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INDUSTRY PROFILE

Industry, Science and Technology Canada
Industrie, Sciences et Technologie Canada

Leather Tanning

Canada

INDUSTRY PROFILE

LEATHER TANNING

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1988

FOREWORD

In a rapidly changing global trade environment, the international competitiveness of Canadian industry is the key to survival and growth. This Industry Profile is one of a series of papers which assess, in a summary form, the current competitiveness of Canada's industrial sectors, taking into account technological and other key factors, and changes anticipated under the Canada-U.S. Free Trade Agreement. Industry participants were consulted in the preparation of the papers.

The series is being published as steps are being taken to create the new Department of Industry, Science and Technology from the consolidation of the Department of Regional Industrial Expansion and the Ministry of State for Science and Technology. It is my intention that the series will be updated on a regular basis and continue to be a product of the new department. I sincerely hope that these profiles will be informative to those interested in Canadian industrial development and serve as a basis for discussion of industrial trends, prospects and strategic directions.

Robert de Cotret

Minister

1. Structure and Performance

Structure

Through a variety of complex tanning and finishing processes, the Canadian leather tanning industry converts raw hides and skins into leather of all types. This includes shoe upper leather; shoe sole and lining leather; glove and garment leather; bag, case and strap leather; and upholstery leather. Climatic conditions influence the thickness and weight of cattle hides. Because of Canada's cold climate, most of its supply of raw hides and skins is in the medium to heavier grades, which are ideally suited to shoe leather production. Requiring a greater selection of weight and quality, tanners need to import their lighter hides from warmer climate zones.

Although some fine leathers are produced in Canada (mostly from imported raw or semi-tanned hides), the tanning industry has capitalized on the abundant supply of domestic raw hides to specialize in the production of shoe leathers. As an intermediate product, leather is sold to upstream producers, which in turn manufacture a wide range of finished consumer leather products.

The complete tanning process consists of three basic operations — the primary tanning of raw hides and skins to produce what is referred to in the trade as "wet blue" stock; a retanning or second tannage operation, which brings the leather to a semi-finished or "crust" stage; and the finishing process, which consists of the application of various surface treatments such as coating, colouring, embossing, etc. Chrome tanning (the use of chromium salts) is the most common primary tanning process used to produce shoe upper leather. One Canadian firm still uses an older vegetable tanning process (using bark, wood extracts and other chemicals) to produce such firmer leathers as shoe sole, harness and belting leathers.

In 1987, the Canadian leather market was an estimated $456 million, with total industry shipments estimated at $260 million, exports at $44 million and imports at $240 million. Canada imports leather from the United States, the European Community (E.C.), Argentina and Brazil. It exports mostly to the United States.

The industry comprises 39 establishments located mainly in Ontario (which accounts for about 70 percent of employment and shipments) and Quebec (about 14 percent of employment and shipments). The total work force is estimated at 2200 persons.

Two major tanneries (in Ontario and western Canada) dominate the industry, producing about 40 percent of domestic output and accounting for 25 percent of employment. They are fully integrated operations, processing raw hides from the primary tanning stage through to and including the finishing stage. Considered world-scale plants (in terms of plant size, output levels and degree of sophistication in production processes), they are comparable to their counterparts in other developed countries. Their location near slaughterhouses allows them to use fresh hides. As a result, they lower their production costs by eliminating the need for various preservation operations such as salting, brine curing or refrigeration.

