statistics, which is key to meaningful analysis. Having a database of leather industry managers, artisans, and workers could aid companies in

accessing talent, and support the government to keep track of the employment figure in the sector, as well as act as a medium to gauge the current state of leather artisans' skill level. This could be an important measuring stick for competitiveness of the sector going forward. We recommend that this HR placement service be established at the KLDC, and perhaps be supported by a business school.

Encourage quality & enforce standards

Overall, Kenya's leather industry currently lacks an orientation to quality and standards.

Action initiatives recommended for improving the quality and standards of Kenya's leather industry include:

- Aligning incentives for quality and promote quality certification systems;
- Developing leather quality awards and recognition programs;
- Initiating regional branding of the leather industry to promote specialization; and
- Increasing the enforcement of quality standards for imported products.

Align incentives for quality and promote quality certification systems

In order for Kenya to compete in global markets, it must improve the quality of its leather and leather products and begin to develop an international reputation for quality. This can be achieved by aligning the incentives of the players throughout the value chain and by using certifications systems as mechanisms through which to teach and verify quality. Although

quality has traditionally referred mainly to the technical characteristics of a product—such as durability, suppleness, and comfort—today it often includes environmental and ethical considerations as well.

Appropriately aligned incentives lead to improved quality: hides and skins are a joint product and they come from a joint production process in which the complementary product—meat—is nine times as valuable as the hide. Herdsmen have less incentive to protect hides and skins than they do the health of the animal or the ownership of the animal because of this disparity. Increasing the incentives herdsmen have to care for hides would greatly increase the quality of leather products. In Spain, for instance, high quality hides are so well paid by the market that some cows are kept in stalls specifically to ensure their hides remain unblemished.

Further along the value chain at the tanning stage, several systems exist for monitoring business processes and certifying standard compliant processes. One of these systems is the Leather Working Group (LWG), under which two Kenyan tanners—one of them Alpharama—are certified. Encouraging that additional tanneries to be certified, would help increase the quality of leather and decrease the environmental ills they cause. Equally important, ensuring environmental regulations are adopted and enforced would provide a strong message regarding the vision for the leather industry (Box 6).

Box 6: Promoting environmental practices in the leather industry

The international Leather Working Group (LWG)—a consortium of major global leather stakeholders—promotes sustainable and appropriate environmental practices within the leather industry. It is a multi-stakeholder organization which has developed and which applies a process management and audit protocol for assessing the environmental compliance and performance capabilities of tanners. Its members include brands, manufacturers, suppliers and NGOs. LWG seeks to improve the tanning industry by aligning industry practices with environmental priorities and by providing guidance for continual improvement. The group works transparently to improve brand value and to strengthen the environmental husbandry of all industry participants. (<http://www.leatherworkinggroup.com>)

At the manufacturing stage, quality certifications should be widely promoted. Quality improvements, and the certifications that go with them, will be increasingly adopted as buyers recognize, reward, and request them, and as companies learn about the tangible benefits of certification in terms of productivity, product duplicability, and prices. KLDC, supported by the Kenya Bureau of Standards (KEBS), can take a leadership role in developing certification standards.

Professional certification programs can serve to guide the training and certification of workers and supervisors on the whole process cycle for the production of footwear and leather goods in which they receive training and certification. This includes product conception and pattern making, cutting, stitching, assembling, and finishing, thus enhancing process efficiency and supply capacity. The skills development and certification process requires a mix of classroom training, practical exercises, and on-the-job training. Independent professionals and company employees can be trained in product design and development and receive individual coaching and certification, for instance, for the creation of a collection of handbags or the development of new footwear. In the area of quality management, laboratory operators can be trained and certified in product testing and certification, and groups can be trained for quality management systems to prepare their companies for ISO 9001 certification.

Similarly, leather sector organizations can be involved in training events so as to develop their awareness and understanding of the issues. This will allow them to directly interact with the participating business actors, stay on top on future initiatives, and participate in the dialogue with policymakers.

We recommend that KLDC consider following the excellent example of Bangladesh, which in 2004 established the public-private “Bangladesh Leather Service Centre (BLSC)” to serve as a training and certification center and central coordination point for enhancing skills of service providers. It has subsequently become the central support hub for the whole sector. The BLSC covers training, quality testing and certification, quality management, product design and development, marketing and promotion, and finance support schemes for micro entrepreneurs and artisanal communities.⁷⁰

Develop leather award and recognition programs

Award and recognition programs are the most cost effective way to create incentives and induce innovation in a sector like the leather sector.

Programs of recognition and award afford several benefits: (i) they foster competition based on distinct quality and design as contrasted with low price; (ii) they facilitate market segmentation and produce category

⁷⁰ See www.intracen.org/itc/sectors/leather/#sthash.4MZZu9FL.dpuf

diversification; (iii) they provide low-cost information which has value both to producers who are striving to create and capture greater value and to businessmen who may be interested in investing in the sector; (iv) they also hold out the possibility of aligning leather quality standards adopted within Kenya with standards applicable in countries whose high-value markets Kenyan producers are attempting to penetrate; and (v) their successful implementation empowers organizations and legitimizes their industry pilotage.

Under the aegis of KLDC and other industry groups discussed in this chapter, programs of recognition and award can be used in a number of different ways: for example, they can be used to create incentives for high quality in intermediate inputs, to encourage distinctive design in finished products, to acknowledge service companies which fill gaps in value chains, and to promote innovative business models. Awards can be significant or nominal. Joint awards undertaken with local banks and other financial institutions that entail the provision of credit lines or seed equity investments are the most effective. However, other forms of recognition such as gold, silver and bronze prizes for innovative leather product design can serve as a value basis for branding and for product differentiation.

The context in which annual competitions are organized may be as valuable, if not more valuable, than the results of the award competition. Conventions which surround and support awards programs can gradually be augmented into leather fairs where buyers and sellers of intermediate leather goods and capital equipment designed to improve leather competitiveness, and finished leather goods producers, business brokers, and principal investors can come together.

Initiate regional branding of leather industry to promote specialization

Kenya's leather industry needs to think and experiment with long term restructuring in order to improve its competitiveness. The Ministry is testing the viability of a number of programs designed to decentralize value addition in the leather industry by establishing new abattoirs and tanners closer to the supply of cattle, sheep and goats. These programs could be leveraged to develop quality differentiated and branded leather in three demonstration districts.

Issues effecting quality in the leather business entail systemic end-to-end changes in the entire farm-to-shelf supply chain. Undertaking systemic changes requires the capture of significant value within the chain through branding or other forms of ownership right. To this end, a system of geographic indications (GI's) affords a particularly attractive possibility, particularly for finished leather and high-end leather products.

GI's are ownership rights which identify a product as originating in the territory of a particular locality where its quality, reputation, or other characteristic is linked to its geographical origin. They can create value for local communities through products that are deeply rooted in tradition, culture, and geography. They support rural development and promote new job opportunities in production, processing, and other related services. Examples include Cognac, Roquefort cheese, Sherry, Parmigiano, Reggiano, Teruel and Parma hams. "Corinthian Leather" is an example of a GI-like brand created for the Chrysler Motor Company to distinguish the upholstery in its automobiles.

