

Do Financial Difficulties Hinder the Export of Processing Industries in Transition Countries? – The Case of Mongolia

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Abstract

The purpose of this study is to investigate what barriers exporters of the processing industry face during export. The research is a qualitative study that looks at if the country's origin and the economic and political situation affect exports. Easing poverty and supporting the economy, export has been considered a vital aspect of development for many countries. The number of livestock is one of the crucial factors for the processing industry, but unlike other countries that receive high revenue and benefit from the export of the processing industry, particularly the leather industry, the export share is small in Mongolia. Although many researchers, and policymakers have tried to explore what brings low-value addition and low export share of end products in transition countries, there are only a few articles conducted in the field of the processing industry. The number of livestock and geographical location between China and Russia seem Mongolia has significant potential to thrive leather sector, more scientifically proven research should be conducted to provide insight into what barriers impede the export possibilities for the Mongolian leather industry and try to shed light on the possibilities in a broad range. The authors adopted qualitative research methods and used both primary and secondary data. At the end of the study, we created three main themes from participants' responses and the result of the study showed there are three distinctive barriers that the leather industry exporters face during export activity.

Keywords: *Export barriers, Transition economies, leather processors and manufacturers, Mongolia, SMEs*

JEL: *M16, F14, O14, R11*

Introduction

Export is a business activity that involves economic development and growth as well as eases poverty and improves profitability (Gebrewahid, 2016). Even in practice, export is seen as the low-risk and low-investment entry mode for all types of firms, although there are several entry modes for firms engaging in the internationalization phenomenon. In addition, a review of the literature revealed that there is a causal relationship between export share, economic growth, and the creation of job opportunities. In doing that, the enhancement of living standards for the local economy also happens (Kahiya, 2013).

World over, leather has been regarded as one of the most traded and valuable products in terms of its total created monetary value per year. In general, the leather sector, individually, generates over 100 billion USD every year on average and creates thousands of employment opportunities globally (Unido, 2010). In such a manner, the numerous developing and less developed countries (LDCs) with abundant livestock resources take into account the thriving leather sector so as to achieve economic development through increased export (Mwinyihija- Quesenberry, 2013).

It is reasonably expected that the number of livestock is an important factor for the processing industry, yet as of today over 78% of total bovine animals, 67% of total sheep, and 92% of the total goat, respectively, are in developing or LDCs. Developed countries such as Italy, Portugal, Spain, Germany, Belgium, France, Netherlands, the USA, and the UK are ranked in the top places for their earned income from the leather sector (Memedovic-Matiila, 2008). Former research consistently shows that processors and producers in developing or LDCs are highly dependent on leading firms because they have less essential know-how, managerial skills, and financial means that are necessary to identify and reach their target market (Erdeiné Késmárki-Gally, 2014). In addition to this, these countries adopt traditional rearing customs and recovery at the farm and slaughterhouse level, which decreases the market value of raw hides and skins significantly and brings about a greater amount of damage. Also, processors and producers in developing or LDCs are not able to adhere to norms and standards set by the global market, so they may lose the chance to access into the global and regional markets (Fenyvesi – Késmárki-Gally, 2005). Finally, inadequate infrastructure and unstable political environments of these countries hinder upgrading to a great extent (Memedovi-Matiila, 2008, Mwinyihija, 2018).

Researchers, practitioners, and policymakers are interested in identifying what issues cause low-value addition and low export share of end products in developing, and LDCs with a large amount of livestock population, such as Mongolia and some African countries. As noted, Mongolia has significant potential to thrive leather sector concerning its number of livestock and pleasant geographical location lying between the world's two big markets China and Russia, but the low export of the leather industry shows the degraded level of skill for these great resources and possibilities. This study provides insight into what barriers impede the export possibilities for the Mongolian leather industry and tries to shed light on the possibilities in a broad range.

