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SOME FINANCIAL ASPECTS OF THE DEVELOPMENT OF THE LEATHER AND LEATHER PRODUCTS INDUSTRY IN AFRICA*

prepared by

UNIDO Secretariat

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I. FEATURES OF THE PRESENT SITUATION

It should be explained at the outset that we shall be dealing here only with the "modern sector of the leather industry", it being however understood that in all countries there exists a mainly rural informal sector of traditional leather craftwork (tanners, shoemakers, saddlers), which while being far from negligible from the output point of view is, as the now accepted term "informal sector" indicates, poorly covered statistically and has few direct contacts with the rest of the monetary economy. It is therefore difficult to analyse it, but one day consideration will have to be given to the extent to which the technological skills of this informal sector can be better appreciated and utilized for the industrial development of the sector as a whole. A number of developing countries (such as India) have already instituted systems to take a census of and to guide the informal sector. In the African countries it should be pointed out also that this sector is a fertile breeding ground for potential small enterprises, and that in a number of cases the boundary between informal sector and small industrial enterprise may be quite indistinct.

A. The main problems

The main problems faced by the leather industry in Africa (at least in the countries not having a long tradition of leather working) are well known and will therefore only be briefly recalled here:

(i) Insufficient attention accorded by breeders to the on-the-hoof quality of hides and skins, leading to a relatively high percentage of hides in bad condition. The number of defective hides is further increased by the flaying and curing operations, which are not always properly carried out.

(ii) Relative inefficiency of the system of collecting hides and skins, leading to the exclusion from the processing circuit of anything up to 60 to 90 per cent of the hides of slaughtered animals. The inadequate renumeration of stockbreeders (sometimes reaching only 10 per cent of the world price level), at the time of collection of the raw hides, is to a great extent responsible for this escape of raw materials, even for its complete disappearance. At the same time this inefficiency may be explained also by the fact that the collecting agencies may belong either to the private sector and hence be angled towards immediate speculation, giving preference to export of the raw product rather than to processing within the country resulting in added value, or to the public or para-public sector, where the management is frequently inclined to neglect the impact on profitability, costs and performance of the operation and organization of the enterprise in its commercial aspects.

(iii) Management difficulties in manufacturing enterprises downstream from collection, and responsible for contributing the maximum added value during the processing of the final product:

- Tanneries are frequently of excessive size, or alternatively suffer from under-utilization of their productive capacity, which naturally has an unfavourable effect on their production costs, by inflating the fixed cost without permitting a reduction in the variable ones. In general management leaves much to be desired, the profit motive frequently and paradoxically playing a secondary role in the intentions of management, particularly where the undertaking belongs to the public or para-public sector.

(iv) Finished product manufactures (downstream from tanneries) producing leather articles (footwear, clothing or other items) are also liable to under-utilization of their capacities, owing to the absence of market outlets, whether internal (local markets whose strength does not match the cost of products) or external (design or quality not suitable for foreign markets).

(v) Another widespread managerial deficiency lies in the inadequacy of working capital financing, and difficulties in guaranteeing regular operation of the enterprise, either as a result of an insufficient number of hides collected (owing to a lack of funds for their purchase), or of the absence, for the same reason, of spare parts or processing chemicals, this factor being aggravated by the existence of obstructive exchange and import controls.

(vi) Note should also be taken of the shortage of trained staff at both technical and managerial levels. In this field also financial resources and the willingness to plan appropriate basic or further training are frequently absent, thus reducing the level of performance of undertakings.

(vii) Non-integration of the leather sector in the general stockbreeding policy. It is frequently stated that in stockbreeding the "fifth quarter" is the one which is profitable and makes all the difference. However, before anything else is done, the maximum should be derived from the "first quarters". Rational herd management (fixing of off-take rates) and the installation of tanneries or leather industries near central abattoirs or meat packing plants are ways in which policies for exploiting stockbreeding potential can be integrated.

(viii) There is another noteworthy feature which has implications as regards economic efficiency and financial management. This is the problem represented by the type of institutional framework responsible for defining strategies and policies and by the choice of management of enterprises. State intervention is essential in defining strategies and selecting policies. It is not always essential, and may even prove to be negative, as regards active intervention, strict control of prices and margins, and the taking of complete responsiblity for the management of enterprises, or even periodically intervening therein. The nationalization of enterprises, whether at the level of collection of hides or at that of leather or leather goods production, has sometimes resulted in management which has been inefficient, sluggish and more interested in pursuing a short-term social and economic aim than in medium-term prospects and bold marketing. Without going so far as to affirm that all undertakings in the sector should be left to private enterprise having the sole aim of showing a profit on the capital invested, it must be observed that the participation of private entrepreneurs, motivated by the risking of their capital or their reputation, can yield better management results than nationalized undertakings managed by officials. Present evidence indicates the advantage of "joint ventures", or management contracts concluded with private enterprises, even foreign ones, particularly for purposes of rehabilitation of existing production units.