Because of their potential to add value and promote rural socio-economic development, geographic indications have become a useful intellectual property right for registration and protection in developing countries. Most countries have a range of local products that correspond to the concept of geographical indications but only a few are already known or protected globally. With this in mind, the concept would be to distinguish, under the terms of registered IP's, the animal husbandry, abattoir processing, and leather tanning chain in three Kenyan districts.

To this end, proposals would be developed for restructuring end-to-end supply chains anchored in three districts, which respond to a competitive tender for full involvement in a branding/GI project. Individual districts would respond with commitments of budget, oversight, and policy realignment. One district which specializes in cattle, sheep, and goat rearing would be selected competitively. In return for their involvement in the demonstration project, grant funding would be solicited from donors like Canada, Australia, India and New Zealand which have deep expertise in rearing cattle, sheep and goats and in processing their hides and skins into fine leather. Project teams from each of the winning donor groups would likely be affiliated with a school of animal husbandry or veterinary medicine. They would undertake programs of genetic upgrading, best practice husbandry, and abattoir operations designed to distinguish the quality of leathers coming from each of the three countries, which would be promoted and sold as a distinctive high quality brand of leather.

Increase enforcement of quality standards for imported leather products

The two biggest obstacles to new investment in the Kenyan leather goods industry are the

unconstrained flow of second-hand leather products and the illegal imports of leather products into the country. Regarding the former, the World Bank recognizes that it is unlikely that new manufactures of footwear, bags or other leather goods will choose to enter a market in which the marginal cost of products for competing goods is zero. Nevertheless, the World Bank believes that the benefits of the second-hand goods trade in terms of employment generation and lower cost of living for all Kenyans outweigh the costs in terms of a smaller domestic market for leather goods producers. To this end, the strategies outlined in this report suggest market segments where second-hand leather products are less prevalent.

Illegal / sub-standard imports

The largest manufacturer of leather goods in Kenya believes that 60 percent of its lost sales result from leather products that are imported illegally in the country. For the manufacturer, this represents a larger share of lost sales than those caused by the importation of second-hand shoes.

The challenge which comes from the import of newly manufactured leather products—shoes in particular—is not the result of the formal design, material, and construction standards set by the Kenyan Bureau of Standards. These are set, periodically updated, and approved by experts both from within the Bureau and from the private sector. In any case, Kenya's leather footwear and leather goods import standards are closely aligned with those of other developed and developing countries and fully reflect best international practice. The challenge resides in the enforcement of these standards. Ideally, arriving shipments of footwear and other leather goods are inspected upon arrival by two sets of officials—one from Kenya Customs and one from the Bureau of Standards. However, this

ideal dual inspection process is frequently short cut and even when it does occur, the application of design and material content standards requires special expertise which inspectors may not possess or which they may choose not to apply. In any case, the ex post inspection of imported goods by industry experts and the number of consumer complaints received by KAM indicate that a large volume of substandard imports are arriving into Kenya.

A related challenge is the enforcement of rules of origin within COMESA. As KAM points out in its most recent survey, “Some FTA countries have imported leather goods intended for their own markets, which end up crossing the borders of other FTA countries at 0 percent duty. In Kenya this smuggling problem has greatly affected the footwear industry, and Malawi has been cited as a culprit in this respect.”

The first step to reducing the flow of smuggled leather products is to understand and raise awareness of how widespread this problem is. Then, a highly effective way to stem this illegal flow is to engage the services of one of the global companies which supply customs pre-shipment inspection services, such as SGS, Crown Agents, Cotecna and Intetech. Their services can be secured through an open tender, which specifies specific ports or countries of origin to be covered.

Pre-shipment inspections prevent substandard goods from entering the country. They also assure that the invoiced price charged by the exporter reflects the true value of the goods and they mitigate attempts to avoid the payment of customs duties. Many developing countries require pre-shipment inspections,

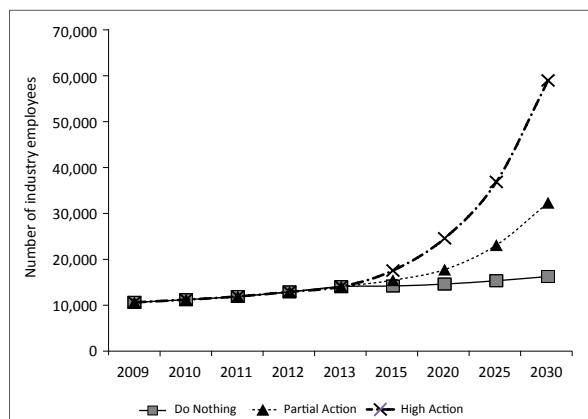
and they include: Angola, Bangladesh, Benin, Burkina Faso, Burundi, Cambodia, Cameroon, Central African Republic, Comoros, Cote d’Ivoire, Ecuador, Ethiopia, Guinea, Indonesia, Iran, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Senegal, Sierra Leone, Togo, and Uzbekistan, among others.

5.6 EXPECTED RESULTS: EMPLOYMENT PROJECTION SCENARIOS

In Chapter 4, the analysis indicated that Kenya’s leather industry competitiveness lagged behind key global competitors, including China, Vietnam, India, and neighboring Ethiopia. The chapter identified a number of bottlenecks that Kenya needs to unclog in order to instill growth into the industry. The competitive positioning analysis for Kenyan leather footwear posited that Kenya must: (i) improve quality and reduce costs in order to compete in and capture a bigger share of its own low-cost leather footwear domestic market, and (ii) must significantly improve competitiveness in order to attract foreign investors and become a player in the global marketplace. For leather bags, Kenya must focus more on creating additional market entry points to further position itself on the global market as a quality leather bag producer.

It is envisaged that the recommendations and action plan proposed will provide the basis for Kenya’s leather industry to increase its competitiveness and grow jobs and income. Projections of future leather industry employment have been generated to show the likely impact of minimal vs. substantial implementation of recommended policy initiatives (see Figure 30).

Figure 30: Leather industry employment projections, 2015-2030



Source: ETG Projections

Three scenarios have been generated to depict the future of the Kenyan leather industry.

- Do Nothing Scenario:** If no significant effort is observed on the policy level, and private sector-led initiatives are not implemented, we project a stagnant industry where there is no notable growth;
- Partial Action Scenario:** According to this scenario, there will be minor improvement in the competitiveness in both the formal and informal sectors, resulting from the successful implementation of only a few recommended actions;

- Action Across Value Chain Scenario:** This positive scenario implies successful implementation of many of the recommended initiatives, improvement in the competitiveness of both the formal and informal sectors, which results in a quadrupling of leather industry employment within 15 years. If Kenya successfully brings transformation across the value chain, scenario C is feasible.