Leather industry in Mongolia

As of 2019, there were 70.9 million livestock in Mongolia, 4.2 million of which were horses, 4.7 million of which were cattle, 0.4 million of which were camels, 32.3 million of which were sheep, and 29.2 million of which were goats (The National Statistical Bureau, 2020). In Mongolia, the hides and skins serve as an added value for the meat and meat products. In light of export contribution, the total share of the leather sector export for Mongolia is comparatively lower than the global level worth over US\$4 million per year. Semi and deep-processed leather products are exported to Ethiopia, Italy, Vietnam, and China, among them, China is considered as the major exporting destination for semi-processed hides and skins (World Bank, 2019). Taken together, the total capacity for hides and skins processing factories in Mongolia is around 20.0 million small animal skins per year, yet only a few factories execute both initial and deep processing and most of them prefer to execute only semi-processing and produce wet blue and then export their output in China directly not adding any more value on the raw materials. As of 2013, the total processed skins and hides were over 1.6 million, which was equal to 9% of the total raw hides and skins produced (SDC, 2015). Currently, there are 34 factories and more than 100 small and medium-sized leather tanneries running their business in Mongolia, 16 of which make final-deep processing, 2 of which carry out fur and end products, another 16 of which are semi-processing factories (Bayarsaikhan-Batbayar 2018, SDC, 2015).

Leather industry in the world

With the advancement of rapid information technology and liberalization, globalization takes place faster than before and the global geographical barrier narrows down day by day. The faster globalization stimulates world economic integration, which can create gains or losses for stakeholders involved in the leather value chain, depending on their relative positions. Both developing and LDCs could expand their businesses either in the domestic or the international market. The main indicator of actors' gain or loss depends on the competitive ability of how stakeholders embedded in the global value chain and the position of the lead firms in the market. Countries that are strongly dependent on one or a few sectors have many barriers to accessing the international market because of fierce competition and low-level capacity, furthermore less experience in playing in the international market (Bekele-Avele, 2008). As a result of globalization, inequality among developing countries and within actors might increase more in developing countries, which could adversely impact poverty. One of the most effective ways of mitigating possible adverse impacts from inequality and fierce competition is sustainable economic growth for developing or LDCs (Kaplinsky-Morris, 2001). The agriculture sector has been playing a key role in poverty alleviation, providing food, and ensuring sustainable development for a long time.

Therefore, it is important to take into consideration all processes involved in global trading, including fair competition, environmental issues, and resource efficiency. Indian leather processors and producers have faced upgrading technology in activities related to processing and production because of government policy of increasing environmental protection standards. As a result of the government, measures that have taken place in India, both unhygienic and hazardous working conditions and environmental pollution has been drastically reduced (Roy, 2012; Nagy et al. 2022). The actors of the global leather value chain can make a significant contribution not only to the economy, but also to health, the environment, and other socio-economic issues. After the global financial and economic crisis in 2007-2008, there has been a tendency of shifting leather production from developed to developing or LDCs, to attempt to decrease the final price of the product.

Lower prices could be good a chance for those developing or LDCs. The reason for considering production shifting from developed countries to developing or LDCs as a good chance is that a higher amount of production results in an increased export rate, which can alleviate poverty and increase employment from an economic perspective (Yamamoto, 2005). At the same time, a higher share of exports increases international dependency. So, one should take domestic and international stability into account to evaluate the effect of increasing export share (Goda et al., 2010). For instance, Rangarajan stated that around one percent of the increase in GDP output for any agricultural sector in India could raise industrial output by 0.5 percent and national income growth by 0.7 percent (Gunawardena, 2012). As mentioned in the study regarding the success factor for the increase in the leather sector export, which was conducted in South Africa, the population, GDP per capita, infrastructure development, and the relationship between regions are the main factors.

The global meat demand has increased due to global population growth, which led to producing raw material supply in the leather sector in every corner of the world at a constant level. Less consumption of red meat among people in developed countries negatively affects the raw material supply in the leather sector. This can be seen in statistical information about the raw material imports from developing or LDCs. The leather and leather product producers in developed countries are required to import more bovine raw materials from developed countries, which were considered raw materials with surface defect or other structural errors before (UNIDO, 2010).

