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UNIDOS DE AMÉRICA

Concept for Leather Cluster Development in Ecuador

“GDA Incentive Fund Application - 2007”

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Quito, Ecuador

2007 GDA INCENTIVE FUNDS APPLICATION FORM

General Information

Mission Operating Unit: USAID/Ecuador

Name of Alliance: Leather Cluster Development

Resource Partner(s):

- ***Cuerotex Confecciones***
Mr. Juan Malo
Tel: 593-7-288-9476
Cuenca, Ecuador
<http://www.maquilaprograms.com/>

- ***Michael Trent Inc.***
Mr. Walter Pieper
Tel: (812) 491-2338
Evansville, Indiana
<http://www.michaeltrent.com/>

- ***Corporación Andina de Fomento***
Ms. Olga Patricia Roncancio
Tel: (593) 222-4080 , Ext 8466
Quito, Ecuador
<http://www.caf.com/view/index.asp?pageMS=13195&ms=11>

- ***USAID/Ecuador***
Mr. Bernai Velarde (Contact for this activity)
Private Sector Officer
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Quito, Ecuador

Implementer(s): Cuerotex Confecciones and Michael Trent, Inc.

Proposal Funding Request Total: \$700,000 (Does not include DCA)

Partner Contribution:

Cuerotex Confecciones:	\$100,000
Michael Trent Inc.:	\$300,000
CAF:	\$50,000
USAID/Ecuador:	\$100,000 + \$200,000 (DCA)

Request from 2007 GDA Incentive Fund: \$150,000

GDA's SELECTION CRITERIA FOR THE INCENTIVE FUND

USAID/Ecuador has examined the criteria that will be used for making the awards under the incentive fund. Below is a summary on how the attached concept meets the selection criteria.

New Alliances and Partners: USAID/Ecuador believes that working with new private sector partners brings the advantage of having a sustainable project that will go beyond the limited assistance that our Agency will offer in the short-run. The new alliances that the Mission wants to support include the following partners:

- ***Cuerotex Confecciones (Spanish Acronym: Cuerotex):*** Cuerotex is a medium size business that has approximately 70 employees. It was initiated by Mr. Juan Malo in 1992 with three employees with the purpose of producing jackets for exports in Spain. This business will be the lead enterprise that will drive the process of cluster development.
- **Michael Trent, Inc., (MTI)** is a U.S. business that has teamed up with Cuerotex as a key partner for this program. MTI will provide market intelligence and distribution of products to mainstream U.S. department stores, catalog companies, NASCAR racing teams, specialty houses, and the National Rodeo Finals. In addition, MTI will provide an initial rotating fund of \$300,000 to finance the working capital needs of micro and small producers. MTI has also indicated that it is in a position to negotiate with US banks the increase this line of credit to more than \$500,000 if necessary. This action is in line with the directive that President Bush recently gave Secretary of State on March 5, in the Ronald Regan Building. President Bush stated that he was “*directing Secretary Rice and Secretary Paulson to develop a new initiative that will help U.S. and local banks improve their ability to extend good loans to small businesses.*”
- **Bob Timberlake:** Mr. Timberlake is one of North Carolina most recognized artist, painting rural landscape and American Realistic Genre concentrating on rural America with arts, prints and posters. Mr. Timberlake is also a successful designer of home furnishing that includes leather. MTI has already contact Mr. Timberlake to design furniture products using the leather cluster of Cuenca.
- **Corporacion Andina de Fomento (CAF)** is a regional development agency that is providing resources to help penetrate the European market. CAF is financing technical assistance in marketing and developing business plans for new products that will be tested in the European markets (El Corte Inglés).
- **Small and Microenterprises:** To achieve the production levels demanded by the international market, thirty-two small and micro producers have already been identified to start the cluster value chain and eventually expand it to the national level to include local tanneries.

