

CREDIT: WTP



Continued fluidity of global manufacturing

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With the global economy gradually recovering over the past two years, it is an appropriate time to consider the implications for the footwear industry in terms of where it finds itself entering 2015, compared to the situation before the recession and how it may develop over the next few years.

Global production of finished footwear rose by 5.6% in 2013 to almost 20 billion pairs, an increase of 1.06 billion. This can mainly be attributed to further growth in Asia which increased by 938 million pairs, South America which achieved a rise of 61 million pairs and Africa with an additional 51 million. Asia's 938 million pairs was predominantly from China which produced an extra 743 million pairs, followed by India with 130 million and Vietnam 44 million more than in 2012.

Conversely, amongst the developed countries, Western

Europe produced just five million more pairs, Eastern Europe three million and North/Central America six million. Whilst these are in themselves commendably positive results, they do not as yet offer any particular threat to the hegemony of the South East Asia. Does this therefore indicate that it is business as usual with the unstoppable march of Chinese footwear, Vietnam mopping up any slack in the market and India servicing its own needs in pretty much glorious isolation?

In 2013 the answer was probably yes as tentative customers and retailers were still wary of the market and new sources and ways of doing things. China alone supplies 57% of global demand. China plus India supply 70%, whilst the further addition of Brazil, Vietnam and Indonesia means these five countries alone are responsible for 81% of the world's footwear production.

FIGURE 1 - COMPARATIVE LABOUR COSTS 2013

COUNTRY	COST PER HOUR (USD)	% CHANGE ON 2012
Ethiopia	0.32	+39.1
Bangladesh	0.44	
Cambodia	0.61	
Vietnam	0.80	+14.3
India	0.85	+13.3
Nicaragua	1.22	0.0
Thailand	1.32	+3.0
El Salvador	1.33	+6.4
Indonesia	1.75	+29.6
Dominican Republic	1.81	+3.4
China	1.90	+18.7
Guatemala	2.15	
Brazil	3.59	+6.5
Mexico	3.87	+28.5
Portugal	6.35	
Italy	18.26	+4.0
Japan	25.7	-21.0

SOURCE: GFP SURVEY

A CHANGE IN THINKING

Certain developments have, however, started to impinge on current thinking as to future sourcing. On the one hand, China has, we are told, entered into a phase of seeing domestic production more for domestic consumption rather than for exports. Labour costs (*Figure 1*) have almost quadrupled since 2005 to USD2 per hour. There is stricter enforcement of overtime, the government minimum wage climbs apace, there are some labour shortages and environmental demands are increasing. Added to this, the currency exchange rate is 30% above what it was in 2005.

In 2013 China produced 11.3 billion pairs of finished shoes of which 8.7 billion were exported. Production for the local market was 23.6% of total output. Domestic consumption in China is estimated at two pairs per capita. Total consumption in 2013 compared to 2009 showed a 43% rise, whilst compared to 2012 it was 15.8% higher in volume terms. Imports at 110 million pairs also grew although at a relatively low level.

So there are signs that demand in China is growing and that Chinese factories are servicing more of that demand. However, exports are also continuing to flourish both directly and

through third parties as will be discussed later. One possible warning light for the future was that exports to the leading market, the United States, actually fell by 15 million pairs in 2013. Therefore, whilst it may be true to say that there is some movement towards providing more footwear to the local Chinese market, the impetus to supply ever more exports does not yet seem to have abated, with the possible exception of the US. This gap was effectively filled by Vietnam which also saw an improved year with an extra 44 million pairs produced and 36 million exported. This surplus was virtually all attributable to the US market and effectively replaced the reduced Chinese supply.

SEEKING ALTERNATIVES

Due to the rapidly rising costs in China's traditional shoemaking areas, there is always a possibility that production will move to ever lower cost regions of the country. Even so, higher labour costs may well start impacting more on the country's exports from 2014 onwards. Organisations such as the FDRA (Footwear Distributors and Retailers of America) and AAFA (American Apparel and Footwear Association) in the United States have been considering possible alternative low cost sources of supply for the US market.

The most cited names have been Nicaragua, Cambodia, Ethiopia and Bangladesh.

