

Indonesia—challenged but recovering

The last decade has been most unkind to Indonesia and its people. Climate-altering forest fires and earthquakes, ethnically inspired rioting, and the Asian financial meltdown during the last years of the 20th century, were followed by a devastating tsunami, early signs of an avian flu pandemic, deadly terrorist bombings, and militant labour unrest which continues to this day.

On the economic front, the bright future that the Indonesian leather industry foresaw in the early 1990s became clouded by the stark reality at the millennium of savage competition from countries having greater business investment and worker productivity, superior logistical capabilities and a more stable and enticing business environment.

Despite the negatives, there is reason to believe that better days for the industry lie ahead. Managers from all areas of the leather industry in general, as well as representatives of the Indonesian government and foreign organisations, all see a reinvigoration and expansion of this labour-intensive sector as critical for the stability and future of the country. A clear strategy combined with ample resources for this task, both of which have been lacking in the past, now seems possible. The unknown factor still remaining is whether the disparate groups that are the nucleus of the industry can work together for a common purpose.

Indonesia's complexity is best understood by looking at its geography and recent history. Its population of some 240 million is the world's fourth largest but is scattered over 17,000 islands. The most prominent of these is Java, home to the capital Jakarta and the second largest city, Surabaya. Java is the most populous island on earth, with 50% of Indonesia's people living in an area the size of the ➤



WORLD FOOTWEAR

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American state of Mississippi. Indonesia's ethnic composition is also complex. Nearly half the population is Javanese, followed by smaller percentages of Sundanese, Madurese and Malays, with 88% of people Sunni Muslims. Ethnic Chinese comprise only 5% of the population but figure significantly in the business community.

Leather industry

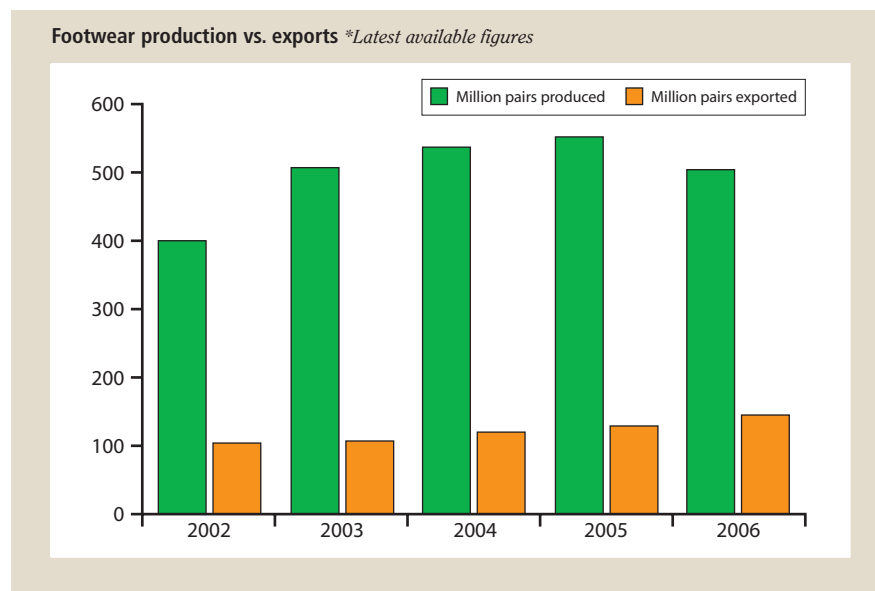
The country's leather industry is relatively small and, according to the Indonesian Tanners Association (APKI), there were 300 tanneries in 2006. While 80% of these are classified as small or home-based, over 50 are large, full-production operations, with about ten capable of producing 500,000 sq. ft of leather or more per year. The remainder have capacities of no more than around 50,000 square feet at best. With such volumes, it is difficult to exploit sudden market upswings such as that presented by the recent European Union (EU) tariffs on leather shoes from China and Vietnam. Indonesia has frequently been mentioned as a likely beneficiary but others, and India in particular, will probably benefit far more.

The majority of leather production takes place on Java and is concentrated in three areas: Garut near the city of Bandung in West Java, historic Yogyakarta in Central Java and at Surabaya, an international port and capital of the province of East Java. The business has traditionally concentrated on processing domestic hides and skins to supply the estimated 6,000 footwear producers in the country.