- **Innovative Approach:** USAID/Ecuador considers this concept to have an innovative approach, which draws upon the strengths of the US and Ecuadorian private sector. New relationships and alliances have been formed between both private sectors to identify new markets, produce competitive products at market prices, incorporate small and micro producers, and provide private sector financing to support the credit needs of the cluster activities.

- **New Models/Best Practices:** The cluster or value chain approach is a relative new model that links firms, industries, and the financial sector to improve competitiveness in a geographical concentrated area. Best practices will be utilized gain international market shares. Some of the best practices have been identified by a recently USAID-funded report prepared by the Mitchell Group. These include:
 - Private sector ownership of the process of cluster development.
 - A champion that will lead the process (Cuerotex).
 - Leadership derived from within the community as is the case of Cuenca.
 - Sweat equity investment from the cluster participants, i.e.; the Ecuadorian micro and small producers committed to the process and risking their business in this venture.
 - Technical assistance to a market driven approach that responds to the needs of the international buyers.
 - Gradual build-up of the value chain to respond to the market.
- These best practices are in place and have already been used in the pilot activity that USAID/Ecuador financed to help form the leather cluster.

- **Leveraging Resources:** As may be observed in the Illustrative Budget, this effort will be financed by a combination of resources from key partners. USAID GDA resources will be leveraged at a ratio of **1:5**, including our DCA resources.

Summary Budget

GDA	USAID/Ecuador	MTI	CAF	Cluster	USAID/Ecuador DCA	Total
150,000	100,000	300,000	50,000	100,000	200,000	900,000
17%	11%	33%	6%	11%	22%	100%

- **Mission Participation:** Trade and Competitiveness is one Mission’s major priorities. Trade diversification and opportunities provide new possibilities for Ecuadorian businesses to access to new markets. It also provide USAID with the opportunity to link micro, small and rural producers directly to medium businesses and international markets so they may form strategic business alliance to meet the international market demands.
- Under its new SO 3, “Improved Business Environment and Private Sector Leadership,” the Mission is committed to promote competitiveness through cluster linkages in productive and service sectors such as, agriculture, agro-industry, industrial and eco-tourism sectors. Through this mechanism, the Mission will provide technical assistance and training to build and consolidate the clusters in initiate alliance with international

buyers. Technical assistance will be provided to increase backward linkages with tanneries, leather hide producers, and leather accessory firms. USAID will also provide technical assistance on environmental issues that affect the tanning and leather industry. In addition, to the activities mentioned in the concept paper (Activities to be Financed by GDA, Key Partners and USAID/Ecuador, page 7), the Mission will ensure that part of a recently approved GDA is utilized to finance the medium term needs of the businesses that are organized in the leather cluster.

GDA CONCEPT

Background Information:

USAID/Ecuador is in the process of initiating a new competitiveness program under its SO 3, “Improved Business Environment and Private Sector Leadership.” The new activity will seek out and support progressive private sector leaders and government officials that are committed to developing a more broad-based and open economy to initiate a process that support reforms related to free and open markets, trade, competitiveness, and poverty reduction. The new activity will focus on improving the competitiveness of micro, small and medium businesses that use cluster and value-chain activities in agriculture, industry, agro-industry and eco-tourism operations. The technical assistance will include market intelligence information for market and product diversification; as well as technical assistance to promote the usage of the USAID funded DCA. The leather cluster value chain activity will be one of the productive sectors that will receive technical assistance from the new activity that the Mission is supporting.

USAID has already started to work with the Cuencana Regional Integrated Development Agency (Spanish Acronym: ACUDIR), which is an agency from the Province of Azuay that promotes a competitive business environment to increase investment and export opportunities for the region. It is composed of members from the public and private sector including: the chambers of commerce, industries, small business, handicrafts, banking association, universities, the Municipality and the Prefect (similar to Governor) of the Province. ACUDIR seeks to influence policy, legal and regulatory environment to improve business competitiveness and remove business barriers.

