

POLICY POINTS

Ethiopian government

ministries have to act in concert to help elevate the leather industry.

The Ministry of Agriculture

should educate small collectors in proper storage techniques to improve the quality of the skin and hide supply.

The Ethiopian government's

policy making needs to include a careful analysis of market mechanisms as an integral component to industrial policy.

Export, Employment, or Productivity? Chinese Investments in Ethiopia's Leather and Leather Product Sectors

Tang Xiaoyang

WITH THE LARGEST LIVESTOCK POPULATION IN AFRICA, and a long tradition of making leather products, the Ethiopian government recognizes the enormous potential these industries have to lead the agriculture to industry transformation. Given that domestic manufacturing enterprises are weak and uncompetitive in the international market, the Ethiopian government acknowledges the need for foreign investors to achieve sectoral development.¹ Currently, the majority of new foreign investors are Chinese. This policy brief focuses on Chinese investment in Ethiopia's leather sector and its impact on local development. This study can help us understand foreign investments' spillover effects and the specific characteristics displayed by increasing Chinese investments in Africa. From 2010 to 2018, nine Chinese (including from Taiwan and Hong Kong) firms have established tanneries in Ethiopia, making China the largest investing country in Ethiopia's leather sector.

LEATHER PROCESSING SECTOR

ALTHOUGH ETHIOPIAN TANNERIES HAVE INVESTED IN MACHINERY, they find it increasingly difficult to find international buyers for their finished leather products. Manufacturers of leather products need to follow the latest fashion trends, which in turn requires a quick response time to be able to produce new designs. The tanneries in China then need to further adjust the finished leathers' color and style to meet customer demands. Because importing chemicals requires long lead times, and small amounts of chemicals cannot be imported, Ethiopian tanneries often cannot obtain the necessary chemicals to conduct more sophisticated processing. Compared to Chinese and other foreign investors, local tanneries have difficulty keeping up with the finished leather markets' style and color changes.

Over the past decade, Ethiopia's leather sector supply chain has experienced significant changes. Recently, parasitic skin diseases have deteriorated the overall quality of both raw skins and hides. Their problematic handling, characterized by backyard slaughtering, unorganized collection, inappropriate storage, and delayed transportation, have caused worsening quality and a shortage in raw materials available for leather processing. To address these obstacles, the Ethiopian government announced a proclamation in March 2014 to regulate the provision of raw hides and skins.²

Unfortunately, the new regulation has not been implemented effectively. Small collectors, who are supposed to supply the larger collectors, do not abide by the system, instead directly supplying the tanneries. Small collectors do not have the capacity to supply buyers in a timely fashion and often store skins and hides for months at a time. Extended storage times combined with a lack of knowledge about proper preservation techniques result in spoiled raw skins and hides. As the Ethiopian climate becomes drier and parasitic diseases in animals increase, these combined factors are contributing to the overall deterioration of Ethiopian leather quality. The tanneries are seriously affected by these quality problems. The owner of a local tannery admitted that most investments have been spent on improving the leather quality, specifically focusing on raising lower-grade skins to higher grade. These investments do not generate greater value, but merely correct the quality defects caused by suppliers.

Chemicals are a critical component of leather processing, largely determining finished leather's quality and patterns. However, apart from some basic ingredients, tanneries in Ethiopia have to import almost all necessary chemicals. The delays associated with obtaining foreign exchange, transportation, and the customs clearance process seriously impact production timelines. Although a 2012 export promotion regulation allowed foreign chemical producers to set up a bonded supply warehouse, few investors utilize this scheme. For small quantities of most chemicals tanneries must still import from abroad.

In a stagnating global market, leather manufacturers from the US and Europe have all lowered their prices. However, Ethiopian leather prices have not gone down because LIDI has set a minimum price for export. This policy, originally aimed at preventing tanneries from exporting unfinished leather, has resulted in weakening the competitiveness of the Ethiopian leather market. In addition, the scarcity of good-quality skins and hides has raised the cost of Ethiopian leather.