The review conducted to investigate the challenges towards the value addition of the leather sector in Africa showed that the high pricing of raw materials causes a lower number of finished

products and a decrease in production volume. In recent years, infrastructure development has been performed in many African countries to attain more accruals from the leather sector. (Mwinyihija -Quiesenberry, 2013). The study conducted in Ethiopia showed that the price of each exported product at the global market and the domestic exchange rate are crucial factors for export in the long term, while the equilibrium of the domestic market's demand and supply, and demand of the world leather market are important factors in the short run. It proves that all businesses, either running the business at the domestic market or international market, depend on the global markets, so each actor in the value chain in the leather sector has to be linked well to be more efficient and productive because of individual efficiencies being less important in the global leather market context.

However, globalization and information technology development narrow down the geographical barriers and provide an opportunity for equal access to the global market for developing or LDCs (Madlenak et al., 2023, Tóth et al. 2008). For developing countries, lack of government support with respect to enabling the environment, availability of resources, and efficient and effective coordination in value chains account for the development barrier in the leather sector. The governmental policy toward increasing competitiveness of the leather value chain actors can be implemented by some steps of supporting small and medium scale (SME) producers disadvantaging in the VC because of lack of investment for technology and raw material purchasing, lack of contact with market players and lead firms, and based on the traditional techniques (Memedovic - Matuila, 2008, SDC, 2015, Guritno, 2016,).

Material and method

This study, first, is exploratory in nature, so we adopted the qualitative research method to investigate the potential barriers facing the export of the Mongolian leather industry. Both primary and secondary data are used to investigate the barriers to the leather industry in Mongolia in general. Then we narrowed down themes raised from the collected data related to the export issues. The documents issued by government agencies, private and public entities, international organizations, and NGOs are also used as secondary data sources. As for primary data, we conducted a semi-structured interview with leather processors in Mongolia so as to familiarize ourselves with the current situation more deeply. The selection process of companies is based on companies' capacity, experience, and especially interest to participate in this research.

Semi-structured interview: Twenty-five-minute interview conducted with the directors and managers of the selected companies regarding issues on procurement, raw material preparation process, quality of raw materials, and export-related issues that led to the low-level export share.

Overall, 18 participants who run leather processing factories and tanneries were interviewed in Mongolian language in 2019, 6 of whom were small-sized tanneries, 8 were medium-sized hides and skins processors, and 4 were manufacturers. In Tables 1 and 2, a breakdown of the participants is presented based on their business type, running activity, and capacity. Before conducting interviews with participants in advance, we drew out five types of general themes regarding problems that might occur in transition countries, which were used as a just general guideline during the interview to prevent any potential deviation and use time efficiently. In addition to this, only one researcher acted as an interviewer to avoid any interviewee-related bias. Altogether, the interview lasted around 25 minutes, and we extracted three main themes from participants' responses, which can be seen in the results part in more detail.

Results

As of today, there are 34 hides and skins processing factories in Mongolia, 32 of them are in Ulaanbaatar and 2 are in Darkhan, which is the second-largest city. Moreover, 16 companies do semi-processing and two of them do only fur processing while the rest of the companies carry out final processing. 18 companies that participated in this study are all located in Ulaanbaatar and fall into the category of small to large-scale (SME) enterprises.

Table 1. Participants' information

Types of activity	Number	Capacity (hides/per day)
Tannery	6	Up to 200 pieces
Hides and skins processor	8	200 - 1000 pieces
Manufacturer	4	Above 1000 pieces
Total	18	

Source: The authors' own collected data based on a questionnaire from participants, 2019

Table 2. The capacity of hides and skins processing companies in Mongolia

Types of activity	Number	Capacity (skins/per day)
Small scale tanneries	7	Up to 200 pieces
Medium-scale factories	9	200-1000pieces
Large scale leather processor	18	Above 1000 pieces
Total	34	

Source: SDC, 2015

From the collected data, we, first, drew out three main barriers hindering potential export development for leather processing enterprises in Mongolia. Almost all participants highlighted the following three issues during the interview.