Based on a cross-country (China, Vietnam, Turkey, Ethiopia) average estimate of 1,500 formal jobs per million pairs of shoes produced (see Table 20), if Kenya was able to increase its competitiveness, productivity, market share, and annual production of shoes by 15 million pairs—from its current 3.3 million pairs of shoes to 18.3 million—, then employment in the leather footwear industry would grow by 22,500 jobs (from 14,000 to 36,500 jobs). This estimate is roughly consistent with Scenario B above. In terms of value, the net exports of the leather industry could grow from US\$140 million a year to close to US\$500 million.

Table 20: Comparison of formal employment generation and productivity in the leather footwear sectors among leading countries (2010-2013)***

| | Leather footwear production* (million pairs per annum) | Leather footwear employment** (1,000 workers) | Employment generated (jobs per 1 million pairs produced) | Worker productivity (pairs per worker per annum) | Projected new employment from 10 million additional pairs |
|----------|--|---|--|--|---|
| Vietnam | 1,172 | 700 | 597 | 1,674 | 5,900 |
| China | 3,120 | 2,702 | 866 | 1,155 | 8,660 |
| Turkey | 79.7 | 100 | 1,255 | 797 | 12,500 |
| India | 200 | 700 | 3,500 | 286 | 35,000 |
| Ethiopia | 5.9 | 7.6 | 1,288 | 776 | 12,880 |
| Average | | | 1,503 | | 15,030 |

* Production estimates taken from World Statistical Compendium for Raw Hides and Skins, Leather and Leather Footwear 1992–2011 (FAO)

** Formal employment estimates from national leather industry association reports (Vietnam Ministry of Industry and Trade; China Leather Industry Association; Turkish Statistical Institute; India Council for Leather Exports; Ethiopia—International Food Policy Institute.)

*** Given the numbers in the table represent only formal sector employment, Kenya has not been included in the table for the sake of comparability.

To achieve this target and more, Kenya’s public and private sector leaders will need to collaborate and work intelligently to create the vision and strategy, implement actions, and develop the conditions for a renewal of competitive strength and dynamism in the leather industry.

5.7 RISKS AND BENEFITS

All strategies entail risks and benefits. Aggressively growing sales of low-value added leather footwear in the domestic and regional markets would result in increased marketshare, profitability and growth of local manufacturers. This is a low-risk strategy because it suggests deepening an existing market and product segment. The drawback of it is that it does not necessarily increase the level of sophistication of manufacturers, given the lack of sophistication of potential customers.

Making a concerted push to sell high value-added specialty products to customers in the EU and US, and to international tourists in the EAC and in Kenya is also low-risk, given the products and markets exist today and are growing. The upside of this strategy is that if sales do increase, greater sophistication and recognition necessarily follow. The risk of this strategy is that there might not be enough high-quality leather and skills in Kenya to quickly respond to increases in market demand, and thus growth may have to be gradual.

Selling increasing amounts of crust and finished leather to China and EU allows more value-addition to be done in the country. Since finished leather requires a close relationship with the buyer such that detailed specifications of color and texture are met, the risk is that current buyers prefer the flexibility wet blue provides them and that a different set of buyers for crust and finished leather have to be wooed.

Regarding the recommended interventions, their overall aim is to improve competitiveness in leather and leather products and grow the industry in current and higher value-added segments. Most of the recommendations will help all producers and not just those gearing up for a specific market segment. The risks of a few interventions are worth highlighting:

- Improving the regulatory framework (and its enforcement) to safeguard the environment is always costly for firms in the short-term. It may be that some tanneries operating today may find it hard to comply with enforced regulations, and they may decide to close given the investments required for compliance. Mitigating measures for this include a soft loan facility or provisions for gradual compliance.
- Developing a leather marketing entity, a Nairobi Leather Products Accelerator, and a Kariokor Market Satellite Leather Accelerator, carries the start-up risks inherent in any new endeavor—the need to find the right team of people, to raise funding, and to put in place the structure for operations—even before marketing or acceleration begins to take place.
- The risk of developing a leather industrial park in Kenya is high. Sector-specific industrial parks have a spotty track record of success in the country, and in Africa more broadly. The effort, time, and investment required to develop a park are significant, and even then, there is a risk market trends change, investors don’t come, and existing businesses prefer not to move. That said, the benefits for tanneries (and for citizens at large) of a water effluent treatment plant are sizable.

- Regional branding of leather, and the demonstration districts proposed within that is potentially high-risk, given the difficulties implementing initiatives in rural areas with poor communications and low levels of

education. Regional branding initiatives have been tried in other parts of the world many times before, often unsuccessfully, so learning about common pitfalls and best practices is a key mitigating measure.

ANNEXES

Annex 1: Leather strategy implementation: Expected activities and results for clustering process (Strategy 1)

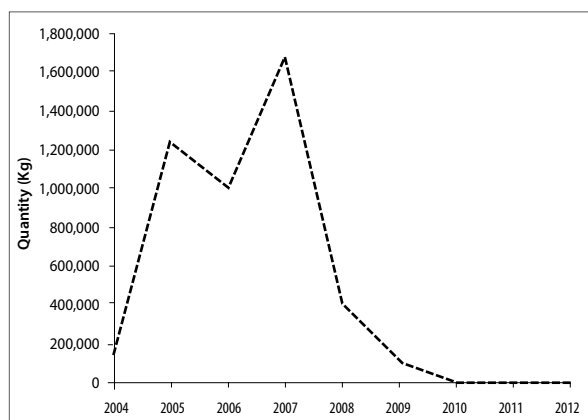
| Proposed implementation process activities | Expected results |
|--|--|
| <p>1. Project Initiation—Interviews with business owners, local sector experts, and relevant entrepreneurs willing to participate in the leather cluster working group process. Assessment of: (i) existing competencies, skills, talents, and products that can be leveraged to develop higher value-added products; (ii) supporting infrastructure of the sector. Conduct a pre-cluster meeting with selected leaders to review process and ensure leadership buy-in.</p> | <ul style="list-style-type: none"> • 20-30 entrepreneurs and others interviewed from the two priority pilot subclusters (footwear and handbags); Implementation of pre-cluster meeting • Development of a committed leadership team • Identification of list of key stakeholders to engage in the leather cluster working group process • Identification and development of 2-3 key action initiatives by leaders. |
| <p>2. Facilitation of a series of four “fast-track” cluster meetings among entrepreneurs and related stakeholders.</p> | <ul style="list-style-type: none"> • Challenges identified, plan of priority activities developed, and initial implementation of cluster initiatives defined |
| <p>3. Implementation of clustering training/capacity building activities for entrepreneurs, government officials and representatives of development agencies and universities.</p> | <ul style="list-style-type: none"> • A series of four training sessions and at least 20 people trained to facilitate clustering such that continuity can be provided for the two pilot clusters and additional sectors and clusters in the future |
| <p>4. Development of “Overview of Best Practices in Leather Footwear and Hand Bag Marketing” and recommendations for study visits.</p> | <ul style="list-style-type: none"> • “Overview of Best Practices in Leather Footwear and Hand Bag Marketing” and recommendations for study visits developed. |
| <p>5. Workshop and recommendations for Decentralization of Kenya’s Leather Clustering program based on experience with two pilot clusters and trainings</p> | <ul style="list-style-type: none"> • Recommendations for decentralization of Kenya’s Leather Clustering program developed. |
| <p>6. Organization of the “Kenya Leather in Action” Clustering Forum with the purpose of demonstrating progress to date, engaging new leaders, and mobilizing for export growth.</p> | <ul style="list-style-type: none"> • “Kenya Leather in Action” Clustering Forum implemented with participation of over 300 leaders from private and public sectors, universities, NGOs, donor agencies, etc. |
| <p>7. Establishment of Leather Cluster Action Fund (\$100,000) to support initial implementation projects/tasks. On-going implementation of priority action initiatives.</p> | <ul style="list-style-type: none"> • Leather Cluster Action Fund established and co-financing provided for at least 10 priority action initiatives. |