One of the main vehicles used by ACUDIR to improve competitiveness is the value chain approach that seeks to support linkages among firms to enhance business opportunities, innovation and dynamism between buyers, producers and suppliers. USAID worked with ACUDIR during 2006 and initiated a pilot activity to support a Leather Value Chain or “Leather Cluster” as is called in Cuenca. With USAID’s support, linkages have been established between local producers and a US buyer through Michael Trent, Inc¹ (MTI).

USAID originally contracted MTI to perform an assessment to determine the viability of exporting leathers products from Cuenca to the U.S. MTI informed USAID that the Cuenca Leather Cluster had the potential to deliver quality products as required by U.S. market. The representative of MTI left some models to see if they could be reproduced by the leather operators in Cuenca. The MTI representative returned to Cuenca to inspect the samples and correct the deficiencies that had been found in the products. The samples had quality control issues and MTI provided technical assistance so that local producers could meet the US standards, customer specifications, international shipping schedules requirements, quality considerations and competitive market pricing. As a result of this technical assistance, the broker contacted a buyer in the U.S. (Carroll Leather) who will purchase 10,000 hand bags and 5,000 hats on a monthly basis from these Ecuadorian firms, once the production capacity is in place.

¹ Michael Trent, Inc. is located in Evansville Indiana, website: <http://www.michaeltrent.com/index.htm>

USAID financed technical assistance to help the local producers increase their productivity and bring their competitiveness levels to the international market standards. This resulted in an increase in productivity of 300% to 525% in three months as may be seen in the table below.

Table 1
PRODUCTIVITY INCREASE IN HATS AND HANDBAGS

Products	Initial Productivity	Actual Productivity	Increment in Productivity
Hats	8 units per person/machine per day	32 units per person/machine per day	300%
Handbags	4 units per person/machine per day	25 units per person/machine per day	525%

Since no one firm in Cuenca has the capacity to produce the volume of products order by the Carroll Leather in the U.S., fourteen firms agreed to participate in a pilot cluster activity. The firms received training and technical assistance from MTI who was in the process of diversifying it sources of supply for its international buyers from China to Latin America. As a result of this activity, 122 new jobs were created and 18 more firms (for a total of 32) have already joined the leather cluster group. The new firms will also receive training and technical assistance so they may increase production to the volume required by international buyers. As of December of 2006 three containers had been exported to the US for a total amount of \$200,000.

Backward Linkages:

MTI also sent samples of the leather quality that are required by U.S. and international buyers, to see if they could be supplied locally. The Cuenca Leather Cluster contacted its traditional suppliers in the City of Ambato to see if they could produce leather of the same quality that is demanded by the buyers. After inspecting the production of the leather from the Ambato tanneries and consulting with the buyers, MTI gave the go-ahead so that the firms in Cuenca could buy the leather from the local tanneries in Ambato, instead of importing them from Argentina, Colombia and other countries. This backward linkage of the value-chain will increase the number of jobs and value-added of the leather cluster in Ecuador. It is important to note that the Cuenca leather cluster has already started to explore new markets in order to diversify the number of products that it will produce and sell. Some of the new examples include motorcycle saddle bags and leather accessories as well as leather jackets.



Leading Firm in Cuenca:

Cuerotex Confecciones, S.A. (Spanish Acronym: Cuerotex²) is the main business that drives the cluster development. The General Manager and owner, Mr. Juan Malo has been in the business leather business since 1992 when he open up his shop with three employees to produce around 35 jackets a month. Today Cuerotex has 70 employees and is exporting to Spain and the USA.

Key Partners:

Michael Trent, Inc., (MTI) has teamed up with Cuerotex as a key partner of this program, to provide market intelligence and distribution of products to mainstream U.S. department stores, catalog companies, NASCAR racing teams, specialty houses, and the National Rodeo Finals. In addition, MTI has provided an initial rotating fund of \$300,000 to finance the working capital needs of micro and small producers. MTI has also indicated that it is in a position to negotiate with US banks the increase this line of credit to more than \$500,000 if necessary. This is in line with the directive that President Bush recently gave Secretary of State on March 5, in the Ronald Regan Building. President Bush stated that he was “*directing Secretary Rice and Secretary Paulson to develop a new initiative that will help U.S. and local banks improve their ability to extend good loans to small businesses.*”

Corporacion Andina de Fomento (CAF) is a regional development agency that is providing resources to help penetrate the European market. CAF is financing technical assistance in marketing and developing business plans for new products that will be tested in the European markets (El Corte Inglés).