Footwear production

Expanding footwear production was the primary success driver of Indonesia's leather processing industry and, as recently as the mid 1990s, the country ranked in the top five footwear exporting nations, with revenues exceeding \$1.5 billion. This was based largely on the production of leather sport shoes by a few large companies for brands such as Nike, Reebok and adidas.

During these tumultuous years, Indonesia's enormous and largely closed domestic market continued to provide opportunities for local producers. Government statistics indicate over 350 million pairs of shoes annually were produced for internal consumption in the late 1990s. This inward focus led to a lack of investment in modern technology by



much of the industry, which left it vulnerable as the home market opened up and it was pressured by lower-priced and more fashionable Chinese footwear. 90% of footwear producers were very small and, lacking the development and marketing skills to become primary production partners for foreign brands, were relegated to subcontracting roles. Foreign shoe-makers from China and Korea play an increasingly dominant role in Indonesia's footwear industry.

It was not until 2006 that export earnings again reached the mid-90s level but, today, Indonesia is barely in the world's top 15 footwear exporters. Total leather sector employment nevertheless remains steady at nearly 400,000. Market changes hit Indonesia's tanners hard as potential customers now required specialty leathers beyond their technological capability and, increasingly, directly imported basic black and white leathers for sports shoes. According to the Indonesian Footwear Manufacturers Association (APRISINDO), imports of finished and synthetic leather approached \$300 million in 2006.

Footwear manufacturers, however, remain reasonably upbeat. APRISINDO chairman, Eddy Widjanarko, says that in 1993 there were about 500 reasonably-sized shoe factories but, today, only about 200 remain due to intense international competition—primarily from China. EU anti-dumping measures have, however, led to increased overseas investor interest from Taiwan, Hong Kong, Italy and even Vietnam. This runs from around \$3 million for a small two-line production

facility to an investment by one Korean company of \$50 million. Most is being used to resuscitate existing 'mothballed' capacity, so that while it may not result in orders for new equipment, it will permit extra production to come on line quickly.

Raw material supply

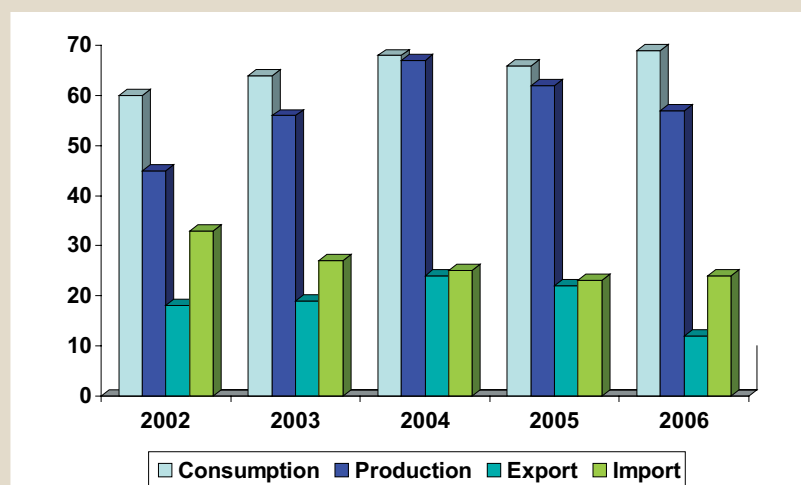
Indonesia's cattle population is estimated by the United Nation's FAO to be 11 million and has remained relatively constant since the early 1990s. There is also a sizable population of sheep and pigs, with both exceeding six million. Although this provides Indonesian tanners with a base of raw stock, it is not sufficient for total production requirements.

While government restrictions are in place against the export of raw hides, informed sources report that a large quantity of highly sought after Java cowhides are regularly and illegally smuggled out of the country from remote ports. They find a ready market due to their unique texture and relatively unblemished grain surface. Indonesia allows the import of raw hides but tanners say that time-consuming permit requirements and a haphazard duty drawback scheme make the process unwieldy.

United Nations statistics put the value of imported hides in 2004 at \$1.7 million, down from \$5 million in 2001. Lack of assured and timely delivery from local tanneries is the primary complaint of the majority of small and medium footwear companies which are unable to directly import finished leather and must rely on Indonesian tanners for supplies. ►

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Finished cow leather statistics



Changing markets

Unable to compete, many Indonesian tanners are looking outside the footwear market. Production of leather accessories and garments has created a sizeable demand for locally finished leather and opportunities for auto interior and furniture upholstery leather are on the increase. Indonesia produces over 500,000 cars per year and local content is being increased as rapidly as qualified suppliers are developed. The Italian firm Gruppo Mastrotto has operated with a local partner in a new industrial area near Jakarta since 2005, supplying finished leather to the automotive and furniture manufacturing industries. Tanners in the Yogyakarta region in particular have reported a shift toward garment or upholstery leather and away from footwear.