(ix) Finally, the financial circumstances of the country also govern the expansion of the leather industries, whether it is a matter of establishing new production units or rehabilitating ailing, stagnating or sluggish existing establishments. National development banks have not always given evidence of their feeling for economic sense, or their capacity to analyse the prospects for the investment projects submitted to them. They are frequently also not interested in financing working capital. The commercial banks, on their side, do not always possess the boldness or the financial and psychological capacity to determine the conditions on which they are prepared to support their entrepreneurial customers. Initial distrust of small and medium enterprises is widespread in banking circles. Industrial enterprises in the leather sector are indeed frequently establishments whose small size, lack of room for financial manoeuvre and large number are a source of anxiety to bankers anxious not to multiply their risks and to hedge them by a maximum of tangible securities. Strict import or exchange controls can also place too many obstacles in the way of the smooth operation of industrial undertakings. The financial implications of these circumstances and constraints are - as can be seen - extremely numerous. We must now consider how the attitude of finance, and the development of new approaches, new systems of managerial control and new methods of financial intervention and support can help to solve these problems and constraints.

B. The financial reflection of this situation: A recent exhaustive and closely documented critical study has been performed by a team of international consultants on behalf of UNIDO. 1/

(i) Pages 110 to 114 of the above-mentioned report represent the first attempt ever made to assess the (theoretical) economic and financial losses which the African continent suffers as a result of the gap between its potential for the industrial processing of leather and the real situation encountered on the spot. The results, offered with the usual reservations when dealing with such overall and systematic calculations, reveal the following deficiencies:

- The mediocre quality of the hides collected at present costs Africa about US$400 million (reduction of 30-40 US cents/square foot x 1.1 billion square feet representing the potential maximum of usable hides).

- The low level of hide collection in relation to the theoretical maximum represents a loss of US$425 million for Africa (385 million square feet x 1.10 US$/square foot).

- Processing of hides to an insufficient extent in terms of added value costs Africa an average of US$2.9 billion per year, in relation to what would be possible if all hides could be processed to the finished leather stage.

(ii) Comparison between added value and investment costs at the various stages of leather processing.

In this same study ("Integrated programme ...") the authors make an attempt to analyse the value added to the basic price of the raw material (hides and skins) by the various stages of the treatment process. They recall that it is usual to consider the following production sequence:

Raw hides - wet blue - crust - finished leather - leather articles.

The analysis carried out on pages 115-119 of the above study is supplemented by a comparison with the average investment costs required for the transition from one industrial stage to another, with a view to deriving evidence on the purely economic and financial advantage of moving from one stage to the next.

1/ Integrated programme for the development of the leather and leather products industry in Africa (X/RAF/85/610) (March 1986).

The values indicated are of course averages and should not be considered as reliable pointers to the real cost of manufacture or the cost prices of various activities in the leather industry. The authors of the study also refer to a UNIDO survey carried out in 1973 in an African tannery operating at 100 per cent capacity and using local raw hides. 1/ In spite of these reservations, the percentages calculated remain significant.

Theoretically, the gross gains in added value at the various levels of leather processing are the following:

	Percentage increase in the value from one stage to the next	Value per ft^2 (in US$) 1973
Purchase price of raw hides		0.187
First level: from raw material to wet blue	+ 66%	0.310
Second level: from wet blue to crust	+ 32%	0.410
Third level: from crust to finished leather	+ 12%	0.460

In order to obtain a more realistic idea of the importance of these industrial activities to the national economy, it is necessary to isc te from these results the additional recurring costs in foreign exchange which each fresh stage in the treatment process involves, and then the new net gains become:

		Value per square foot, US$ (excluding expenditure in foreign exchange)
Purchase price of raw hide		0.187
First level:	+ 40%	0.262
Second level:	+ 23%	0.322
Third level:	+ 2%	0.329

These net gains in added value should be compared with the increased investments called for.

In this connection use has been made of the investment levels applicable to the various stages of the leather industry derived from the collection of industrial profiles which UNIDO (Investment Co-operation Programme Branch) issues and regularly brings up to date. 2/

1/ Some economic aspects concerning the establishment of tanneries in developing countries ID/WG.157/11, 1973.

2/ How to start manufacturing industries: files C6, C7, C8.