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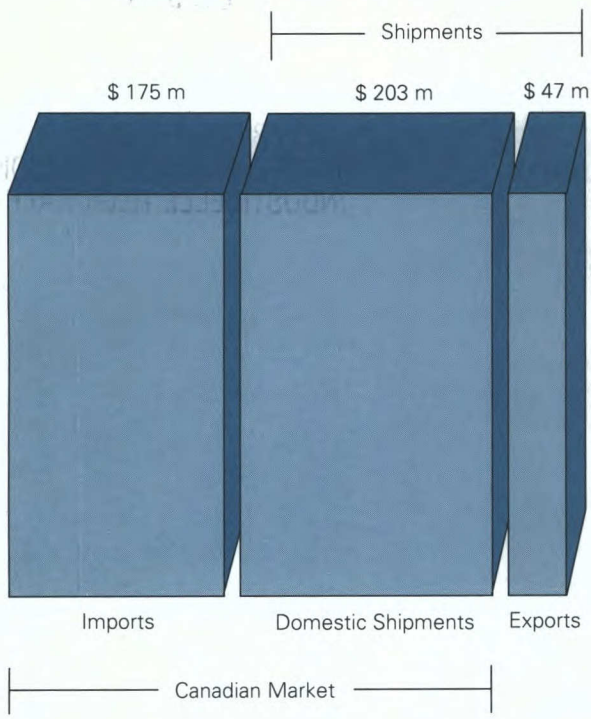


Imports, Exports and Domestic Shipments 1986*

** ISTC estimate*

Two medium-sized Ontario firms are involved in different stages of processing. One is a primary tannery only (producing "wet blue" hides) and the other a finisher of leather splits (in which a hide is severed horizontally over its whole area into two or more layers).

With a few exceptions, the remaining establishments are mostly smaller firms employing fewer than 50 workers each. Some specialize in retanning or contract finishing from the "wet blue" or "crust" stages. Others process sheep, deer and lambskins, etc., primarily for the domestic and regional markets. Only one small firm has integrated "forward," producing both finished leather and finished leather products (footwear). The industry is nearly 100 percent Canadian-owned.

The industry maintains a close relationship with domestic meat packing houses and abattoirs (mainly in Toronto and Alberta) as well as with hide brokers for most of its supply of raw hides. Hides are an internationally traded commodity, highly sensitive to world output and demand for both cattle hides and beef, and subject to erratic swings in price and availability. The supply of hides and skins is governed by a somewhat unusual factor: the demand for red meat. Slaughterhouses produce hides only as a by-product of their primary activity — producing meat for human consumption.

The market for leather is determined by supply and demand. With an essentially fixed-proportion relationship between the availability of hides and skins and the output of leather, the leather *supply* depends on conditions prevailing in the beef products market. The *demand* is influenced more and more by factors such as price and competitive substitutes (i.e., textiles and plastics). For example, recent price increases for hides and leather have led to the introduction of substitutes in some shoe components such as soles.

The major end-use of leather is for processing into footwear. All-leather footwear continues to hold a dominant place in the footwear industry. However, the use of synthetic soles and textile uppers, particularly in athletic footwear, is increasing. In the luggage industry, plastic and textile materials now dominate. Women's handbags are often lined with vinyl and, in many cases, are a combination of leather and textile materials, or of completely synthetic materials.

These substitutions are most common in lower-priced articles. However, a combination of materials and products made from wholly synthetic materials are being offered increasingly by the high fashion industry. The tanning industry is constrained by this demand-supply relationship. Since the markets for leather are highly competitive, the individual tannery must maintain its costs within the limits set by these constraints. The tannery cannot pass excessive costs on to its customers nor can it force down the hide and skin prices of its suppliers.

Demand for leather is driven by a number of factors such as fashion trends (more prevalent in garments), changes in disposable income and, ultimately, price. In fact, the increasingly higher leather prices have been the result of the growing worldwide demand for leather, together with the reduced supply of hides (from the declining slaughter rates caused by lower beef consumption in developed countries). For example, between January 1987 and January 1988, some bovine hide prices have risen by as much as 40 percent.

Two major sub-sectors, *shoe leather* and *glove and garment leather* account for about 50 percent and 25 percent of the total Canadian leather market, respectively. Canadian tanneries have traditionally produced mostly shoe leather (about 65 percent of total industry shipments by volume versus 10 percent for glove and garment leathers).