Activities to be Financed by GDA, Key Partners and USAID/Ecuador

Some of the major activities that require funding under this proposed GDA activity include the following:

- Technical assistance and training for standardization of products to incorporate more micro and small producers in the value-chain of existing products.
- Technical assistance and training to increase backward linkages into tanneries, leather hides and accessories.
- Technical assistance and training to contract designers produce new products, including samples and full



Figure 1: Production of Hats

² Cuerotex website may be found at: <http://www.maquilaprograms.com/>

collections of products for purchasing consideration by international buyers.

- Technical assistance on environmental issues that affect the tanning industry.
- Development of an electronic catalog and webpage to sale leather products from business to business (B2B) and business to consumers (B2C).
- Support for international participation in fairs such as the Magic Show in Las Vegas where producers introduce new products into the market and where buyers, retailers and distributors purchase and order these products for their clients.
- Working capital and fixed capital loans for short and medium term investment for members of the value-chain.
- Expansion of the cluster from a regional level to a national scale.
- Financing a permanent showroom for its products in Ecuador.

Long Term Sustainability and Funding:

The leather cluster sustainability is based on market incentives that may be attained once there are a critical number of micro and small producers that have been trained to meet the international standards. The existing products that have started to be exported include coats, hats, and handbags. In addition, other products like motorcycle saddle bags samples have been sent to potential buyers and distributors. MTI has already identified new market niches such as varsity jackets, gun holsters, and rodeo products. MTI is also seeking to establish a strategic partnership with Bob Timberlake, who

is a recognized artist and a successful designer of home furnishings.



Figure 2: Hats in Export Boxes



Figure 3: Hats Packed for Exports

The key to the sustainability of this project is to open new international markets for the Ecuadorian leather cluster, so it may compete with other countries with quality products, at market prices, with sufficient volume of production, on a timely basis. The leather cluster and its key partner MTI have proven that this is possible, and are currently selling to Carroll Leather in North Carolina. The GDA fund will help increase the number of micro and small producers that will join this value chain so that new products are developed and sold to international buyers. The bulk of the resources will be used to finance technical assistance and training to consolidate the leather cluster and increase its suppliers and producers from a regional to a national level.

This GDA activity will be used as a model for other nine clusters that USAID/Ecuador will support with its new competitiveness program.

Table 2
**Illustrative Budget
 In US Dollars**

Description	GDA	USAID	MTI	CAF	Cluster	Total
Standardization TA & Training	\$100,000	\$25,000	\$0	\$35,000	\$0	\$160,000
Backward Linkages & National Scale	\$25,000	\$50,000	\$0	\$0	\$0	\$75,000
Product Design	\$0	\$15,000	\$0	\$15,000	\$0	\$30,000
Samples & Collections	\$0	\$0	\$0	\$0	\$65,000	\$65,000
Electronic Catalog	\$10,000	\$10,000	\$0	\$0	\$0	\$20,000
International Fairs	\$15,000	\$0	\$0	\$0	\$0	\$15,000
Working Capital	\$0	\$0	\$300,000	\$0	\$0	\$300,000
Permanent Show Room	\$0	\$0	\$0	\$0	\$35,000	\$35,000
Total	\$150,000	\$100,000	\$300,000	\$50,000	\$100,000	\$700,000
%	21%	14%	43%	7%	14%	100%

In addition to the above, USAID/Ecuador estimates that the private banks with USAID's guarantee will provide medium term financing for approximately \$200,000.