For an average plant processing 110,000 cattle hides per year (60,000 dried cattle hides (area 190,000 m^2) and 50,000 wet salted cattle hides (area 200,000 m^2), and 400,000 dried goat skins (area 220,000 m^2)), the relevant investment data are the following:

	In $ Total investment	In $ Investment cost per m^2 processed		In $ Investment cost per job
Level of treatment:				
Hides to wet blue	345 600	0.576		12 000
Wet blue to crust	519 300	0.866		27 333
Crust to finished leather	492 700	0.821		27 372
Total	1 357 100	2.263	Average	20 562

The comparison between the percentage net gain in added value (after deduction of recurrent supplementary expenditure in foreign exchange) and the additional investment required for each new processing stage is given in the following table:

	Net gain in added value/preceding stage	Net gain in added value/raw material	Additional investment costs/preceding stage
1st level	+ 40%	+ 40%	-
2nd level	+ 23%	+ 72%	+ 50%
3rd level	+ 2%	+ 76%	+ 57%

It will thus be seen that passage to the second processing level involves a net added value gain of 23 per cent but requires a supplementary investment of 50 per cent. Passage to the third level, will require a supplementary investment of 57 per cent for a net gain in added value of 2 per cent only. Proceeding to the third processing level of the raw material thus implies very substancial supplementary investments in return for a very modest increase in net national added value. If one also takes account of the low level of local development of the leather goods industry, the slender domestic markets for such commodities, the slight increase in net value added and the requirements in terms of skilled labour, transition to the third level does not automatically seem to be essential for many developing countries, from a strictly economic and financial point of view, particularly if one considers the large number of industrial sectors which require expenditure of foreign exchange. On the other hand, since the added value balance remains positive in any case, account must also be taken of social and political pressures which may make it necessary to maximize at any cost the creation of additional local added values.

II. THREE SERIES OF RECOMMENDATIONS WITH FINANCIAL IMPLICATIONS

1. Rehabilitation rather than new establishments

If there is under-utilization of tannery or leather goods manufacturing capacity, the natural reaction is that the time is no longer appropriate to the establishment of new enterprises. More widespread rehabilitation operations on already existing units are desirable instead. However, rehabilitation is quite difficult to implement on the financial level because it consists of reorganizing, restructuring and imparting new life to already existing technical units with their investments, their staff and their technology; it is not the aim to restore these for productive purposes, but to reintroduce a dynamic outlook into them.

It is by no means certain that the costs involved in rehabilitation are much lower than those required for the establishment of a new undertaking or that the necessary procedures are easier to apply. In some countries systematic rehabilitation programmes have been launched; they of course involve financial intervention, since they have to do with enterprises in difficulty, i.e. having problems of financial balance. In the case of such rehabilitation programmes, the tendency of governments - normally, incidentally, wrestling with budgetary problems - is to call on foreign financing whenever possible or on private financing. The financiers associated with foreign aid operations are frequently reluctant to contemplate rehabilitation, which appears to them difficult to control owing to the constraints represented by what is already there. In addition, it is normal to consider that the leather industries under normal conditions are profitable industries, which therefore do not need to enjoy particularly easy terms of financing. Rehabilitation projects, when recommended, therefore encourage the economic authorities to turn to national financiers in the private or para-public sectors or to private foreign partners. In a general way, any partner finally selected will be anxious not to take over the liabilities accumulated by the enterprise, and will want to be in a position to control management. The most frequent solution will consist of:

- The State taking over the liabilities accruing during the previous management (particularly in the case of an enterprise in the public or para-public sector (PPS)), the State incidentally waiving its own fiscal or semi-fiscal claims upon the company.

- Proceeding to liquidation of the former company or enterprise, simultaneously with the establishment of a new entity.

- Floating a new company which will take over the assets of the old one (by way of a government financial contribution - as shareholder for example), the new partner contributing only the fresh money essential for financing the working capital or purchasing specific new items of equipment.

- Sometimes it is possible to distinguish an "inheritance company" (which will take over the assets of the former enterprise), remaining the property of the State, and a "management company", in the form of a mixed-economy company in whose capital the State will participate together with the technical partner.

- The advantage of calling in a foreign technical partner lies essentially in the acceptance by the latter of responsibility for management, and in the contributions which he will make in terms of transfer of technology and the guaranteeing of market outlets. This type of agreement frequently gives rise to a "management contract" in quite strict terms strongly resembling a concession agreement with the rights and obligations on each side clearly defined, together with certain provisions as regards organization, management and price conditions or enjoyment of advantages as set forth in the Investment Code.

- Before launching the rehabilitation operation, it is also frequently of value to involve in the project a local development bank in order to guarantee any necessary supplementary financing in the medium or long term, and a local commercial bank for the purposes of financing the working capital. These two categories of establishment, which are often reluctant to intervene directly, may prove to be more favourable to the idea of a simple supporting intervention provided that it is certain that there will be a new management and that the rehabilitation plan is sufficiently convincing on the technical, commercial and financial levels.

- In the tanning sector, where the investments required are not in fact very high, it is not difficult to find a foreign partner, because there is in fact a world shortage of good quality tanned hides. As regards factories producing leather articles, foreign partners may be inclined to intervene if a guarantee is given to them by the local economic authorities regarding technical management (design, quality control), commercial management (regularity of supplies) and financial management. Such foreign partners may be footwear manufacturers, luggage manufacturers, couturiers or ready-made clothing manufacturers, and in many cases may wish to participate personally in management.

