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STRATEGY OF ENHANCING THE COMPETITIVESS OF LEATHER'S SMEs : STUDY IN MANDING YOGYAKARTA

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ABSTRACT

The majority of the Manding's leather manufacturers are small medium entreprise (SME), with limited productive resources. The paper try to identify problems of leather's manufacturers and formulate strategy to enhance their competitiveness in domestic and overseas market. Most of the SMEs have characteristic as follow : utilization of old manufacturing processes, traditional management, low labor productivity poor intelligence and information systems on trade and marketing, rarely work with other firms, have no development activities, lack of technology adoption, and hardly ever bring new products on the market which lead their product being uncompetitive in market. To attain the competitiveness, SMEs need to consider some of the principle strategies, first, the innovation strategy, in which SMEs try to appropriate returns from their knowledge base. Second, the information technology strategy, which makes innovative uses of information technology in order to reduce SME costs and increase productivity. Third, the network strategy, in which SMEs work and co-operate with other firms, be they SMEs or large enterprises in order to improve their ability to access and absorb innovations. Fourth, the cluster strategy, in which SMEs locate in close proximity with competitors in order to take advantage of knowledge spill-overs, especially in the early stages of the industrial lifecycle.

Keywords: Competitiveness, innovation strategy, information technology strategy,network strategy, cluster strategy

INTRODUCTION

The Development of Indonesian Leather Industry. The Indonesian leather industry plays a significant contribution for developing economies. The industry is among the ten largest export earning industries within the so-called non-oil and gas sector. It is a labor-intensive undertaking as the majority of the processing and manufacturing industries consists of medium and small-scale industries. The leather processing industry consists of leather tanning industry and the leather manufacturing industry, producing various finished leather articles such as footwear, bags, suitcases, belts, gloves and apparels.

The development of the Indonesian leather industry, however, has revealed a downward trend, particularly for the period of 1996 to 2002. Up until the year 1996, the industry flourished due to a government regulation prohibiting the exports of raw leather. The total export value of processed leather and finished leather articles in 1996 was in excess of US$ 2.2 billion as compared to US$ 1.1 billion in 2002 (Yunus, 2006). The export ban was lifted in 1998 as part of an agreement signed with the IMF to deregulate the international trade sector, causing thereby a decline in the exports of semi-finished and finished leather articles as a result of shortage of domestic raw material supply in the

subsequent years. Suppliers of raw leather prefer to export their product of raw leather rather than selling to the domestic leather processors or manufacturers. The production situation became even worse due to the fact that the leather raw material needed by the tanning industry of some 70.000 tons can only be supplied domestically at a level of less than 50%, e.g. around 31.000 tons, out of which, approximately 70% of this output is being exported and the balance sold to the domestic manufacturers. This condition has forced many leather manufacturers of finished leather articles to change the raw material from raw leather to plastic or imitation leather.

One of the main challenges confronting the national manufacturing industry is a lack of domestic supply of raw materials due to an undeveloped supporting industry. Because of the shortage of domestic raw materials, companies had no choice but to import them so that production will not be disrupted. It is almost certain that the use of imported raw materials has made Indonesia's manufacturing products uncompetitive, both in the domestic and overseas markets, because of additional costs and more time spent on importation and transport.

Domestic raw hide, despite its lack of quality due to poor handling, is still in high demand overseas because Indonesia is a country which is free from foot and mouth disease according to the International Organisation for Animal Health (OIE). This makes Indonesia's raw hide attractive in countries that adopt maximum security policy with regard to the product. This is a big loss for Indonesia because have to import the materials after they become finished products, which certainly cost more.

Domestic leather thanning's manufacturers primarily utilizing cow, buffalo, sheep and goat hides in the production process. Medium to large-scale tanneries are located in several areas throughout Java, including Greater Jakarta, West Java (Cianjur and Bandung), Central Java (Jogjakarta, Solo, Semarang and East Java (Malang, Pasuruan, Sidoarjo and Surabaya); while home tanneries are primarily in West Java (Garut) and East Java (Magetan). These firms differ in both size and technological capability, with approximately 25-30% having the necessary equipment to automate all critical steps to produce finished leather (e.g., cutting, stretching, dying, buffing, etc.). The remaining 70-75% can be categorized as home or "cottage Industry" tanneries, which rely on employees to undertake the same processing steps by hand.