Raw material-related barriers

Raw material quality is one of the crucial ingredients that help to produce qualified end products for manufacturers. All participants noted that they lose their competitive advantage at the stage of processing their purchased raw materials. Because they usually discard more than 40% of total purchased raw materials during the processing phase caused by low-level quality. Reasons for that the traditional slaughtering method damage hides and skins to a great extend and animal skin health issues as well create invisible damages from outside on the surface of the hides and skins. Also, participants underlined that treatment after slaughtering is needed to be done in a quicker manner according to the proper technology. Extending this line of inquiry, almost all participants pointed out that the processor costs a lot of money because of low raw material and poor procurement system. Also, due to poor quality raw materials, end products quality does not meet world standard either the unit price for per end products increases that is very expensive compared to the same kind of products at the world market. Both processors and manufactures pointed out that location nearby to the world one of the biggest market, China, has both pros and cons, which creates significant negative impact on tanneries, processors and manufacturers because they have no choice

to export semi-processed raw material to China without adding less amount of value and then the manufacturer in China produce end product adding more value using their semi-processed raw material “ wet blue” and exports them to the world market. Although exporting semi-processed raw materials to China is considered to be export, it also comes up with some negative impacts on the environment, low-value addition, and reduction in production for domestic manufacturers.

Financial means-related barriers

Almost all participants mentioned they have financial problems that hinder their potential export development. Most of them source money from commercial banks with high loan interest for the short run which in turn causes a shortage in turnover. Financial problems impede both processors and manufacturers from purchasing large quantities of raw materials when they need them. Although the government of Mongolia initiates soft loans and grants to support small and medium-sized enterprises (SMEs), the financing process is provided by commercial banks, so the interest rate is slightly different from the commercial bank loan program. This financial situation also reduces the ability to upgrade factory equipment, introduce new technologies, and keep pace with global markets. In addition, because of financial instability, participants are not able to maintain their human resources on a regular basis, and their salaries are not competitive, so there is a lack of a stable labor force. In a broader context, participants concluded that they are unable to compete in world markets due to a lack of funding and they cannot be involved in the international trade fairs, as well as renew their technology and innovation.

Network related barriers

Another barrier proposed by the participant barrier participants proposed was a lack of a network that helps to build vital connections with other actors in the world’s leather value chain. It implies that the manufacturers in Mongolia barely are not able to get connected with the world’s leading actors in the global market because of a lack of finance and networking. In the business environment, it is very crucial to have connections with other actors, which helps eventually the actors in the developing world to get a big share of the world market. Unfortunately, according to this study, networking possibilities with other actors in the global market are low for processors and manufacturers in Mongolia and they mostly export their semi-processed raw material to the closest market, China, or Russia. Even though participants have an interest to be involved in the foreign market, it brings about trouble in case they have no skilled managers who have experience in international trade and sufficient amount of funds to search for potential partners from outside.

Conclusion and suggestions

Even though this study topic covers potential barriers that might occur for manufacturers in transition countries, the result is only based on a single case “Mongolia”. That is why it might be different in other transition countries because of different business settings. In addition, this study only measured the potential barriers on a single sector” Leather processors and manufacturers”, therefore further studies should be conducted on different settings and different sectors separately to reveal what hinders the potential development of each sector in all transition countries. During the interview, the participants mentioned several other problems that may cause a low level of export, but we chose only three of them are the main barriers based on the mentioned frequency.

As far, in Mongolia, the internationalization phenomenon is considered only an export practice, so developing export is one of the crucial paths to thrive in future internationalization. In line with the result of our study, we concluded that the policymakers must be concerned about issues related to raw material quality, lack of finance, and poor networking with international actors in a quicker but effective manner. The formerly conducted research also pointed out that there are the same kinds of barriers causing the low-level export or internationalization toward manufacturers in the transition countries.

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