- Co-operation with southern countries in matters of rehabilitation may at first sight appear more difficult, although it could prove beneficial or in terms of transfer of technology or techniques for organizing manufacturing operations and marketing. Certain countries which already have a well-developed leather sector in Africa (Morocco, Zimbabwe) or elsewhere (India, Mexico) might turn out to be excellent partners. The main difficulty is that the promoters in these southern countries, whether public or private, rarely have the ability to contribute fresh money, something which is essential for relaunching an enterprise on a new basis, without going in further detail into the fact that these countries would then find themselves in competition from the point of view of maximizing job creation.

- The intervention of a foreign partner belonging to the same sector also offers the following advantages:

  . Facilitating access to foreign markets;

  . Making possible clearing operations, exports of leather or leather products to the undertaking operated by the foreign partner being paid for, e.g., by shipments of chemicals without foreign exchange leaving the country. It is of course necessary to make certain that the national financial legislation governing foreign exchange permits this form of export-import without having to go through the stages of repatriation of foreign exchange and licensing of the export thereof.

Conclusion

The rehabilitation of existing enterprises is quite difficult. It is not necessarily less expensive, but makes it possible to limit the losses incurred in the past. It may involve the State in a relatively modest initial effort (waiving or clearing settlement of debts).

It makes it possible to transform the management conditions of the enterprise, and to call upon the local or foreign private sector. Local financial institutions should be involved, even if they are not the principal agents of the operation. In fact, it is not sufficient merely to put back on the rails an enterprise which was previously in difficulties, but steps must also be taken to ensure that it will be able to continue operating and that it will not suffer from any further shortage of raw materials or chemicals owing to the temporary absence of working capital.

2. Large units, small units, small or medium industrial enterprises (SMIE) or very small enterprises (VSE)?

Study of the VSE concept is relatively recent, and its emergence has coincided with the flourishing of this type of enterprise in the economic systems of advanced countries. For certain industrial sectors in the developing countries, the idea of the VSE will be worthy of investigation, because it can be particularly valuable for filling the gap between the informal sector and the SMIE. In particular it seems that in the leather products sector, in which the essential investment is not exhorbitantly large, the transfer from the stage of "village shoemaker" to the VSE making shoes (or other articles) should be relatively easy, calling only for the use of new managerial techniques or the formal introduction of production techniques or managerial attitudes, which are less difficult to assimilate than the financial and technical constraints implied by passage to the SMIE stage.

Regarding tanneries, the passage to the modern sector imposes financial and technical constraints due to the desire to show a profit in relatively heavy investments, to benefit from economies of scale, to avoid under-utilization of productive capacity and to guarantee consistency of product quality. It is therefore difficult to imagine the involvement of VSEs in this area of activity. However, profiles of enterprises indicate that the level of investment and the labour force required are within the reach of SMIEs, at least up to a certain stage of finishing of the product.

Thus, in order to reach the wet blue stage in a medium-sized plant 1/ handling 200,000 m^2 of dried cattle hides, or 220,000 m^2 of goatskins, the FOB investment, including a spare parts reserve, would be about US$350,000, and would need 29 persons operating in a workshop of 750 m^2. The cost of creating a job would be US$12,000. A medium-sized plant employing 48 persons, covering the wet blue leather and crust levels and having the same processing capacities, would require an investment of about US$870,000, and the cost of job creation would be US$18,000.

1/ "How to start ...".

Although an integrated plant of this type needs to make provision for various specific arrangements of the process sequence leading to the wet blue stage, it can nevertheless be approximately estimated that the wet blue to crust treatment sequence needs a supplementary investment of about US$500,000 with 19 additional staff (mainly skilled workers). Technical and financial hindrances represented by investment of US$500,000 and a workforce more than half of which is composed of skilled labour and relatively senior staff are very serious for a SMIE in a developing country. Experts nevertheless recommend reaching this level of processing of the raw material, in view of the substantial gains in added value and the complementary earnings effected in export operations, because it is cheaper to handle and carry crust than wet blue which still contains a large share of water.

In conclusion:

- For leather articles (footwear, handbags, clothing and other items), it is possible to conceive that the developing countries could proceed to industrialization on the basis of VSEs, SMIEs or large units, with nevertheless a preference for VSEs and SMIEs, owing to the fact that market uncertainties are fairly marked thanks to the effects of fashion, design and customer taste. Indeed, VSEs and SMIEs are in a better position to adapt themselves to market trends than are large units. The investment costs per job also remain fairly low, from US$3,000-5,000, and are acceptable to this kind of promoter (factory with a capacity of 1,200 pairs/day).