Leather production is a complex task, encompassing 23 distinct steps, starting with the flaying of raw hides or skins and finishing with embossing, which presses a chosen grain into the surface of the finished hide. During the past five years, domestic production of finished leather has significantly varied. For example, from 2004 to 2006, leather production for footwear increased 49% from 45 million square feet in 2002 to 67 billion in 2004. However, in the past two years, production levels have decreased by 15%, from 67 million in 2004 to 57 million square feet in 2006 (Senada,2007)

Tabel 1. Domestic Production for Footwear

Year	Consumption	Production	Export	Import
2002	60	45	18	33
2003	64	56	19	27
2004	68	67	24	25
2005	66	62	22	23
2006	69	57	12	24

Source : Snada,2007

As shown in Tabel 1, the level of domestic leather produced has not been enough to satisfy consumption. In 2006, domestic finished leather for footwear consumption was estimated to be 69 million square feet, while domestic leather production was only 57 million square feet. Of the 57 million square feet produced, 12 million was exported to foreign-owned footwear manufacturers, creating a deficit of 24 million square feet. This deficit was overcame by imported finished leather, primarily from firms in India, Italy, Bangladesh and China.

Tabel 2. Number of Operating Tanniers

Year	Total of Medium-Large Tanneries	Total of Home Tanneries
1998	112	400
2000	76	252
2002	46	136
2004	55	200
2006	67	240

Source : Indonesia Leather Profile, 2007

This deficit is partially explained due to a declining the number of tanneries that are still in operation. For instance, in 1998 there were 112 medium-to-large scale tanneries and 400 home tanneries, while this number dropped significantly to 67 and 240 firms respectively in 2006 (Tabel 2). This represents a decrease of 40% in the total number of tanneries still manufacturing leather available for use in production. Although Indonesian tanneries have faced difficulties during this decade, the outlook for the industry is improving. In 2006, 45% more medium-to-large scale tanneries and 76% more home tanneries are in operation compared to 2002. If this condition goes along with Indonesia's ability to produce highly desirable leather types, position of the domestic leather industry is promising for future growth.

Leather Manufacturers in Yogyakarta: Profile and Problems. One of the prominent Leather's manufacturers in Yogyakarta is located in Manding village, Bantul Regency. The current situation of leather processing industries here is exactly the same as national feature, a shortage in the supply of raw leather due to the raw leather material being exported. The leather manufacturers are faced with the choice of either closing down their factories or using substitute materials such as plastic or imitation leather with the latter being mostly the better choice for the industry.

Tabel 3. Leather Manufacturers in Manding Yogyakarta : Profile and Problems

Business Aspect	Remark
Equipment, Process, product	▪ Main product : Shoe, sandal, bag ▪ Additional product : Bag, jacket, glove,belt, hat ect ▪ Unpredictable production scale (production depends on demand). ▪ Insuficient equipments ▪ Old manufaacturing process ▪ Limited supply product per item ▪ Lack of variety Product desain ▪ A product-oriented rather than a market-oriented ▪ Lack of effective product control mechanisms ▪ None of product has certificate of intelectual property right
Management	▪ Poor management : family based management, there is no clear distinction between business and family management.
Technology	▪ Lack of information technology adoption ▪ Inadequate levels of technological development
Marketing	▪ Insufficient experience in trade negotiations ▪ Mostly serve domestic consumers ▪ Poor intelligence and information systems on trade and marketing, resulting in a limited availability of trade information. ▪ A lack of training and experience in marketing, in trade negotiations, & in negotiating partnership ps ▪ Limited knowledge of market trends in finished leathers.
Human resources	▪ Low labor productivity ▪ Lack of well educated employee ▪ Out-dated training experience ▪ Lack of technical know-how ▪ A frequent lack of trained personnel at management, processing and supervisory levels
Capital	▪ lack of acces to financial institution. Financial institutions require some requirements that SME's unable meet.
Networking	▪ Weak co-operation with other firms