Annex 2: Ethiopian trade and investment policy to promote value addition

Ministry of Industry and Trade (MOTI) of Ethiopia proactively implemented a “top down-pull approach” strategy, which called for increased production of value-added finished leather products, especially footwear. The strategy was supported by the ban on export of raw hides and skins and the imposition of 150 percent tariff on export of wet blue in 2008.

The Figure below shows the effect of the government’s 150 percent tariff on wet blue export in Ethiopia. The quantity of wet blue export dropped dramatically and immediately after the trade policy implementation in 2008 and it continues to be marginal. The implementation and enforcement of the regulation encouraged tanneries to move up to producing more crust and finished leather both for export and for local production of finished leather goods. Consequentially, this increased the supply of finished leather in the local market and allowed the Ethiopian leather good producers to enjoy finished leather at lower prices.

Figure 31: Quantity of sheep wet blue exports



Source: ETG

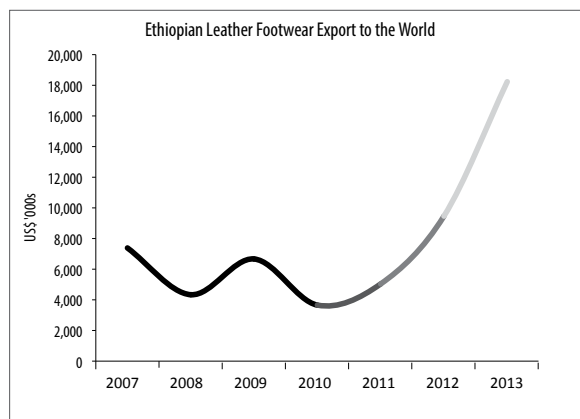
This strategy was carefully delivered under the auspice of MOTI through a series of Public-Private Partnership (PPP) dialogue. In its preparation leading up to the implementation of high export tariffs, MOTI closely engaged the Ethiopian Leather Industry Association (ELIA), Ethiopian Customs & Inland Revenue Authority (ECIRA), Ethiopia Chamber of Commerce (ECC), and Quality & Standards Authority of Ethiopia (QSAE). At the same time, the Ethiopian Government proposed an attractive incentive package to attract new foreign and local investments into the production segment of the supply chain. This was to ensure the domestic market’s capacity to absorb increased supply of finished leather. New investors were given tax exemptions on a wide range of imported goods from raw to packaging materials for production. Furthermore, they were also exempted from export taxes as well as income tax for 2 to 8 years.⁷¹ Such government incentive packages, combined with the high export tariff, low labor cost, and abundant livestock, resulted in the increase in Foreign Direct Investment (FDI) to Ethiopia. All footwear manufacturing was owned by Ethiopians until recently. Footwear manufacturers from Germany, Italy, and China have built manufacturing facilities in Ethiopia and are bringing employment opportunities as well as promoting export.⁷² For example, Haujian Group has built a footwear manufacturing plant in Ethiopia.

⁷¹ Ethiopian Investment Agency. (2008). “Investment Opportunity Profile for Tanning of Hides and Skins Up to Finished Level in Ethiopia.” USAID. (2013).

⁷² “Agricultural Growth Project –Livestock Market Development.”

Despite having challenges commonly shared by other African countries such as low productivity and low quality of raw material, Ethiopia has managed to move up to producing higher value leather products under the leadership of the government. In response to the increased domestic finished leather supply, Ethiopia has succeeded in increasing the production and export of leather footwear dramatically over the last few years as the graph below indicates. In conclusion, the government's determined effort has successfully attracted a number of FDIs, generated significant employment, and made the Ethiopian leather industry more competitive.

Figure 32: Ethiopian leather footwear export to the world



Source: ETG

Annex 3: Kariokor market satellite leather accelerator (for informal sector)

The idea of a Kariokor Market Satellite Leather Accelerator (KMSA) requires the development of a two pronged initiative, which include a common manufacturing facility, and sales, operations and administration functions.

1. Common Manufacturing Facility

Most of the leather product workshops in KM already run at very high capacity. Every aisle is bustling with stalls and artisans making leather products to meet their respective orders. As of now, no space is available to accommodate any additional facilities unless some producers are ousted from the market. In light of expanding to facilitate new growth at KM, the idea is to build an additional floor on an existing facility to house KMSA as well as potential incoming producers. KMSA's common facility will have five components:

- a. **Common Manufacturing Machinery**—KMSA will provide a very simple set of common manufacturing machinery such as sewing, cutting, and skiving machines. This machinery will primarily be focused on footwear. Idle machines could be sourced from factories in the EPZ, other manufacturers, or companies such as General Machines, which import machines.
- b. **Training**—KMSA, in collaboration with TPCSI, will provide training on a regular basis. A technician will be present at the facility at all times to support artisans in using machinery.
- c. **Incubator**—KMSA will also operate as an incubator to support promising entrepreneurs from KM in the development and implementation of their business plans, such as how to introduce new products, grow their scale of operations, upgrade their quality, expand into new markets, etc. The KMSA incubator will support entrepreneurs to graduate from the informal sector to the formal sector.

d. **Quality Control Lab**—KMSA will also have a quality control lab to encourage artisans to improve finishing. Proper use of machinery will increase both efficiency and quality of finished products. Artisans will bring leather and other inputs to cut, assemble, and finish their products at the facility. The facility will be accessed with a small fee to ensure the facility is financially sustainable.

e. **Development of Karikor Market Leather Cluster**—KMSA will oversee the implementation of a leather cluster development process, designed to increase collaboration and competitiveness of leather cluster stakeholders in KM.

2. Sales, Operations and Administration Functions

The KMSA will be managed under the partnership of KM leaders and the KLDC. This will be done through implementation of a pilot project with a select group of willing leaders from KM that will improve product quality, launch the Kariokor brand, and facilitate greater market access. The initial steps will involve:

- a. Roundtable meetings with key players/stakeholders in KM;
- b. Assessing and selecting leadership from KM artisans who will volunteer to participate in a pilot program;
- c. Organizing a tour for KM leaders to TPCSI in order to raise awareness of how machinery could enhance efficiency and quality;
- d. Organizing a team of willing leaders to participate in the program;
- e. Provide workshops on using machinery in collaboration with TPCSI; and
- f. Providing access to machinery and training at KMSA.