- As regards a tannery working for export, the minimum production threshold is 200 cattle hides/day or 60,000/year. This is approximately the capacity referred to above. It is a practicable proposition for SMIEs provided that they go no further than the wet blue stage. However, if the transfer is made to the crust level (let alone the finished leather stage), the investment sums and the skilled workforce required are such that we move into the sphere of operation of the medium or large enterprise. The passage from one technical level to another of course represents each time a gain in added value for the country hosting the enterprises in question.

Most African countries have remained at the wet blue level, with frequent under-utilization of an installed capacity going beyond the SMIE sphere. One could therefore imagine a separation between units producing wet blue leather and those undertaking the operations leading to the crust level.

3. Suitable financing procedures

(a) The manufacture of leather articles at industrial level depends on the regularity of the supply of finished leather. If there is a local finishing undertaking, it will reserve part of its output for manufacturers of leather products. If no such undertaking exists, it will be necessary to import finished leather. Consequently, in either case there will be a need for leather article manufacturers to have sufficient working capital available. This is normally the principal difficulty encountered by the SMIEs and even more by VSEs, which are too small to benefit from foreign funds and are obliged to turn to local finance and banking institutions; these are normally reluctant to help them owing to anxiety regarding their managerial capacity, weakness of financial infrastructure, and insufficiency or even total absence of real security, since the type of activity and the operating conditions of these enterprises are precisely such as to call for low investments and presuppose fast turnover of stock.

On the other hand, at the initial investment level, their financial requirements are modest, since for a footwear factory, for example, funding corresponding to about US$3,000 per job is all that is required.

The financing problem is therefore associated rather with working capital expenditures - e.g. the expenditures of the daily running of a factory. It is well known that financial institutions oriented towards promotion of nationally-based enterprises (and particularly SMIEs) 1/ are interested above all in establishing their firms and plants, and in the purchase of machinery and equipment. Recourse to commercial banks therefore seems necessary for this type of financing of working capital expenditures. The present mentality of bankers is not favourable to action of this kind. Frequently the top monetary authorities (Central Banks and National Credit Committees) place commercial banks under a theoretical obligation to show a certain minimum quota of re-financed bills following the grant of credits to SMIEs. However, checks on observance of these quotas remain largely theoretical. The definition of compulsory quotas of re-financable credits granted to SMIEs, at a higher level, and enforcement of respect for these quotas by the banks is a theoretical constraint imposed on the latter. In any case this type of measure would be more convincing if the banks had less fear of the risks involved as soon as they lend money to small or very small enterprises.

Various procedures can be envisaged in this respect, ranging from Mutual Security Societies to Guarantee Funds for SMIEs, and these arrangements could serve both at the investment stage and during subsequent operations. It would also be possible to promote co-operatives or joint purchasing groups, provided that the managements of the SMIEs and VSEs see in them economic advantages and have an adequate sense of solidarity. These kind of arrangements would be of a pious nature, were there not some successful examples in Africa.

Finally, one can conceive co-operation between numerous SMIEs or VSEs grouped together on the one hand, and various foreign manufacturers or entrepreneurs on the other, who would fix manufacturing standards, ensure the transfer of technology, undertake design, and agree to purchase a part of the output on a regular basis, in return for the supply of tanned hides or various other inputs. It would thus be possible to envisage a kind of clearing agreement, which at present is frequently recommended as a way of avoiding stoppages in the supply of inputs and irregularities in production. This type of agreement will be practicable only if there are reciprocal guarantees regarding quality and regularity of mutual deliveries and of understandings in the field of price determination for each item of production covered - something which presupposes joint discussions on matters of management, definition of production programmes, and aims in general. That naturally also presupposes that the VSEs or SMIEs concerned work both for export and for the local market, and are in a position to adapt their various products to the tastes of their different customers.

1/ The reference here is to local development banks or investment companies.

(b) The problems of financing tanneries relate both to the provision of funds when the enterprise is established or when rehabilitation of an existing enterprise is effected, and to regular operation, i.e. the availability of working capital and the problem of determining cost and selling prices.

In the case either of establishment or of rehabilitation, as soon as investment is mentioned, thoughts must turn on the question of Promoter's Funds or Permanent Capital. Although certain tannery units (for example wet blue) call for an investment which is conceivably within the capacity of the individual, it is rare that in a developing country a single promoter is in a position to contribute the whole of the necessary capital. On the other hand it has become well known that the individual contributions of the promoter should reach a minimum level which, in simplified terms, may be estimated at not less than 20 to 25 per cent.

The rest of the permanent capital may originate:

- From participation by local financial institutions (local development banks or investment companies) in cases where the SMIE acquires the status of a company and provided the promoter agrees to share managerial responsibility - which is frequently desirable. Direct participation of this kind thus offers the advantage of not immediately burdening the future operational balance sheet with financial costs, and of procuring support for the promoter in the matter of management. However, participation of this kind normally ensues only after the production of convincing project feasibility reports, which in its turn assumes that the promoter is capable of preparing them or that there exists a "support centre" for SMIEs with particular responsibility for drafting these feasibility reports.

