

# HOW TO MINIMIZE THE DEPENDENCY OF THE SHOE INDUSTRY IN INDONESIA ON SOUTH KOREA

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## Abstract

Since their establishment, most of Indonesian shoe manufacturers have been using foreign technology, especially Korean technology. Most of the Koreans are working as technical experts in these shoe manufacturers. Besides the technical aspects, most of the shoe making materials and chemicals are also imported from South Korea. To minimize the dependency of the Indonesian shoe industry on South Korea, more in-depth studies on the local supporting industries should be conducted.

## Background

The relationship between North Korea and other nations was critically strained because North Korea is accused of having a nuclear weapons program. This crisis subsided, in mid June, 1994, when President Clinton announced that the United States of America is prepared to continue the third round summit meeting if Pyongyang gives its guarantee to freeze its nuclear program. The U.S. foreign secretary, Warren Christopher, added that there is hope of a meeting between President Clinton and The Presi-

dent of North Korea, Kim Il Sung, if Pyongyang changes its views.

As of July 8, 1994, a summit meeting was scheduled to take place on July 25 to 27, 1994. But the sudden death of Kim Il Sung, the President of North Korea on July 8, 1994, meant a postponement of this meeting. The situation might still be critical and could affect the supply of raw material for the shoe industry in Indonesia.

This paper will discuss the degree of dependency of the shoe industry in Indonesia on South Korea, and possible solutions to minimize this dependency.

## The Development of the Shoe Industry in Indonesia

As we are all aware, the shoe industry in Indonesia has shown a remarkable growth as a result of the relocation of this industry from other countries, South Korea and Taiwan in particular. This exodus started in 1988 as shown by Table 1.

The growth of the shoe industry in Indonesia is also indicated by the increase in production as shown by Table 2.

**Table 1**

**Number of Investments in the Shoe Industry  
By Local (PMDN) and Foreign (PMA) Investments  
1987 - 1992**

Year	Local	Foreign	Total
1987	15	2	17
1988	35	16	51
1989	40	16	56
1990	30	8	38
1991	15	9	24
1992	6	5	11

Source: BKPM (Investment Coordinating Board)

**Table 2**

**Production of Shoes  
1988 - 1992  
In Thousand Pairs and Million Rupiahs**

Year	Quantity	Value
1988	64,000.00	570,000
1989	107,984.70	851,335
1990	167,203.41	1,345,940
1991	217,078.00	2,028,732
1992	301,800.00	3,159,554

Source: BPS (Central Bureau of Statistics)

The number of shoe factories increased to 353 in 1994 with an estimated production capacity of 800 million pairs annually.

The importance of the shoe industry as a foreign exchange earner for Indonesia is shown in Table 3.

### The Growth of the Supporting Industries

The growth in the number of shoe factories has not been accompanied by a growth in the number of supporting industries. By supporting industries are meant those industries which produce raw materials or other components for those manufacture of shoes including leather, certain kinds of textile, bonding agents etc.

Most of the shoes produced and exported are sport shoes. An average sport shoe requires some 140 to 160 different kinds of materials. The number of raw materials is not immediately apparent from the material bill of quantity (see Appendix I) as some intermediate products like outsoles and midsoles are considered as one component although they are actually a mixture of some 20 kinds of chemicals.

The supply of both natural leather and artificial leather, which form the main raw materials for the production of shoes is still far from adequate. The existing tanneries cannot supply the required quantities. Import of finished leather is shown by Table 4.

With over 260 millions shoes to be exported the Indonesian shoe industry will need around 500 millions square feet of leather. The local tanneries can only supply 40% of the total requirements. So Indonesia has still to import approximately 300 million square feet of leather annually.

Although showing an impressive growth in general, the textile industry in Indonesia has not supported the raw material requirements of the shoe industry. Once again a considerable amount of specialty textile materials has to be imported. Materials such as Nylon Spandex, Terry Cloth, MD Nylax and Non-Woven have

to be imported. So far, there is not one single textile factory in Indonesia specializing in materials for the shoe industry.

Besides raw materials, the shoe industry also needs toolings. Molds for the preparation of rubber outsoles and polyurethane midsoles still have to be imported. Almost all of the moldshops in Indonesia are still concentrating on the production of molds for plastic injections.

Some of the component products which are available locally are:

- Adhesive Tape
- Sticker Paper
- Inner Boxes
- Corrugated Carton Boxes
- Cutting Board
- Cutting Dies
- Canvas
- PU Foam
- Latex Foam
- Printed and Woven Labels
- Latex Arch Cookies
- PVC/Nylon/TPR Molded Parts
- Shoe Laces

Some of the companies supplying these products, especially those directly related to the end product, are of Korean origin. Local companies seem to be reluctant to invest in manufacturing products directly used as components in shoes.

### Dependency on South Korea for Raw Materials

As shown by Table 4 Indonesia still imports huge quantities of finished leather. Further analysis of the source of finished leather in Table 5 shows South Korea as the main supplier of finished leather.