Performance

The largest sub-sector, *shoe leather*, is dominated by domestic tanneries which currently hold an estimated 75 percent market share, compared to nearly 90 percent in 1976. Developed countries (primarily the United States) have accounted for more than 70 percent of shoe leather imports (on average) into Canada between 1976 and 1987, but their share has been declining in recent years. During the same period, low-cost countries (mainly Argentina) have more than doubled their share of total imports and now account for about 44 percent of shoe leather imported into Canada, compared to 56 percent for developed countries.

The fortunes of the tanning industry are tied closely to those of the Canadian footwear industry, which has seen its share of the domestic market (in volume terms) decline from 48 percent in 1976 to 30 percent in 1987. Further details on the Canadian footwear industry can be found in the Footwear industry profile.

The second sub-sector, *glove and garment leather*, is dominated by imports, which currently hold an estimated 90 percent market share. Low-cost countries, such as Argentina and Brazil, now account for approximately 40 percent of the total imports (compared to about 10 percent in 1976). The United States and the United Kingdom together account for about 36 percent (versus 80 percent in 1976). Only a few firms in Canada currently produce this type of leather, largely from lightweight, semi-finished hides (crust) imported from Argentina.

Exports, as a share of industry shipments, have averaged about 17 percent since 1976. In value terms, it is estimated that about 70 percent of exports are shoe leathers and eight percent glove and garment leathers. The United States has traditionally been the major market, absorbing around 80 percent of Canadian leather exports.

Employment in the tanning industry declined by around 30 percent between 1973 and 1983. Since then, employment has stabilized, reaching an estimated 2200 in 1987, a level not seen since 1979.

There have been two plant closings in recent years. In September 1986, Canada Packers Inc. (Canada's largest meat packing firm) closed its Beardmore tannery division in Acton, Ontario, and in March 1988, its Collis tannery division in Aurora, Ontario. About 400 employees in total were affected by the company's decision to consolidate its operations by getting rid of its leather tanning and finishing divisions. Until these closures, Canada Packers Inc. had been the only Canadian firm vertically integrated into leather tanning.

Industry profits between 1980 and 1983 were between $3 million and $10 million. As a percentage of capital employed, industry profits were fairly comparable to those of the footwear industry and consistently higher than the figure for total manufacturing. Although the industry suffered a net loss of $1.7 million in 1984, successive increases in shipments, in 1981 constant dollar terms, in 1985 (actual) and 1986 and 1987 (estimated), should restore the industry to more normal levels of profitability.

Two important worldwide trends in leather products will likely have a significant long-term effect on the Canadian tanning industry. The first is the increasing use of synthetic and natural textile materials (cotton) and synthetic soles in footwear production. From a global perspective, the share of shoes made of leather declined from about 67 percent of world production in 1977 to 50 percent in 1985. However, this trend has not yet affected the Canadian footwear industry, which has consistently used leather in its domestic production (46 percent of input material costs in both 1977 and 1984).

The second trend is the increased importance of the developing countries (for example, the Republic of Korea, Taiwan and the People's Republic of China) as tanners and producers of leather products.

Partly as a result of existing expertise in garment and shoe production, some countries in the Far East (notably the Republic of Korea and Taiwan) have been developing their domestic tanning industries systematically. Consequently, more and more finished leather products are being shipped to developed countries, including Canada. The sophistication of tanneries in the People's Republic of China has also risen enormously in recent years.

Demand from Far East countries for hides from the United States (the largest world producer of raw bovine hides) has increased dramatically in recent years with the Republic of Korea overtaking Japan as the largest major customer — accounting for 35 percent of U.S. supplies in 1986. Canada exported nearly 50 percent of its raw bovine hides to Taiwan and the Republic of Korea in 1987 for further processing into leather.

Growth of the overall leather market in Canada has been stagnant in the past few years, largely because of increasing substitution of less expensive synthetic products for leather in certain applications (i.e., footwear, luggage, handbags).