- From financial participation by local or foreign associates. The intervention of a foreign partner offers the additional advantage of being accompanied as a rule by agreements governing transfer of technology, choice of equipment and export market research, and that in general a technical assistance agreement accompanies financial participation. The main drawback, and it is only a relative one, is some restriction on the promoter's autonomy and a degree of dependence on a foreign country. Naturally, when the undertaking is a large one and when the State is itself the promoter, or when it is a case of establishing a new enterprise, the negotiating strength of the local partner *vis-à-vis* the foreign partner is greater than in the case of an individual promoter or of a rehabilitation operation.

If the promoter's own funds are not sufficient to furnish the permanent capital, recourse must be made to a long-term loan. Here we must indeed recognize a preliminary drawback to financing by loan, namely the fact that borrowing involves a debt service which will burden the future operating accounts and balance sheets. Another major drawback exists: these loans are normally granted only against collaterals (real securities) which are thus subsequently not available for other loans needed to support the working capital, for example. To offset the first drawback provision must therefore be made for delays and terms of payment which will vary depending on the time the enterprise requires to become operational. Regarding the second drawback, an effort must be made to persuade institutional lenders (in general local development banks) to modify their security requirements (mortgages on property, liens on machinery) and at least to increase their estimate of the value of the real security in relation to the worth of the assets. Such a proposal means from part of the banks or financial institutions a new approach and mentality regarding their financial relations with SMIEs or VSEs:

- Either they agree to abandon the requirement of collaterals for short-term loans (for working capital) and agree to new shapes of guarantees such as for example the "Société de Caution Mutuelle" (Professional Mutual Guarantee Unions).

- Either especially the public financial institutions depending on the state and multinational lines of credit, agree to trust the small "entrepreneurs" who normally may bring only their knowledge, their intelligence and respectability as guarantees. Such institutions can open to them checked overdrawings or short-term loans which, in case of default, could be compensated in a National "Guarantee Fund Scheme" or any other equivalent scheme.

- Or the banking system in general, agrees to adopt a more understanding view regarding the estimation of collaterals and, e.g. instead of taking a US$1000 valued equipment as a guarantee for a loan of only US$400, agree to increase the estimated value of the guarantee to US$800.

<u>Origin of these loans</u>: In the case of an undertaking in the public or para-public sector, the loans can come just as well from the State or from public financial institutions as from abroad. In general, it will not be necessary to provide real pledges to secure loans, even foreign ones, because they will be guaranteed by the State. On the other hand, in the case of a large private undertaking, the State may, or may not, guarantee a foreign loan. In general the loan will be transmitted to the enterprise by local financial institutions which will then proceed to obtain the necessary real security.

The main specific problem raised by foreign loans lies in who meets the risk of exchange factor. It is dangerous for this risk to be taken over by the recipient enterprise, which will then not be in a position to programme its date of payment, or to implement even a provisional programme of financial and funding management. Priority accorded to industrialization assumes that the State will enable industries to develop in a difficult technical and commercial environment, but one which will not be further perturbed by financial hazards beyond their power to control.

Some analysts believe that all foreign loans should be considered as being made to the State, as a substitute for non-available or uncollected national savings, and that only the State should bear the exchange risk and certainly not the industrial enterprises receiving the credit.

<u>Domestic loans</u>: Loans of this type granted to an enterprise in the para-public sector raise no particular problems. It is merely a matter of deciding where funds available in the investment budget should be placed. They may or may not pass through the intermediary of the local development bank. Advances directly granted by the Treasury are in fact most frequently a form of supplementary capital, because neither the conditions of repayment nor the interest are always stipulated. They may also take the form of equipment subsidies, and here the situation is clearer. Loans to enterprises in the para-public sector will most frequently originate from the local development banks, and the question of theoretical securities will then arise. It would be normal to think that the same financial logic will then be applied to enterprises in the para-public sector as to those in the private sector. One is dealing with undertakings which are intended to be profitable, thanks to sound management and to accepting the spur of competition, which should thus yield competitiveness and profitability.

One may think that in in the industrial field the same financial principles should be applied to all enterprises, whether they belong to the para-public or to the private sector. A financial advance or subsidy should be reflected by an increase in capital and intervention in or modification of management, all the more so if the operation is specifically one of rehabilitation, i.e. a thorough recasting of the managerial and operational conditions. If on the other hand one is dealing with a loan from a local development bank, there is no logical reason why a para-public enterprise should enjoy more favourable conditions than one in the private sector.