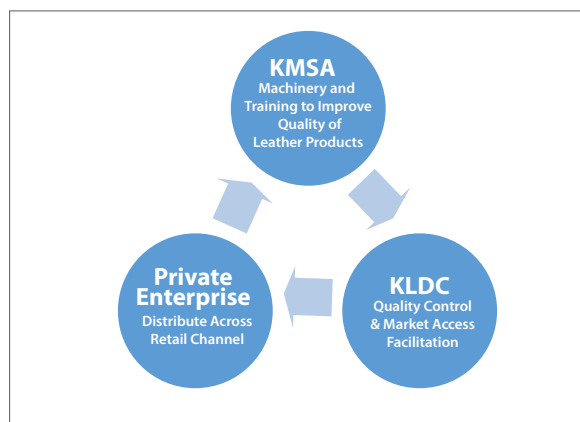
Simultaneously, KLDC will explore private retail chain such as Nakumatt, Uchumi, and Tuskys, which all have extensive distribution channels throughout Kenya. Consumer insight reports show that with the growth of the number of retail chains and the size of middle-income class, more Kenyans are flocking to big retail chains to shop. Over 66 percent of the population shop at retail chains due to their convenience and price.⁷³ This trend presents a great opportunity. KM, together with KLDC, will develop a three party partnership to have Kariokor branded footwear distributed across retail stores. Initially, a small number of retail stores will be selected to test the market as well as to ensure a steady supply of shoes. KLDC will be in charge of the quality control lab within KMSA to inspect all finished products. Only the products that meet the quality standards prescribed by KLDC will bear the “Kariokor” brand and be distributed to the pre-selected stores. Products that fail to meet the standards can be sold cheaper through the usual conventional channel.

Although KM has been a competitive player in Kenya’s low-cost segment of the leather footwear market, two key endogenous constraints are limiting its growth. First, in the age of highly mechanized manufacturing, the lack of machinery in KM severely undermines the quality of finishing. New Ethiopian and Chinese leather footwear with better finishing quality are gradually gaining higher ground in Kenyan and regional markets. Second, KM still depends solely on a conventional marketing channel developed decades ago. The current distribution channel is limiting KM’s expansion and access to the wider public.

Therefore, the recommended program is designed to directly address three of the biggest challenges. First, with increased machinery and training, KMSA will unquestionably improve the

quality of its finished product. Second, KM will dramatically expand its marketing channel to reach a wider spectrum of consumers under a partnership with a private retail chain. Finally, organizing KM players under KMSA will allow them to have more bargaining power in dealing with tanneries. By having tanneries compete against each other to meet the large collective demand of KM, they will be able to procure better leather quality at a cheaper price.

Figure 33: Proposed partnership structure for Kariokor Market satellite accelerator



Source: ETG

If the pilot project proves to increase production, efficiency, and product quality, additional producers will be willing to join KMSA, which will increase both supply and demand for Kariokor brand footwear. In this case, KLDC’s role will be to manage and balance both supply and demand chains in retail stores. The potential is immense. With higher quality, KM products will become more competitive against Chinese and Ethiopian products. Furthermore, the success and scaling up of this project can give KM the potential to close the gap which is created by the decreasing number of leather shoes in the second-hand Mitumba market. Gradually, KM will become a recognized player in the region and will be a strategic source of wealth and an employment generator for Kenya. Furthermore, the success of this model shows significant potential to be implemented in other counties.

⁷³ <http://www.cofek.co.ke/index.php/14-news/340-kenya-s-growing-consumerism-sparks-huge-interest-among-multinationals>

Annex 4: Leather city (Leather Industry Park)

For the development of a leather industry park in Kenya, it is extremely important to assure that a standard set of incentives are offered to private developers so that no opportunity exists for corrupt practice and unfair treatment. A zone development program quickly develops a reputation among sophisticated investors as being either competent and honest or incompetent and dishonest. Only one opportunity exists to start up a zone program. In this regard, tenants who first move into a new zone should not be able to gain a permanent competitive advantage over subsequent entrants. Pro-competitive policies based on equal opportunities to produce zone appropriate products, open entry into new zones, and equal access to zone infrastructure, at least until zone are fully occupied, are all sound principles which need to be enforced through the even handed award of zone licenses. To this end, standardized incentive packages across zones and standardized definitions of public private partnership rights within zones are critically important.

What is most important in developing a leather industrial park is not the “bricks and mortar” aspect of the park or the low-cost access it may provide to essential infrastructure, but rather the enhanced business environment which the government endeavors to create within the park boundaries to support a vibrant emerging industry—in this case a vibrant leather industry. Recently completed World Bank studies demonstrate that the real economic growth advantages associated with developing specialized processing zones come more from the “software” aspects of their design than from the “hardware” aspects.⁷⁴ Lessons learned from China, Korea, Malaysia, Mauritius, and Dubai all suggest that correcting fundamental

problems within Kenya’s general business environment, problems which adversely affect industrial development generally, and within the demarked business environment of a leather park, will ultimately prove more important for attracting private investment and for activating potential sources of competitive advantage than investment in new industrial infrastructure per se.

Indeed, it is the instrumentality by which a leather park development project supports reassigning risks that makes it most useful, particularly if the park development project is conceived and executed in a way which assists with the restructuring and the pro-competitive reorganization of the leather industry. Only to the extent that a leather park project is undertaken with the intention of restructuring the non-competitive, low value-adding leather industry, will real value for investment be realized. To this end, implementation tactics need to be developed which involve the effective assignment of investment and operating risks between park developers, feed lot operators, abattoir operators, large scale dynamic leather processors specializing in high value leathers, smaller scale and more specialized processors, leather product manufactures of all kinds and sizes and, importantly, the government.

In addition to being subjected to rigorous analysis of financial and operational feasibility, any leather industry park project which is ultimately undertaken needs to be subjected to several market tests which prove, through an open and competitive process, that the park will actually generate greater social benefits than it will require in capital and operating costs. No financial or operational feasibility study will suffice to prove

⁷⁴ Thomas Farole. (2011). “Special Economic Zones: Progress, Emerging Challenges and Future Diversions” and “Special Economic Zones in Africa: Comparing Performance and Learning from Global Experience.” Both World Bank Publications.

this important sustainability condition. Only an experienced private sector developer will be able to implement a leather park concept and to manage all of the project risks associated with this concept by laying these risks off on various leather park tenants and other park development partners. Only the engagement of private capital and of private sector “know how” and “know who” will assure that resources committed to the park result in significant net economic benefits for the entire Kenyan economy. Private development leadership affords an effective market test through financial risk sharing. The intermediation of a well capitalized developer in the form of a special project corporation will be able to limit government liability over the long term and assure that real value is realized from public and private capital committed to the project. One way to assure that government receives value for money is to tie government financial support to jobs created, skills developed, linkages realized between subsectors and with other supporting technical institutions, R&D transfers, and technology adoption impacts.