Canada's two major tanneries have modernized and restructured to maintain their competitive position in Canadian and world markets. They have also attempted to reduce their dependency on the footwear industry, to some extent, by diversifying into non-footwear leathers such as upholstery. Two medium-sized firms have also benefited from modernization and restructuring projects.

Footwear imports have been under restraint in Canada, in one form or another, since 1977. During this period, the footwear industry has continued to restructure and upgrade its product lines by specializing in medium-priced fashionable footwear (particularly winter boots, which require more leather per pair than shoes). More recently, it has consolidated through mergers and acquisitions. Since 1985, only women's and girls' footwear have been subject to import controls, which were phased out in November 1988.

2. Strengths and Weaknesses

Structural Factors

The strengths of the Canadian tanning industry are its ready access to supplies of raw bovine hides, favourable differences in Canada-U.S. labour costs, and its established record of export activity. Its major weakness is its heavy dependence on the footwear industry.

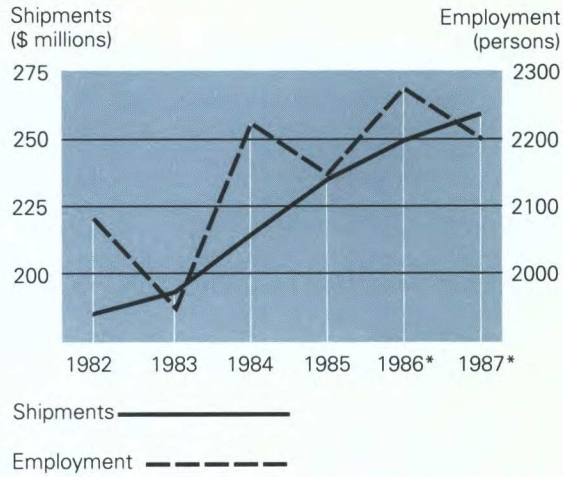
Canada has an ample supply of bovine hides suitable for tanning for most shoe leather requirements, rather than hides and skins suitable for fine leathers. Its major tanneries are close to these supplies.

The tanning industry is more capital intensive than the footwear industry, with wages accounting for about 16 percent of shipment value as compared to 24 percent in footwear. It is still considerably more labour intensive than the all-manufacturing average of 13 percent. Current Canadian wage rates are about 20 percent lower than those in the United States, taking into account exchange rate differences.

The industry has been successful in exporting significant quantities of tanned and semi-tanned leather. In 1987, its exports were estimated at 17 percent of shipments. About 70 percent of these export sales were to the United States. This export activity is concentrated in only a small number of firms.

Trade-related Factors

Canadian Most Favoured Nation (MFN) tariff rates on most leathers are between eight and 10.2 percent. The U.S. rate is currently five percent on shoe leather (estimated to account for 70 percent of Canadian exports to the United States). European rates on most bovine leathers are around seven percent. Certain specialty leathers used to produce shoe linings and high-end footwear are accorded duty-free treatment by Canada.



Total Shipments and Employment

* *ISTC estimate*

While there are few worldwide restrictions against imports of raw hides and skins (Europe, Japan, Canada and the United States provide duty-free treatment on an MFN basis), governments of many developing countries (Argentina, Brazil and India, in particular) periodically impose restrictions on the export of raw hides and skins to promote the domestic processing of raw hides into leather. As a result, tanners in these countries have access to government-controlled supplies of lower-cost raw materials which enable them to export leather at less than international market prices. Lower wage rates in these countries provide an additional competitive advantage.

Under the Canada-U.S. Free Trade Agreement (FTA), all leather, except semi-tanned bovine and footwear upper and sole leather, is duty-free when imported from either country on or after January 1, 1989. Duty on the exceptions will be gradually phased out over a five-year period, attaining "free" status on January 1, 1993.