Research and the environment

Yogyakarta is also home to two of the country's technical and leather industry research facilities. The Centre for Leather, Rubber, & Plastic (BBKKP) is operated by the Ministry of Industry. The facility, which was damaged extensively in a 2006 earthquake, contains a working tannery and shoe production line. Research into the tanning of available exotic skins, chrome recovery in the tanning process and environmental issues are major areas of focus. The other local institute is the Leather Technology Academy (ATK) which is one of the few in Asia to offer a three-year course in leather technology.

Yogyakarta is also the first Indonesian city to develop a long term plan to address leather industry environmental issues.

As the city's population has grown, many small and older tanneries find themselves in the middle of residential areas. Often operating with antiquated machinery and producing leather via traditional methods, they lack any but the most rudimentary forms of effluent treatment. A new industrial area outside the city has been identified and plans are underway for a relocation project with a common effluent treatment plant. The first company to locate in the area was PT. Adi Satria Abadi, whose owner, Mr. Diyono H. Sasmito, is also chairman of APKI. One other has also relocated to the area and a further seven are expected to do so in the near future.

Contrasts in East Java

Surabaya, located on the north coast of East Java, is another centre of leather and

footwear manufacture. The country's sole government-owned tannery, PT Rajawali Tanjungsari, is located nearby and produces 400,000 sq. ft per month of crust and finished leather for local companies and exports to China and India. General manager, Meddy Irianto, says the industry is facing a 'raw hide crisis' that is severely impacting his company's ability to operate. There are no plans to privatise the company at present but it is badly in need of modern technology if it is to remain competitive.

Not far in terms of distance from PT Rajawali, but light years away in investment and capability, is the leather processing, footwear manufacturing and finished goods distribution complex of ECCO. The Danish manufacturer began operation in Indonesia in 1991 and has steadily expanded investment and production at the Surabaya facility. It now ranks as one of the world's finest integrated operations with a labour force of over 4,500. 2007 is expected to see ECCO Indonesia produce over 20 million sq.ft of leather, which will go into two million pairs of full shoes and an additional 3.5 million pairs of uppers, destined for its factories worldwide. A small amount of leather is also sold to outside customers.

ECCO Indonesia buys a mix of approximately 60% local hides and 40% foreign, mostly from America. Future investment will be aimed at reducing water and power demands and further expansion after 2008. General manager Sylvain Bussiere also acknowledges a shortage of local hides but believes this is a reality he and other Indonesian tanners

Leather Industry Strategic Roundtable sponsored by SENADA and USAID in May 2007



REGIONAL SURVEY: INDONESIA

All Industry conference in Surabaya Indonesia discussing better cooperation between tanners and footwear producers. May 2007.



will have to adapt to for the future. Surabaya is an international seaport as well as international airport and ECCO uses both modes of transport for worldwide product distribution. The import of raw hides and finished European leather also appears to be straightforward.

The obstacles facing the Indonesian leather industry are no more serious than those facing many other countries, but

seem less well addressed due to a lack of unified purpose. The opportunities, on the other hand, appear intriguing.

Prospects

Indonesia has among the lowest labour costs in Asia and productivity at well managed factories is said to be on par with other footwear producing countries. While Jakarta's traffic is notorious, outlying areas offer prompt movement of

goods. The country is also well located relative to major markets and raw material component suppliers. Singapore is only an hour away by air and offers all the efficiencies that should be a model for the entire Indonesian economy.

The Indonesian Leather Fair could be developed into an important venue to showcase the country's footwear and leather industry. APKI and APRISINDO unfortunately lack the necessary resources to promote the industry to the degree needed to compete with countries such as India and China.

The Indonesian government has lately recognised the importance of the leather sector and is promising help. America's USAID has recently provided assistance to the industry via its SENADA Competitiveness Project, which is working to increase the effectiveness of both APKI and APRISINDO. While it may be too early to claim Indonesia's leather industry is undergoing a renaissance, all signs do point towards a steady recovery. 

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