Private sector project leadership affords additional benefits in the form of: (i) implementation speed; (ii) management expertise; (iii) efficient representation of collective private sector interests in the process of negotiating sector-specific, public policy reforms; and (iv) giving the market a clear signal that an investment-ready enclave is emerging in Kenya.

Finally, additional lessons can be learned from India’s recent experience in the development of specialized leather industry parks where developers have attempted to create external economies for the co-location of tanneries. These external economies involve treatment of effluents, and provision of infrastructure, including the provision of power, water and roadways. The conditions under which mega leather cluster projects have been developed in Uttar Pradesh and Tamil Nadu are instructive and should be considered as the Kenyan leather park is being planned.

India Leather Industry Development

India's rise from a small raw leather exporter in the 1960s into one of the world's primary exporters of both raw and finished leather today is a testament to at once liberalization and central planning. Today, raw leather makes up only 26 percent of India's leather exports, meaning finished leather garments, accessories, and footwear have taken an impressive share. Clearly, a concerted effort has been made to capitalize on the value addition of finished leather, and thus maximize export return.

In 1991, the Indian government ushered in a policy of 'de-licensing,' targeting several manufacturing industries including leather. The Industries Development and Regulation Act (IDRA) sought to jump start the leather industry (and others) by liberalizing the market and allowing free entry to all firms. Moreover, de-licensing simplified FDI regulations by affording an 'automatic route' to foreign investors seeking entry into the Indian market.

Over time, the government has sought to develop leather clusters converging producers along various stages of the supply chain and based throughout the country. Of particular note, the Indian Ministry of Small and Medium Enterprises (MSME) has taken charge of organizing and funding the vast number of SMEs in the leather sector, most of which lack a strong and centralized base. In its most recent Indian Leather Development Programme (ILDPA), the MSME laid out plans for a new series of interventions—comprising a diagnostic study, the setting up of Common Facility Centers (CFC), and infrastructure development—in Bihar, Haryana, Tamil Nadu, Uttar Pradesh and West Bengal, through its own support as well as that of state governments.

Mega leather cluster projects have been developed in Uttar Pradesh and Tamil Nadu. In both cases a special purpose vehicle (SPV) was organized by private investors to bid on the mega leather cluster projects and win a capital grant to implement the projects, involving leading development and negotiating the basis on which risks and rewards were shared among tenants. The SPV's are corporate bodies, promoted by entrepreneurs willing to set up the proposed leather parks. Local governments contribute undeveloped land to the SPV's and private investors provide paid-in capital. As part of the bidding process SPV apply for Environmental Clearance from the Government of India. Importantly, these Indian mega leather parks are being located where skilled tanners and workers already exist and where a tradition of leather production has already taken hold.

Annex 5: Action plan for implementation of the leather sector strategy

In order to develop an action plan for the implementation of the leather sector strategy, an assessment of the expected impacts and feasibility of implementation of the proposed strategy and actions was undertaken. Each action initiative was assessed in terms of its expected impact on: (i) jobs generated; (ii) increase in value added; (iii) increase in investment; and in terms of (iv) implementation cost; and (v) ease of implementation. The estimation of expected impact is shown as follows.

Figure 33: Expected impact and feasibility of recommendations

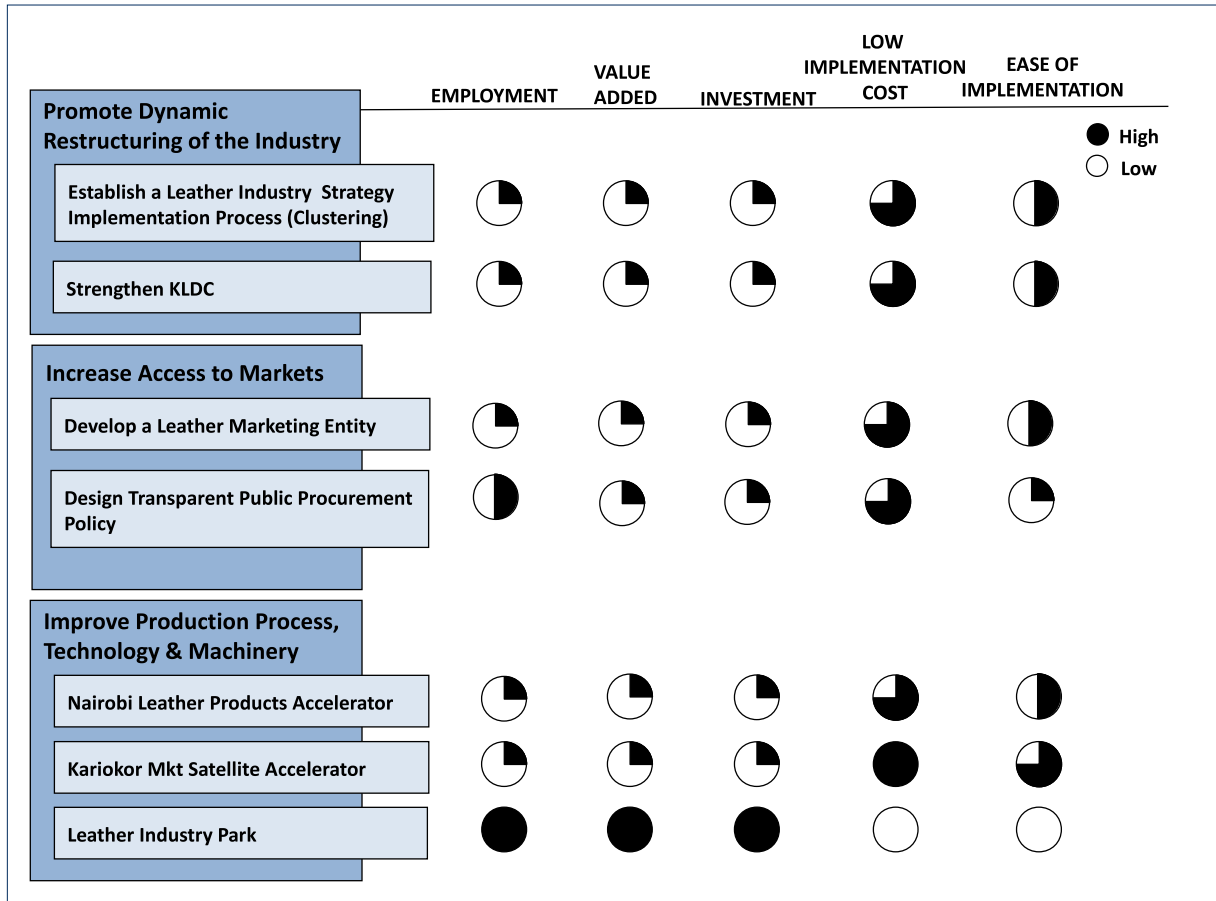
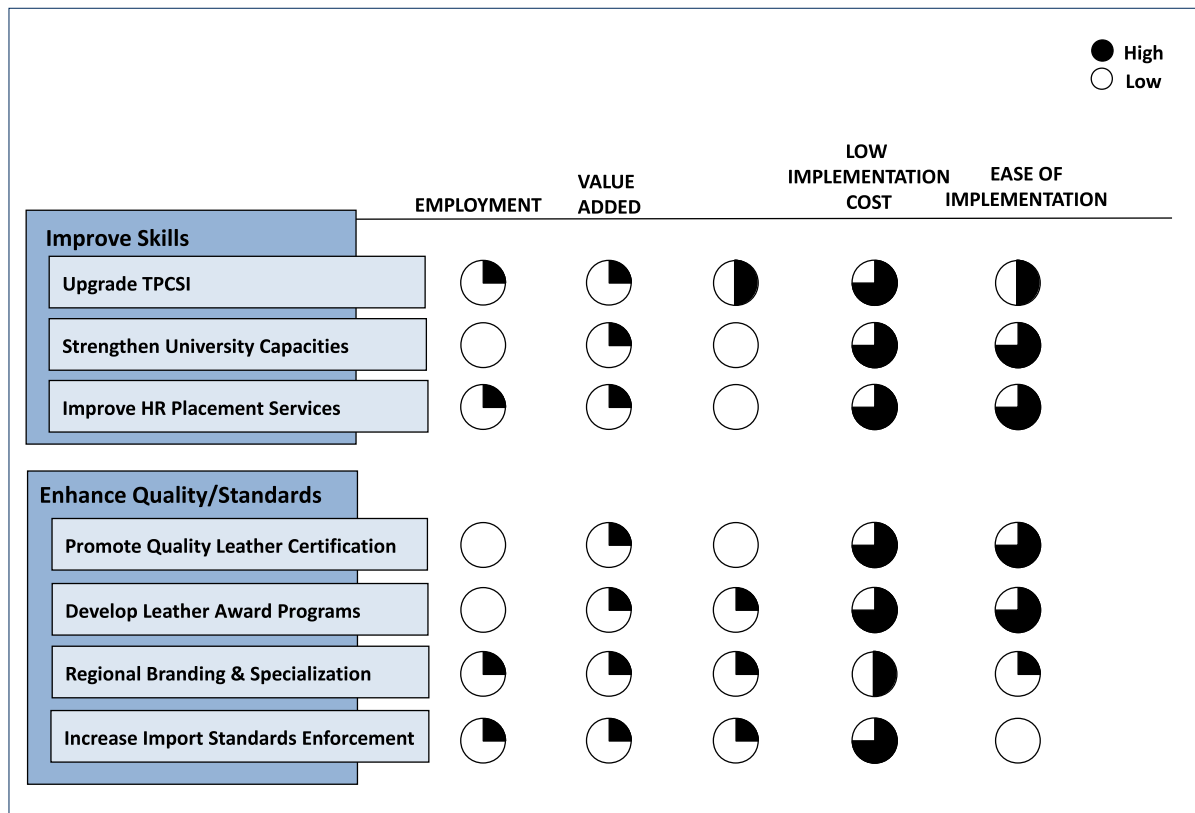