Skilled engineers are required to manage chemical recipes and control finished leathers' quality. Chinese tanneries hire large numbers of workers and employment figures are still growing. The Ethiopian government eagerly wants to create jobs for its youth and welcomes these figures. However, most of the local employees are low skilled laborers. Most Chinese expatriates occupy management and technical supervising positions in Chinese-owned tanneries; however, a small number of Ethiopians have been promoted to management positions. They serve mainly as intermediaries between Chinese managers and local workers, human resource managers, or specialists

in acquiring good quality skins and hides. Those who speak Chinese are likely to be promoted, but in general they tend to play a secondary role assisting and coordinating.

LIDI encourages its students to do a practicum and both foreign and local tanneries receive LIDI interns. However, the outcomes of the internship program are lacking. Several Chinese tannery managers complained that LIDI interns only had theoretical knowledge. The main challenge is that upon graduation students are not willing to work in the tanneries. According to LIDI's general director, the leather processing sector is the lowest paid in Ethiopia. Many students choose to study leather processing mainly to get a university degree.

MARKETING AND SALES

MARKETING SKILLS MAKE THE BIGGEST difference in terms of competitiveness. Both Chinese and Ethiopian tanneries have upgraded and added machinery, yet Chinese firms' strength in marketing and sales have allowed them to change operating procedures without altering basic business patterns. By contrast, although Ethiopian tanneries have upstream resources, they are weak in understanding and finding downstream markets. The main exporting customers have changed from leather processing factories to leather products manufacturers; as such, Ethiopians must look for new buyers and adjust their business practices to meet new customer's demands. This transition, in general, has proven to be the least successful.

Even when Ethiopian tanneries stress the importance of marketing, their understanding is quite different from that of the Chinese tanneries. Almost all of the Ethiopian tannery managers interviewed believe they just lag behind in technology and blame foreign investors for not bringing their best technology to Ethiopia. Ethiopians know finished leather exported by Chinese tanneries will still be further processed in China. To them, this demonstrates the unwillingness of Chinese tanneries to use the most advanced technology in Ethiopia and transfer their knowhow. Yet, Chinese managers explain such arrangements are made to meet customers' demands and ensure timely delivery.

LEATHER PRODUCTS MANUFACTURING

ETHIOPIA'S EXPORT OF SHOES SOARED rapidly after three large Chinese shoe factories, Huajian, New Wing, and George Shoes, began their Ethiopian operations in 2012. Huajian is by far the largest investor in the leather products sector in Ethiopia and one of the largest in the country's manufacturing sector. Apart from shoes, three foreign-invested glove factories have

been established since 2010, including Pittards, Ottokessler, and LYU. Both of the European factories hired Chinese technicians to train Ethiopian workers. These three factories have increased Ethiopia's export of leather gloves significantly. However, all shoe and glove manufacturers must import their leather from abroad because leather quality and processing capability in Ethiopia cannot meet production needs.

TRAINING AND EMPLOYMENT

MANUFACTURING LEATHER PRODUCTS IS labor-intensive, and factories expend great effort to train and manage local workers. Huajian, for example, imported 300 technicians to start production in 2012 and train Ethiopian workers. However, after a quick start and intensive training, Ethiopian workers replaced many expatriates. The percentage of expatriates reached as low as three percent after five years of operation. Among Chinese investors, Huajian group has the most ambitious training program for the thousands of workers in its factory. In 2011, as soon as Huajian decided to invest in Ethiopia, they selected 86 Ethiopians to send to Guangdong for training. Between 2011-2018, approximately 500 Ethiopian workers went to China for similar training. One Ethiopian department manager says he learned two highly critical skills from the work and training received at Huajian. First is communication. Chinese proficiency is an enormous help. The second is work efficiency. Ethiopian managers learned that targets set by management must be adhered to and met on time.

In its Ethiopian factory, Huajian has implemented a multi-level training system. After the initial pre-work education phase, workers are taught in the factory's skill training center. Once workers pass proficiency examinations, they begin on the production line. Training continues on the job as each production line supervisor monitors the performance of every worker, providing one-on-one tutoring. Despite all these efforts, Ethiopian workers' productivity has not reached satisfactory levels according to the management team. Huajian's director of Ethiopian operations estimated that Ethiopian workers can only achieve 50 percent of the productivity achieved by Chinese workers. For other shoe and glove factories, learning by doing is also the most common approach to train Ethiopian workers, most of whom have no previous factory experience.