Technological Factors

The Canadian industry's overall level of technology is equal to that in the United States and other developed countries. Machinery and equipment, available without restriction in the world marketplace, are becoming increasingly advanced in the tanning industries of developed countries. For example, precision metering equipment is used to control the flow of chemicals throughout the tanning process. New equipment is also being installed to recycle chemicals and water, reducing input costs and the cost of waste disposal. Microcomputer technology is expected eventually to control most of the tanning and finishing operations and so improve labour productivity. The evolution of technological change in the tanning industry, however, has been and is expected to remain gradual.

Other Factors

Managing inventories can be difficult for many tanneries. A tannery needs a substantial amount of working capital, most of it to finance the inventories of hides and skins as well as finished leather. In addition, favourable supplier credit terms must often be extended to customers. Inventories tend to be very large at times, because efficient tanning requires a steady processing of hides and skins, whereas the demand for tanned leather is highly seasonal.

During low demand periods, the tanneries are producing larger volumes than can be sold. However, they must stockpile inventories to fill peak season demands, which exceed productive capacity. The management of these financial needs can be highly complicated under high and volatile interest rate conditions, coupled with intermittent fluctuations in the exchange rate. The financial calculations are further complicated by varying inflation rates which alter the value of the tanners' inventories of hides and skins and finished leather.

There are certain entry barriers characteristic of leather tanning. Establishments in this sector are capital intensive and, as such, require large and complex machinery and equipment. They also need access to an abundant supply of water as vast amounts of it are used throughout the tanning process. Finally, they require sophisticated effluent treatment facilities to comply with stringent environmental controls.

Canada's environmental regulations are on a par with those in most developed countries. Many developing countries, on the other hand, have lower levels of pollution control regulations and, thus, lower costs of leather production.

3. Evolving Environment

Over the next five years, the following factors are expected to affect the tanning industry:

- Heightened environmental concerns may require the industry to invest in more sophisticated effluent treatment systems, increasing its production costs.
- Recent advances in micro-electronic technologies will continue to be incorporated in leather tanning equipment, but are not expected to lead to substantial increases in productivity performance.
- Demand for shoe leather is expected to stabilize and possibly increase as domestic footwear producers strengthen their specialization in winter boots and expand their market base through more aggressive marketing. A short-term drop may occur temporarily with the termination of footwear quotas at the end of 1988.
- Canadian tanners will continue to rely heavily on the domestic footwear industry. This industry will face continuing import competition in a market that is expected to follow the Canadian demographic growth rate of one to two percent. It will also see its domestic production increase as a direct consequence of the new export opportunities offered by the FTA. As a major supplier to domestic footwear producers, the tanning industry stands to gain from an increase in its sales to Canadian footwear manufacturers, who are expected to increase their exports under the FTA. Direct exports of its finished leather to the United States in the past has not been substantial, in spite of a low U.S. tariff rate.
- Rising worldwide demand for leather should provide some stability to the industry. However, it will continue to come under pressure as recurrent raw hide shortages (caused by cyclical fluctuations in cattle slaughter rates, compounded by declining beef consumption in developed markets) raise prices for raw hides and leather and result in increased substitution.
- The past 10 years have seen a gradual shift in the sources of supply of imported shoe leather on the Canadian market from developed to developing countries. Although Argentina is still a major supplier of garment leather, it has also made dramatic gains as a producer of shoe leather during this period. In addition, as the recently developed tanning industries mature in low-cost countries such as the Republic of Korea and Taiwan, they are expected to funnel increasingly larger quantities of finished leather products into the Canadian market. These two countries together purchased more than 50 percent of the raw cattle and calf hides and skins generated by Canada in 1987 (compared to less than 14 percent in 1976).
- The continuing development of tanning industries in the Far East will place increasing import pressures on the Canadian industry, both in the glove and garment, and footwear leather sub-sectors. At the same time, these Far East countries will continue to compete with Canadian firms on the open international market for dwindling supplies of raw hides and skins. Although the glove and garment leather sub-sector is expected to be vulnerable to low-cost competition, shoe leather should be in a better position to withstand these pressures.
- The tanning industry has benefited from various government programs in the past. More recently, the government concluded an agreement with the Footwear and Leather Institute of Canada (FLICCC) to assist in strengthening the technological and marketing capability of firms in the footwear and tanning industries. This measure is primarily footwear-oriented and the benefits should favourably affect the tanners in their capacity as major suppliers.