Figure 33: Expected impact and feasibility of recommendations



Based on the likely impact and relative feasibility of the leather sector implementation strategy, an action plan recommends the following priority actions for 2015. Priority actions, key steps, timeline, and actors responsible are proposed in the table below.

Table 21: Preliminary action plan for the leather sector strategy, 2015

| Strategy 1: Dynamic Restructuring of the Leather Industry | | | |
|--|--|----------|--|
| Short-term actions | Key steps | Timeline | Actors responsible |
| Establish & implement the collaborative, stakeholder-driven leather industry strategy implementation process | <ul style="list-style-type: none"> Interview key stakeholders and conduct pre-cluster meeting. Conduct “fast-track” cluster meetings Develop 15+ action initiatives, with champions Establish the Leather Industry Action Fund and co-finance early implementation of 10+ action initiatives Scale up the process | 4 weeks | Ministry of Industrialization, KLDC & LAEA with cluster facilitation team |
| | | 8 weeks | Private sector engagement |
| | | 16 weeks | |
| | | 18 weeks | |
| | | 20 weeks | |
| Strengthen KLDC & Restructure TPCSI under KLDC | <ul style="list-style-type: none"> Conduct strategy meetings with KLDC & Min. of Industrialization for strengthening KLDC Develop new administrative and funding arrangements for KLDC Develop strategy for restructuring of TPCSI Implement TPCSI restructuring | 2 weeks | Ministry of Industrialization & KLDC |
| | | 4 weeks | |
| | | 6 weeks | |
| | | 10 weeks | |
| Improve the Regulatory Framework to Reduce Production Costs and Safeguard the Environment | <ul style="list-style-type: none"> Identify imports for which a decrease in duties would be meaningful for the industry Develop strategy and negotiate with relevant agencies Enforce the environmental regulatory framework | 12 weeks | Ministry of Industrialization, in collaboration with key government agencies |
| | | 16 weeks | |
| | | 16 weeks | |

| Strategy 2: Increase Access to Markets and Induce Greater Demand for Kenyan Leather and Leather Products | | | |
|---|---|----------|--|
| Short-term actions | Key steps | Timeline | Actors responsible |
| Develop a leather marketing entity to increase domestic and international awareness, and coordinate branding of Kenya leather | <ul style="list-style-type: none"> • Develop “lessons learned” • Design marketing strategy • Engage in pilot events for domestic awareness raising and branding • Scale up the campaign | 6 weeks | KLDC, Export Promotion Council |
| | | 10 weeks | |
| | | 16 weeks | |
| | | 24 weeks | |
| Medium-term actions | Key steps | Timeline | Actors responsible |
| Design a transparent public procurement policy | <ul style="list-style-type: none"> • Develop inventory of demand, select pilot products • Design mechanism for strict transparency in competitive open bidding • Implement & evaluate pilot bids • Scale up bidding process | 12 weeks | Ministry of Industrialization, and KLDC working with key government agencies |
| | | 16 weeks | |
| | | 24 weeks | |
| | | 36 weeks | |

| Strategy 3: Build Quality and Standards, and Reduce Production Costs Throughout the Leather Value Chain | | | |
|--|--|----------|-------------------------|
| Short-term actions | Key steps | Timeline | Actors responsible |
| Establish the Nairobi Leather Accelerator | <ul style="list-style-type: none"> • Development of design and feasibility study • Establishment of implementation team and access to funding • Establishment of a private-sector led, common manufacturing and marketing platform to enable collective generation of competitive leather products • A pilot center will be established in Nairobi and then replicated in the 8 regions. | 8 weeks | LAEA & KLDC |
| | | 12 weeks | |
| | | 16 weeks | |
| | | 24 weeks | |
| | | 1 year | |
| Design & establish Kariokor Market Satellite Accelerator | <ul style="list-style-type: none"> • Development of design and feasibility study • Establishment of implementation team and access to funding • Establishment of a common facility with shared simple production machinery for local businesses, which will enhance the quality of its products | 8 weeks | Kariokor leaders & KLDC |
| | | 12 weeks | |
| | | 24 weeks | |