High turnover is a detriment to the formation of a reliable work force and to the accumulation of production skills in the manufacturing sector. Some foreign shoe and glove factories in Ethiopia have experienced high local worker turnover rates,

especially at the beginning of operations. However, high turnover is also a problem in China, where managers reported turnover was even higher than in Ethiopia. The situation is improving, however, as more and more experienced workers choose to stay in the factories where they have accumulated training. The competition for skilled workers is a shared challenge for all factories, as well. For Chinese factories, the local workers who can speak Chinese are most desirable, although workers who received training in China were more likely to leave to go to other Chinese firms because of their language and communication skills. Ultimately, high turnover within this segment of workers discourages Huajian and other Chinese factories from providing overseas or intensive training.

ETHIOPIAN MANUFACTURERS

AS THE COUNTRY'S FISCAL SITUATION deteriorates, it has become more difficult to obtain the foreign exchange necessary to import essential supplies. Accessories as simple as thread, glue, and cartons must be imported because the quality of locally made inputs do not meet international standards. When Chinese investors attempted to produce cartons for the factories, they found their prices would be too high compared to the imported alternative. Shoe and glove factories import their cartons duty-free because the cartons are used for export, whereas locally made cartons are not exempted from tariffs, thus increasing their price. In this case, incentives aiming to encourage exports actively deterred the growth of a local supply chain.

However, Chinese investors have created some positive impacts for indigenous downstream manufacturers by offering better supplies in certain cases. Huajian also has a workshop to manufacture shoe materials in Ethiopia. While the workshop mainly serves its own factory, it used to sell materials to local shoe factories when its capacity allowed. Its clients were mainly small and medium-sized Ethiopian shoemakers selling on the domestic market. However, after 2017 Ethiopian customs officials ordered Huajian to stop supplying local shoemakers as Huajian enjoyed duty exemptions to export 100 percent of its products, not to sell locally. Huajian complied with the order, but local shoemakers suffered. Local shoemakers banded together with LIDI and lobbied the government for permission to continue purchasing supplies, but as of August 2018, the policy remained in place and unchanged. Stakeholders in the leather sectors criticized government officials for not understanding the shoemaking business, since imposing constraints like these on

foreign investors ultimately resulted in limiting the growth of indigenous manufacturers.

Ethiopian shoe factories sell more in domestic and African regional markets, as market demands have increased in recent years along with a growing middle class. Thanks to tariff protections against imported shoes in Ethiopia, the margin in the local market is almost double as compared to exporting. The manufacturers in Ethiopia also have a relatively good capacity in comparison to other African countries.

CONCLUSION

INVESTIGATING ETHIOPIA'S LEATHER and leather product sectors' development trajectory clearly demonstrates that Chinese investments have indeed contributed a great deal to both exports and employment. However, closer examination of the interaction between Chinese and Ethiopian stakeholders puts sustainable growth and effective knowledge transfer into question. All of the Chinese tanneries and manufacturers attach great importance to market mechanisms. They develop their expertise and capabilities according to client demands and put an emphasis on timely delivery, good quality customer service, and mobilizing resources in Ethiopia and China to meet market needs. Ethiopian factories are not lagging behind in terms of machinery or production techniques, but their understanding and knowledge of the international market is very limited. Both Ethiopian managers and authorities appear to be interested in Chinese firms' technical skills without recognizing the market logic behind successful Chinese business practices. Their

takeaways from Chinese factories have been largely constrained to production management and technical imitation. Yet, technical improvements without markets and customers to sell to are useless and unsustainable.

POLICY RECOMMENDATIONS

1. Ethiopian government ministries need to act together in concert to help elevate the leather industry.
2. The Ministry of Agriculture should educate small collectors in proper storage techniques to improve the quality of the skin and hide supply.
3. The Ethiopian government's policy making needs to include a careful analysis of market mechanisms as an integral component to industrial policy. ★

ENDNOTES

1. National Planning Commission, Growth and Transformation Plan II, p. 141.
2. Proclamation No. 8J4/2013, "A Proclamation to Provide for Raw Hides and Skins Marketing."

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THE SAIS CHINA-AFRICA RESEARCH INITIATIVE at the Johns Hopkins University School of Advanced International Studies (SAIS) in Washington, D.C. was launched in 2014. Our mission is to promote research, conduct evidence-based analysis, foster collaboration, and train future leaders to better understand the economic and political dimensions of China-Africa relations and their implications for human security and global development.

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