4. Competitiveness Assessment

Canadian tanneries have capitalized on the abundant domestic supply of raw hides and skins and their close historical ties with the footwear industry to specialize in the production of shoe leather. In an uninhibited market environment, the industry is competitive with producers in other developed countries and continues to dominate this market in Canada. It has achieved some success in exports (particularly to the United States) and has sufficient management and marketing expertise to expand its performance in this area.

Freer access to the larger U.S. market will more than offset any possible losses in the Canadian market under the FTA. The elimination of tariffs will strengthen the industry's competitive position against third-country exports of shoe leather to the U.S. shoe leather market. It will also stimulate domestic production of leathers for markets other than footwear.

Glove and garment leather production currently represents a small percentage of Canadian tanning output, due mainly to the absence of a domestic source of lightweight hides. Although this sub-sector is expected to undergo further relative contraction, domestic output, at least of leather finishing, could increase moderately as a result of the FTA.

For further information concerning the subject matter contained in this profile, contact:

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235 Queen Street
Ottawa, Ontario
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(613) 954-2893

PRINCIPAL STATISTICS

SIC(s) COVERED: 1711 (1980)

	1973	1982	1983	1984	1985	1986e	1987e
Establishments	30	37	35	37	40	39	39
Employment	2 732	2 091	1 962	2 219	2 153	2 250	2 200
Shipments ($ millions)	94	183	192	217	234	250	260
Investment ($ millions)	N/A	7.1	6.2	6.4	5.4	6.0	N/A
Profits after tax ($ millions)	N/A	3.3	4.9	–1.7	N/A	N/A	N/A

TRADE STATISTICS

	1973	1982	1983	1984	1985	1986e	1987e
Exports ($ millions)	13	34	34	37	39	47	44
Domestic shipments ($ millions)	81	149	158	180	195	203	216
Imports ($ millions)	47	94	129	151	147	175	240
Canadian market ($ millions)	128	243	287	331	342	378	456
Exports as % of shipments	14	19	18	17	17	19	17
Imports as % of domestic market	37	39	45	46	43	46	53

Source of imports (% of total value)		U.S.	E.C.	Asia	Others*
	1982	31	23	15	30
	1983	28	25	14	33
	1984	22	29	12	36
	1985	21	36	6	37
	1986	20	28	18	34
	1987	29	39	8	24

Destination of exports (% of total value)		U.S.	E.C.	Asia	Others
	1982	80	9	10	1
	1983	83	5	12	—
	1984	81	6	12	1
	1985	82	4	14	—
	1986	78	6	16	—
	1987	70	16	14	—

(continued)

REGIONAL DISTRIBUTION — Average over the last 3 years

	Atlantic	Quebec	Ontario	Prairies	B.C.
Establishments – % of total	5	33	40	18	3
Employment – % of total	X	13	69	X	X
Shipments – % of total	X	11	70	X	X

MAJOR FIRMS

Name	Ownership	Location of Major Plants
Dominion Tanners (a division of United Canadian Shares Ltd.)	Canadian	Winnipeg, Manitoba Edmonton, Alberta Toronto, Ontario
A.R. Clarke & Co. Ltd.	Canadian	Toronto, Ontario
Frank Heller & Co. Ltd.	Canadian	Acton, Ontario

e ISTC estimate
X Confidential
* Mainly Argentina, Brazil and state trading countries
N/A Not available

Note: Statistics Canada data have been used in preparing this profile.

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