| Short-term actions | Key steps | Timeline | Actors responsible |
|--|---|----------|--|
| Establish leather cluster awards, public recognition & outreach program | <ul style="list-style-type: none"> • Design award programs • Launch initial events • Evaluate and scale up | 8 weeks | KLDC |
| | | 16 weeks | |
| | | 24 weeks | |
| Medium-term actions | Key steps | Timeline | Actors responsible |
| Establish the Leather City/ Industry Park | <ul style="list-style-type: none"> • Complete feasibility study • Develop private sector approach • Identify and contract private sector developer • Determine funding structure for the park • Prepare Master Plan • Initiate construction | 8 weeks | Ministry of Industrialization, Leather Task Force, private developer |
| | | 12 weeks | |
| | | 16 weeks | |
| | | 20 weeks | |
| | | 24 weeks | |
| | | 40 weeks | |
| Restructure and upgrade the Training and Production Center for the Shoe Industry (TPCSI) | <ul style="list-style-type: none"> • Develop restructuring plan • Identify new administrative structure • Implement plan | 12 weeks | KLDC, TPCSI, Ministry of Industrialization, private sector |
| | | 16 weeks | |
| | | 24 weeks | |
| Strengthen university leather design, technology, and marketing capacities | <ul style="list-style-type: none"> • Develop university task force • Develop individual university plans • Identify cross-cutting capacities and develop collaborative strategies | 12 weeks | KLDC, University of Nairobi, Dedan Kimathi University of Technology, Technical University of Kenya |
| | | 24 weeks | |
| | | 36 weeks | |
| Enhance HR placement services for the leather industry | <ul style="list-style-type: none"> • Evaluate success models and lessons learned • Design central HR placement service center • Pilot test new center | 12 weeks | KLDC, University of Nairobi Business School, LAEA, Cobblers Association |
| | | 20 weeks | |
| | | 30 weeks | |
| Align incentives for quality and promote quality certification systems | <ul style="list-style-type: none"> • Develop framework for total quality management • Support adoption by key agencies • Develop coordinated plan for TQM services delivery | 16 weeks | KLDC, KIRDI, TPCSI, LAEA, Cobblers Association |
| | | 24 weeks | |
| | | 36 weeks | |
| | <ul style="list-style-type: none"> • Conduct needs assessment for professional certification • Design and establish certification capability | 24 weeks | KLDC, Kenya Bureau of Standards, LAEA |
| | | 36 weeks | |

| | | | |
|--|--|---|---|
| Initiate regional branding of the leather industry to promote specialization | <ul style="list-style-type: none"> • Identify competitively three districts in which to restructure end-to-end supply chains. • Solicit grand funding from donors with relevant country expertise. • Affiliate winning project teams with a husbandry or veterinarian school. | <p>16 weeks</p> <p>8 weeks</p> <p>4 weeks</p> | KLDC, Council of Governors, Ministry of Industrialization |
| Increase Enforcement of quality standards for imported leather products | <ul style="list-style-type: none"> • Review quality standards • Develop strategy for stricter inspection of imported goods | <p>12 weeks</p> <p>24 weeks</p> | Ministry of Industrialization, Kenya Bureau of Standards |

Annex 6: List of Interviewees

| Name | Organization | Title |
|---|---|------------------------------|
| Leather Processing & Tanning | | |
| P.V.S. Rao | Alpharama Limited | Managing Director |
| Robert Njoka | Reddamac Leather Center | Managing Director |
| Saqib Munir | Athi River Tanneries Ltd. | Managing Director |
| Waqas Munir | Athi River Tanneries Ltd. | Executive Director |
| Ashwin Punja | Dog Bones Ltd. | Company Director |
| Anuj Parmar, CEO | East Africa Tanners | CEO |
| Mohamed Abubakar | Mas Trading Company | Managing Director |
| Mr. Kinyanjui | Hide and Skins Trader | Director |
| Peter Ndung'u Kamau | Ondiri Tannery Kikuyu | Managing Director |
| Hides & Skins | | |
| Mr. Kinyanjui | Hides and Skins Trader | Director |
| Manufacturer / Producer | | |
| Alberto Errico | Bata | Managing Director |
| Michael Rutto | Bata | Costing & Efficiency Manager |
| R. K. Shah | United Footwear Ltd. | Director |
| Idris Rupani | Leather Masters Ltd. | Managing Director |
| Robert Njoka | Reddemac Leather Industries | CEO |
| Beatrice Mwasi | Sanabora Design House Ltd. Leather Articles Entrepreneurs Association (LAEA) | Managing Director |
| Anne Moraa | Sanabora Design House Ltd. | Director |
| Nalina Rupani | Aldephi | Managing Director |
| Gabriel O. Anzala | Gonzales Leathers | Director |
| Jacob M. Mwangi | Palm Prints African Artifacts | Sales & Marketing |
| Yonathan T. | Zeebaan Design | Director |
| Francis Otanga | Masero Boots | Director |
| Mark Stephenson | Sandstorm Kenya | Managing Director |
| Mohamed Baraka | Mohazo | Managing Director |
| Leather Shoe Producers | Kariokor Market | |
| Sandal producers | Kariokor Market | |
| Leather Middlemen | Kariokor Market | |
| Other Component Middlemen | Kariokor Market | |

| Institutions & Associations | | |
|--|--|--|
| Charles Mwangi Ndung'u | Kenya Leather Development Council (KLDC) | CEO, Research, Standard & Policy |
| John Muriuki | KLDC | Ag. Secretary/Former CEO |
| Jacquiline Caroline Siwo | KLDC | Marketing & Resource Mobilization Officer |
| Halima Juma | KLDC | Corporate Communications Officer |
| Onyango G. J. | KLDC | Monitoring & Evaluation |
| Moses Maina | Training and Production Center for the Shoe Industry (TPCSI) | Trainer |
| Joseph Wairiuko | Kenya Association of Manufacturers (KAM) | Executive Officer |
| Catherine Minayo Mukoko | KAM | Executive Officer, Manufacturing Academy |
| Agnes Mwatu | Kenya Bureau of Standards | Leather and Leather products |
| Patricia N. Kimanathi | Kenya Bureau of Standards | Corp. Communications Mgr. |
| Simon Ng'ang'a | Kenya Footwear Manufacturers Association | Secretary |
| Maurice Omondi | Leather Articles Entrepreneurs Association (LAEA) | Chairman |
| Government | | |
| Hezekiah Bunde Okeyo | Ministry of Industrialization | Director Vision 2030 / Manufacturing Sector Delivery Secretariat |
| Julius K. Korir | Ministry of Industrialization | Director of Industries |
| Nancy Wachuka Muya | Ministry of Industrialization | Senior Assistant Director of Industries |
| Simon N. Atebe | Ministry of Industrialization | Assistant Director of Industries |

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