Leather & Footwear: Regulatory & Policy Benchmarking

India currently ranks amongst the top three global exporters in leather apparel but is way behind at 11th position in case of leather footwear (as discussed in the Market Composition section). The global market for leather and footwear is dominated largely by China across all the geographic regions. Though both India and China evolved as leading footwear producing nations around 1980s, over the last two decades China has grown by leaps and bounds while Indian market share has eroded considerably. Other major competitors for India in leather trade are Pakistan, Vietnam, Italy and France. A closer examination of the industry structure, factor conditions and policy environment in the competing countries reveals the source of competitive edge enjoyed by these countries vis-à-vis India.

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

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

China's leather and footwear sector also enjoys strong backward linkages, with presence of strong components and machinery industry, whereas these supporting industries in India are not well developed, leading to supply constraints and high dependence on imports for same.

Over the past two decades, the Indian government has provided several support measures for growth of the leather industry, which has helped in transformation of the sector from a mere exporter of raw material in the 1960s to one of the major exporters of the value added finished products. However, the product portfolio of the sector is still lopsided as high value added segments like footwear continues to have a smaller export share in relation to relatively lower value added products like finished leather. In contrast, China's export portfolio comprises large share of high value added products, thereby generating higher overall revenue.

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

Indian leather sector has witnessed extremely low FDI, which generally brings in state-of–the art machinery, best practices in the industry and efficiencies in operations. In contrast, foreign investments have played a central role in the development of leather and footwear industry in China as well as Vietnam. The Chinese government has lured foreign investors by providing several incentives such as subsidized land and power, reduction of import duties, tax holidays etc. Special preference was provided to Hong Kong and Taiwanese enterprises to invest in China, due to which majority foreign companies in

China are from these two countries. FIEs brought in the linkages with the western markets (especially USA), which played a major role in expansion of Chinese exports to these regions.

Similarly, Vietnam's footwear industry has recorded unprecedented growth following the economic reforms and policies that encouraged FIEs to set up their factories in Vietnam. The Vietnamese government encourages foreign investors through various tax and non-tax incentives to invest in a variety of leather related projects such as supplying and production of footwear materials, components and accessories, setting up institutes for shoe technology, design development, training of human resources, service centres and waste treatment system for tannery and footwear enterprises.

Indian leather sector has not been able to attract large FDI in part due to the erstwhile restrictions and reservations and partly due to operating constraints such as rigid labour market and relatively poor infrastructure (leading to high logistics costs) in comparison to China.

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

Almost all leather and footwear manufacturing countries have initiated various tax and non-tax incentives for the sector's growth and development. Pakistan, for instance, has earmarked special export investment fund for the leather sector that would enable sector firms to establish various facilities and hence improve their competitiveness; the fund would be used for providing grants to various sub-segments of leather for a variety of purposes including establishing design studios, setting up of effluent treatment plants, setting up labs in tanneries and installing flying machines.

Vietnam had also put forth a master plan for development of its leather and footwear industry by 2010, which accorded priority to development of raw materials and accessories for the industry as the country has high import dependence for raw materials and semi-finished products (tanned leather, heels, accessories, chemicals, glues, etc.), which puts it at a disadvantage in relation to countries like China in terms of production costs.

The French government places high importance to research and development and thus various R&D related tax exemptions are available to enterprises. Some of the popular instruments include the Research Tax Credit (*CIR*), the 'innovative start-up scheme' (*JeuneEntrepriseInnovante*), funding by the Innovation Agency (*OSEO*) and support to 'Competitiveness clusters' (*Pôles de Compétitivité*).

Cluster development efforts have yielded high benefits in SME-intensive leather sector

Cluster based approach has played an important role in building the competitiveness of leather footwear and leather goods manufacturers in China as well as Italy. Most of the SMEs in Italy operate through consortia, which support the small firms in areas where they are traditionally weak, such as finance or export. These consortia also receive government support at both national and local levels. In China too, both central and local governments provide support to the industrial clusters to build a favourable environment for improving competitiveness. Additionally, most units in China's leather clusters follow a collaborative approach for marketing, wherein huge export orders received by a unit are often collectively undertaken for timely completion and delivery.

The leather clusters in India have benefited from government intervention in the form of financial and technical support for technology up-gradation, awareness programmes for cost reduction, skill development initiatives and export promotion, etc. However, only a few clusters like Chennai and Kolkata leather clusters have largely benefited from developmental initiatives while several other clusters are yet to be developed in a similar fashion. Moreover, in contrast to China, there is a lack of collaboration and co-ordination among units within a cluster in India, which generally limits the capacity of units to produce large volumes per order and also results in high wastage across the supply chain, thereby affecting their international competitiveness.

Most competitive nations provide huge export incentives

All countries have introduced several incentives for their exporters to render them competitive in the global market. However, the types of incentives offered by competing countries are comparatively higher than that offered by India. As discussed in the above sections, China offers its exporters full rebate of excise duties, high rebate rates for VAT, exemption of import tariffs and refund of local income tax, amongst several other incentives. Vietnam provides several incentives to foreign and domestic enterprises such as tax holidays, lower income tax, refund of import duties, duty free import of machinery, etc. Pakistan too provides benefits like tax holidays, indefinite carry forward of losses, duty-free imports, and no import restrictions. Further, Exporters are also assisted via general schemes such as freight subsidy, concessionary finance, tariff concessions on raw materials, intermediate inputs and equipment used in manufacturing products for export, tariff refunds, duty drawback scheme and duty and tax remission for exports (DTRE) scheme. Sector specific schemes have also been introduced such as R&D subsidy and freight subsidy for leather garments and footwear. Leather also enjoys zero-rating of exports since 2004-05. In contrast, export incentives provided in India are mainly in the form of duty drawback, duty credit for exports to focused markets and duty free imports of inputs.

Trade agreements provide easy market access to several competing countries

The free trade agreements signed by various competing countries with the western and regional markets provide an easy market access for their exports of leather products. Vietnam's bilateral trade agreement with the US has helped Vietnam in gaining strategic access to the world's largest market for leather footwear. China does not have any FTA with the US or the Europe but it enjoys trade advantage in the Asian market partly due to its agreements with the ASEAN countries. Similarly, Pakistan has signed FTAs with China, Sri Lanka as well as other countries, which has enabled duty free or concessional duties access for various products including leather products to these markets. India too has actively engaged in various free trade agreements in the recent past. However, it does not enjoy preferential access to the major markets like the US and the EU. An FTA with EU is in pipeline and likely to commence by end 2012, which can prove to be beneficial for India's leather products' exports in the future.

The European market generally exhibits high intra-EU trade, with large export shares being held by the EU countries itself, primarily due to the cost advantage rendered by way of duty free market access, common currency trade and logistic cost savings due to geographical proximity. As such, most competing countries in Asia (including India) lag behind the European countries in the EU market.

Meeting environmental standards enhances international competitiveness

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