Source : Primer data, 2010

The majority of the Manding's finished leather manufacturers are small medium entreprise (SME), more of a type of cottage, home industries with limited resources on capital, market and product design. Unless the government, related intitution and external parties such pivate sector and university provide assistance to and in favor of the leather industry, the current condition will not be supportive to the future development of this labor-intensive and export-oriented industry. The objective of this paper is try to identify problems and to formulate a approach of enhancing SMEs competitiveness. Observation on several Small and Medium Entreprises (SME's) provides general characteristic of the manufacturers, particularly on profile and problem as shown in Tabel 3.

RESEARCH METHOD

Strategy Of Enhacing Competitiveness. The profile of leathers' SMEs as describe in the table 3 above confirm that they do not see innovation as part of their business strategy. It is clearly indicated by utilization of old manufacturing processes, traditional management, Low labor productivity poor intelligence and information systems on trade and marketing, rarely work with other firms, have no development activities, lack of technology adoption, and hardly ever bring new products on the market. Whereas these are important factors to accomplish their competitiveness. Furthermore, as Ocde (2002) mentioned, attaining a business competitivess have to consider some of the principle strategies such as :

- The *innovation strategy*, in which SMEs try to appropriate returns from their knowledge base
- The *information technology strategy*, which makes innovative uses of information technology in order to reduce SME costs and increase productivity.
- The *network strategy*, in which SMEs work and co-operate with other firms, be they SMEs or large enterprises in order to improve their ability to access and absorb innovations.
- The *cluster strategy*, in which SMEs locate in close proximity with competitors in order to take advantage of knowledge spill-overs, especially in the early stages of the industrial lifecycle

The Innovative Strategy. One of the important sources of competitiveness for SMEs has been to serve as *agents of change*, as the engines for new idea generation and innovative activity. However, that SMEs would pursue innovation as a strategy for competitiveness at all seems to run contrary to many of the conventional theories of innovation. The starting point for most theories of innovation is the firm. In the literature of technological change, for example, the most accepted model of the knowledge production function assumes that firms exist exogenously and that firms engage in the pursuit of new economic knowledge as an input into the process of generating innovative activity. But knowledge as an input is inherently different than the more traditional inputs of labour, capital and land because the value of knowledge is intrinsically uncertain and its potential value is asymmetric across economic agents.

Investing in new knowledge is a risky activity that most SMEs cannot justify. The most important (though not the only) source of new knowledge is research and development (R&D). Other key factors generating new economic knowledge include a high degree of human capital, a skilled labour force, and the strong presence of scientists and engineers. The breakdown of the knowledge production function at the level of the firm raises the question, Where do innovative firms with little or no R&D get the knowledge inputs? This question is particularly relevant for new SMEs that undertake little R&D themselves. One answer is that knowledge inputs come from third-party firms or research institutions, such as universities.

Knowledge is exogenous and embodied in a worker. The firm is created endogenously through the worker's effort to appropriate the value of his knowledge through innovative

activity. What emerges from new evolutionary theories and the empirical evidence on innovation as a competitive strategy, is a picture of markets in motion with a lot of new firms entering and industry and a lot of firms exiting.

When SMEs engage in a strategy of innovation, they typically start at a very small output scales. Empirical evidence shows that the post-entry growth of surviving new entrants tends to be spurred by the extent to which there is a gap between the MES level of output and the size of the firm. However, the likelihood of any particular new firm surviving tends to decrease as this gap increases. Only those SMEs offering a viable product that can be produced efficiently will grow and ultimately approach or attain the MES level of output. The remainder will stagnate, and depending upon the severity of the other selection mechanism - the extent of scale economies - may ultimately be forced to exit out of the industry. Thus, in highly innovative industries, there is a continuing process of the entry of new SMEs and with low levels of individual SME survival. Although a skewed size distribution of firms can persist with remarkable stability over long periods of time, it is not due to a constant population of SMEs. Rather, by serving as agents of change, SMEs provide an essential source of new ideas and experimentation that otherwise would remain untapped in the economy.