Domestic loans to enterprises in the private sector raise greater difficulties. When the loan originates from a public or para-public financial institution, of the local development bank kind, one is faced with the same problems as those explained above with reference to foreign loans passing through the intermediary of local development banks: real security furnished prior to the granting of the loan, insistence on evaluating the viability of the project and the competence of the promoter etc. If the loan is bought from the conventional banking sector (commercial banks), the constraints are theoretically the same as in the context of loans requested from the local development banks, but applied in a different context: there is no longer the insistence on examining profitability and cash-flow forecasts, on structural checks and balances, or on guarantees which may range from real security to payment of a deposit etc. It may be noted that banks operating in the developing countries display a tendency to establish their own sections for surveys, studies and advice to enterprises, while continuing to exhibit a clear preference for supporting commercial enterprises rather than industrial ones. Here it has to be admitted that the poor liquidity of commercial banks discourages them from making long-term loans for purposes of industrial development instead of short-term loans to commercial enterprises, whose operations are conducted swiftly, thus permitting rapid repayment.

Conclusion

In the case of units manufacturing leather articles, the requirements in terms of initial capital are relatively modest, and it is not necessary to borrow in order to finance these investments. On the other hand these manufacturing units must have recourse to loans for financing their working capital, and they will in this connection turn to the banks or conclude clearing agreements with a foreign partner.

In the case of tanneries, depending on the level to which the raw material is processed, we shall deal with the financing capacity of SMIEs or of large enterprises. Partnership in a joint venture with a foreign operator is recommended, and may take the form of inverse flow financing agreements, and for transfer of technology from abroad to the enterprise and of finished products abroad. Clearing agreements and direct participation frequently make it possible to solve problems both of financing investments and financing operations. If the need for a loan arises, certain widespread practices which handicap the enterprise from the very start should be changed, for example poor synchronization of the term of the loan with the lifetime of the investment equipment, payment datelines not integrated with output, the question of real security, responsibility for exchange risks, and failure to evolve a proper plan for financing the enterprise covering working capital, training expenses, marketing costs and so on.

4. Environmental constraints imposed by the leather industry and their financial implications

(a) Whereas the existence of units manufacturing leather articles can be conceived even if the raw material utilized (finished leather) is not locally produced, that is not the case for the tanning industries. The first constraint in a tanning industry is therefore the collection of a substantial quantity of raw hides. In order not to place too heavy a burden on the cost price of the manufactured products, it is important that the basic raw material should have as low an initial cost as possible. However, in order to ensure maximum collection, the price paid to producers must also represent an incentive. The only room for manoeuvre is therefore with the costs associated with collection. It is necessary to establish a simple, flexible, inexpensive and effective collection structure. The administrative systems frequently established in Africa do not seem to have been entirely satisfactory in the light of the results obtained: poor quality of hides, avoidance of the purchasing teams by the producers, little incentive attaching to the prices offered, cumbersome and expensive purchasing teams. Conversely, adoption of a system founded exclusively on private collectors is also not automatically to be recommended, because although the results in terms of the percentage collected may be better, it is by no means certain that the products collected reach the tanneries regularly and in sufficient quantities.

The establishment of a suitable collection system will therefore depend on numerous local criteria, particularly on the economic and sociological climate and on the transport infrastructure, the geographical distribution of stockbreeders, and the existence of regulations (together with the degree of respect therefor) governing export of raw hides.

(b) Intermediate storage arrangements are essential. Thus, a tannery with a capacity of about 2,500 million ft^2 (i.e. approximately 250,000 m^2) requires 1,000 m^2 of buildings if the level of treatment ends at the wet blue stage, 2,300 m^2 if processing is taken to the crust level, and 3,100 m^2 if the final leather stage is reached. 1/ The construction of 1,000 m^2 of industrial buildings costs at least US$215,000. The making available of industrial land and building by the State, in its desire to promote industrialization, therefore seems essential: in order to make the cost more bearable for SMIEs, recourse is suggested to the leasing of industrial estates, or the use of industrial waste land. However, such land is in general available in urban industrial zones, and is hence not really suitable for tanneries, which have a considerable polluting effect and require very large quantities of process water together with arrangements to protect the environment.

(c) The water requirements of tanneries are enormous: a minimum-size unit processing 200 hides per day will require at least 135 m^3 of water per day, an extremely heavy and costly constraint in the Sahel zone, which is at the same time the area most suitable for stockbreeding.

(d) The "chemical products" constraint associated with processing is undoubtably the most serious for a facility located in countries permanently short of foreign exchange, since these items are mostly imported (at least in the case of finished chemical products). Merely the production of wet blue leather requires 15 different chemicals for an annual total of 258 tons (tannery processing 200 hides per day). Proceeding to the crust level calls for 10 further chemicals with an annual tanning output of 50 tons. However solutions can now be regarded as available consisting of clearing or barter agreements with industrialized countries producing the necessary chemical mixtures and with the leather importers.

1/ "How to start ..."