Table 3

Export of Shoes from Indonesia  
1989 - 1994  
In Million Pairs and Million US Dollars

Year	Quantity	Value
1989	45.0	221
1990	106.6	569
1991	174.6	993
1992	204.1	1,323
1993	215.0	1,621
1994	260.0	1,950

Note: Figures for 1994 are estimated

Source: BPS (Central Bureau of Statistics)  
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Table 4

Import of Finished Leather  
1988 - 1993  
In Tons and 1,000 US Dollars

Year	Quantity	Value
1988	1,053.3	9,050.1
1989	3,871.3	33,326.5
1990	9,544.0	95,550.4
1991	15,187.3	184,879.1
1992	20,513.7	261,534.2
1993	25,851.7	318,355.1

Source: BPS

This not very surprising as some of the shoe factories in Indonesia are Korean owned. Even companies which are pure domestic investments still rely to a certain extent on Korean technology, machinery, raw materials and Korean technicians.

Shoe factories employing Korean technicians will be very much dependent upon the supply of raw materials from Korea because these technicians are not as familiar with materials from other countries. The outbreak of a war between North Korea and South Korea would disrupt this source of supply for raw materials. And tooling too, as most of the moulds are still made in Korea.

#### Possible Actions to Minimize Dependency on South Korea

Again and again the Association of Shoes Manufacturers in Indonesia has emphasized to the Indonesian government the need to attract more investment for the supporting industries to the shoe industry. If the shoe industry is expected to show continued growth, then the climate for investment in supporting industries should be made as attractive as possible.

Value Added tax regulations have to be reviewed so that local suppliers are exempted from the Value Added tax if they sell their products to manufacturers producing goods for export. They should also be exempted from paying import duties. Otherwise their prices will not be competitive with imported goods.

Local tanneries can produce adequate quantities of acceptable quality leather if the Indonesian government reduces import duties on chemicals used for tanning and reviews the Value Added tax to make it more attractive and competitive.

Some of these suggestions were accommodated by the Indonesian government in its latest deregulations of June 27, 1994. Yet the exemption of paying Value Added tax only applies if local manufacturers supply to exclusive export processing zones. While imported raw materials for the supporting industries still attract import duties. This latest deregulation still does not provide a stimulus to invest in supporting industries.

So far the Indonesian textile industry is hesitant to produce special textiles used in the shoe industry because of the relatively low demand and non-competitiveness in price. With the new deregulations decreed by the Indonesian government, and if foreign sources dry up, then the business will become more attractive. Another alternative for the shoe industry is to explore developing shoes using non-Korean materials. As it takes some time to develop new models, the process should start right away. The Association of Shoe Manufacturers can form a company and start producing specialty textiles for shoes.

Many companies have recognized the weakness of over reliance on South Korea. Step by step and gradually these companies have increased the local content of their products and thereby decreased the import content. One well known shoe factory in Tangerang made a big step forward by establishing its own mold

Table 5

#### Import of Finished Leather by Country of Origin 1988 - 1993 In Tons and 1,000 US Dollars

Country	1988	1989	1990	1991	1992	1993
South Korea	646.5	2,989.7	6,732.4	10,552.4	17,219.1	17,604.8
	6,733.9	27,316.6	79,487.7	156,668.7	216,512.9	244,018.8
Taiwan	190.5	245.3	1,031.2	1,420.8	1,414.0	1,650.5
	897.9	2,109.3	6,378.5	14,174.9	19,179.1	21,328.5
Japan	21.7	191.3	485.5	91.9	268.8	286.2
	261.4	1,128.1	2,513.9	1,862.6	3,380.1	5,280.0
United States	53.4	94.1	114.8	176.8	370.0	3,670.0
	769.7	880.6	850.7	1,675.9	4,194.4	17,176.2
Others	131.2	350.9	1,180.1	2,945.4	1,241.8	2,640.2
	387.2	1,891.9	6,319.6	10,497.0	18,267.7	30,551.6
Total	1,053.3	3,871.3	9,544.0	15,187.3	20,513.7	25,851.7
	9,050.1	33,326.5	95,550.4	184,879.1	261,534.2	31,355.1

Source: BPS

shop. Although it is true that the capacity is still small, yet this factory has shown that it can produce outsole molds, PU molds and phylon molds by using modern technology and computers and not following the traditional Korean way. This experience will form the basis to replace Korean molds. This factory also established its own cutting dies shop, embroidery shop and other facilities which will produce previously imported components.

As the shoe industry reaches its fifth year of reactivated production, it is time to replace some of the machineries of Korean origin and thereby once again break the ties of dependency on South Korea.

The author of this paper believes that the shoe industry can minimized its dependency on imported materials if the factories in Indonesia make a concentrated effort to develop the supporting industries with the help of the government to make the investment climate more conducive.

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