The Information Technology Strategy. A second strategy SMEs can use to improve their competitiveness in global markets involves the application and adoption of new technologies that effectively serve to reduce costs. A number of significant new technologies, which include the Internet and the microprocessor, help mitigate economies of scale and the gains traditionally associated with large-scale production.

New web-based information technologies are enabling SMEs to attain global marketing capabilities at very low costs. SMEs are also using electronic commerce and internet-based access to products like financial and accounting management software systems that enhance organisational and management capabilities, while at the same time reduce the high costs associated with managing SMEs. Such products enable SMEs to create virtual warehouses, where they build direct links between manufacturers and final customers. But to properly take advantage of such internet-based financial and accounting systems, SMEs typically need to modify or change their organisational structure.

In the physical world, scale economy and standardisation plays a major role. The digital world enables individual product customization. The customers will directly interact only with the intermediary, which provides the appearance of having a huge inventory of a wide range of products. An important strategy deployed by SMEs to create competitiveness in global markets is to use the digital echnology to develop core competencies and collaborate with other SMEs to construct innovative content tailored to the unique taste of each consumer.

The Network and Flexible Production Strategies. The next strategy to SMEs who want to remain competitive in global markets is to actively participate in networks and cooperate with other firms be they other SMEs, large enterprises, or a combination of both. The culture of interdependence and exchange among individuals will contribute to its superior innovative performance, especially when compared to where firms and individuals are more isolated from one another. A variety of regional institutions - including Universities, several trade associations and local business organisations, market research, public relations and venture capital firms – provide technical, financial, and networking services which the region’s enterprises often cannot afford individually. These networks create forums where relationships are easily formed and maintained, technical and market information is exchanged, business contacts are established, and new enterprises are conceive.

The Cluster Strategy. Related to the

network strategy, SMEs can opt to enhance their competitiveness in global markets by participating in localised geographic clusters. In a clustering strategy, firms take advantage of linkages with other enterprises afforded by geographic proximity, in order to better access new ideas and knowledge. This strategy may be especially important in young industries or industries where strategic knowledge is tacit. The importance of knowledge spill-overs in spurring innovation undisputed. However, Krugman (1991) and others argue that such knowledge externalities are so important that there is no compelling reason for geographic boundaries to block the spatial extent of the spillover. It may seem paradoxical to claim that geography matters for innovative activity in a world of E-mail, fax machines, and cyberspace, where the cost of communications has plummeted. But there is an important distinction to be made between knowledge and information. *Information*, such as the price of gold on the Jakarta stock exchange or the value of the Yen in London, can be easily codified and has a singular meaning and interpretation. By contrast, *knowledge* is vague, difficult to codify and often only serendipitously recognised. While the marginal cost of transmitting information across geographic space has been drastically reduced with the telecommunications revolution, the marginal cost of transmitting knowledge, and especially tacit knowledge, actually rises with distance.

CONCLUSION

The Leather industry occupies a place of prominence in the Indonesia economy in view of its massive potential for employment and exports. Nevertheless, this is the fact that Indonesian leather manufacturers, included in Manding Yogyakarta, are still facing of some crucial obstacles in term of appropriate product design, production method, technology, marketing, capital and human resourse. The future of this particular industrial sector, however, may be looking bright especially when considering the principle strategies such as innovation strategy, *information technology strategy*, *network and cluste strategy in their business. Additionally, w*hat the industry needs is supportive government regulation to protect domestic supply of raw materials and at the same time provision for improvements in various production aspects. Only by doing so will the industry be capable of competing not only in the international market but also fulfilling the potential domestic market demand.

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