(e) The energy constraint is also important for tanneries: regularity of supply, installed capacity, power consumption may reach 1,100 kWh/day in a tannery processing 200 hides per day. In view of the cost of power in the Sahel countries remote from production areas, and where electricity can cost up to 50 US cent/kWh, it can be seen that this constraint will weigh heavily on project evaluations.

(f) The spare parts constraint is important in the case of a tannery using various items of equipment subject to severe wear. The generally accepted industrial profiles take the precaution of including a stock of spare parts in the equipment constituting the initial investment.

(g) The transport constraint concerns tanneries both at the stage of collection and at that of sale to local or foreign purchasers. Freight charges in many sub-Saharan African countries are certainly among the highest in the world.

The aim must therefore be to limit their impact, on the one hand by establishing the tannery near to the main production centres of the raw material whenever possible, and on the other hand by minimizing the ratio freight charges/product value for the final product. This is possible by increasing the denominator in the above ratio, hence by taking the product to its furthest level of processing. The less the processing to which the product is subjected, the greater the percentage of freight costs in its selling price.

(h) The human constraint is basic. Whereas the tanning industry does not make excessive demands on labour in quantitative terms, it is nevertheless relatively demanding in terms of skilled labour and craftsmanship: between 55 and 60 per cent of the total labour force depending on whether one stops at the wet blue or the crust stages. That means that an appropriate environment regarding education and vocational training should exist or must be established.

- Several countries which have decided to promote the development of the leather industry have established training institutes which have gained a favourable reputation abroad. The existence of these training institutes represents an opportunity for improving and increasing south-south co-operation through exchanges of students or participation in co-operative research and training programmes.

- Governmental policy regarding vocational training implies a choice between a permanent training system intended to promote the establishment of new manufacturing units, or the establishment of units responsible for supplying areas of vocational training as required, on an on-the-job basis.

In most African countries it is the second system which will be preferred, thanks to the uncertainties which still exist regarding the likely extension of the leather sector, and hence regarding the prospective need for skilled labour.

This last remark leads one to recall the importance of making generous financial provision to cover the cost of training which should represent a part of the working capital. Training expenditure normally constitutes an item of operating costs in the same way as staff costs in general. But are they not also a form of intellectual investment, hence an item of fixed costs? That raises the problem of what type of financing is appropriate for these expenditures. Some experts believe that training costs should figure among the long-term financing requirements. That is in particular the view of the World Bank.

CONCLUSION

The leather industry (tanning and leather articles) is paradoxically characterized by an under-utilization of installed capacities and a shortage of leather on the world scale. The recent development of this industrial sector has occurred in an uncontrolled fashion in Africa, and has led to a situation in which numerous enterprises which were originally not well calculated and not well integrated in the economic system are now bankrupt or at least having to default on payments and in a most critical financial condition.

The initial conditions of financing are in part responsible for this state of affairs. The production potential and the market potential of African tanneries are enormous, and the under-utilization of installed capacities results in high losses which can be reckoned in billions of dollars over the whole continent.

An analysis of the values added at the various stages of the processing of hides shows that the optimum stage in Africa is the crust level, whereas passage to the finished and dyed product level (third stage) requires a great increase in expenditure of foreign currency in return for a small increase in added value.

A financial analysis of the economic situation and prospects shows that sources of financing should be devoted more to the rehabilitation of existing units in Africa involving total or partial disengagement by the State and by recourse to joint ventures or to technical support from abroad. This rehabilitation operation should be accompanied by a search for new financing procedures, such as clearing or repurchase agreements.

It also seems that whereas the manufacture of leather articles can be envisaged on the basis of the VSE or of the SMIE, tanneries on the other hand should proceed to the SMIE level or even to that of the medium-sized enterprise.

The modes of financing to be encouraged should allow for the fact that the enterprises concerned are of the SMIE type or in other words the modern fringe of the informal sector, and the local banks should be associated in the work in order to ensure financing of the initial investment, particularly the working capital. Financial and banking institutions should reconsider their loan-securing arrangements, so as to meet the situation of enterprises in the leather industry.

There is also a clear consensus that the financial difficulties of the leather industry can be solved only if the economic and financial authorities consider the financial implications of the environmental constraints upstream and downstream from the leather industry, constraints which govern the operation of this industrial sector. Each of these constraints calls for a particular kind of financial intervention.

Finally, it is observed that the situation of the leather industries in the various African countries is extremely varied, and that the financial constraints are felt there with an extremely wide-ranging degree of seriousness. In a general way, the technical and organizational level achieved by the leather industry in the countries of northern Africa (Morocco, Tunisia and Egypt in particular) justifies the industrialists of those countries regarding the future with much more optimism than their counterparts in the countries of sub-Saharan Africa, where in the majority of cases there exist the most serious structural imbalances and inadequacies, both technical and financial.