The footwear industry in these countries is at different stages of development, with Bangladesh and Cambodia having production levels of more than 50 million pairs and export levels of around 40 million. *Figure 2* indicates the state of play in these other

FIGURE 2 - ALTERNATIVE PRODUCERS

COUNTRY	PRODUCTION	EXPORTS	COMMENTS	CAUTIONS
Bangladesh	100m pairs	36m pairs	Young One 30m pairs Development	Strikes, Fire in Walmart supplier
Cambodia	51m pairs	42m pairs	Kingmaker 25m pairs Development with Chinese involvement	Factory problems (Asics) 2013 pay rise
Ethiopia	25m pairs	6m pairs	Huajian 25m pairs Development	Ara withdrew
Nicaragua	4m pairs	2m pairs	Brazilian investment Exports for Clarks	Schmidt problems

SOURCE: GFP SURVEY

countries' industries and their possible developments.

Bangladesh and Cambodia are clearly further along the development road than Ethiopia and Nicaragua and also have some large scale developments coming on stream. Bangladesh is able to offer cheap labour, raw material availability and duty free exports plus the presence of the likes of Bata, Tata, Apex and Young One to provide overseas know-how. Cambodia is already exporting over 40m pairs, with the UK and Germany as important markets. Kingmaker has manufacturing plant in Cambodia. Originating in Taichung, Taiwan in 1980, the company now has its headquarters in China. With five plants (three in China) and around 15,000 employees, it is an important presence in Cambodia. The "Better factories in Cambodia" programme should help to address any safety and health issues.

Ethiopia has a large livestock population and developments by the Chinese company Huajian are quite extensive. Interest shown by Japanese and UK companies is also indicative that Ethiopia has the potential to become a leading 'Shoe Hub' in Africa.

Currently, Nicaragua is the least developed of the four. It does however offer proximity to the United States and Brazil to interest both buyers and developers in those countries. The involvement of two Brazilian shoe manufacturers, Schmidt and Aniger, seemed at one stage to presage an expansion. However there were rumours that Schmidt was closing and the future is now not so clear. Exports to the United States actually fell in 2013 from one million pairs to 600,000 but ProNicaragua claims that Clarks and Ecco will both now be buying in the future.

RELOCATION

There has been some discussion on the topic of relocation of shoe production back to developing countries instead of—or in addition to—alternative sources to China. If Chinese costs rise to a level that it is no longer as attractive to source from that country and/or it devotes itself more to domestic consumption (still a big 'if'), then there is the thought that some production which has been lost to Europe and North America could return.



Automation makes footwear manufacture possible in industrially developed countries.

CREDIT: HEINRICH KLUMPEN SONS

Why might that necessarily happen, besides costs? The possibilities include reducing time to market especially for fashion products, making use of the "made in 'our' country" tag, to service military requirements, achieve greater control over the entire process and to give more cachet to a brand. To achieve this goal requires sufficient skilled labour and an ability to reduce costs as much as possible which, in turn, may call for greater automation. The questions therefore are whether this relocation is happening, to what extent and where.

There are in fact already instances where shoe production is either being switched to European plant or extended in existing plant. Two examples are the German comfort shoe manufacturer Ara in Portugal and high end men's Goodyear producer Church in the UK.

Ara was due to move some of its production to Ethiopia but decided instead to make use of existing plant in Portugal and Romania. In Portugal it increased its production capacity from 1.4 to 2.0 million pairs, an increase of 600,000 pairs per annum. This example shows a commitment to Portugal which has been following a strategy of upgrading quality and introducing the latest technology and automation.

Church in the UK, now owned by Prada, has announced that it will

increase its output by 20-30% with an extra 150 employees. Dr Martens, a one time major UK manufacturer, had already brought back some production from abroad although only about 70,000 pairs per year.

Also in Portugal, Ecco announced in 2013 that it was bringing some bulk production back to Portugal with a USD 5.7 million investment which was to be completed by August 2014. 200 new jobs were being created and production capacity increased to a million pairs. In 2013 there were 600 employees with 200 working on R&D. Ecco had moved bulk production away from the country in 2009. Since then, Portuguese costs have fallen and there is also greater flexibility in production.

Under the Berry Amendment in the United States, prior to 2002, athletic footwear for the military had to be produced there, as were dress shoes and combat boots. In 2002 athletic footwear was deemed to be exempt. This is now being re-considered as it is felt that there are US manufacturers such as New Balance and Wolverine who have the capability to produce them. Some estimates claim that as many as 4,000 new jobs could be created as a result.

New Balance has in fact successfully used the 'Made in United States' promotional strategy for some time, producing about 25% of all its footwear

domestically. Even so, the bulk is still produced in China and Vietnam, plus some in a plant in the UK. These examples perhaps indicate that a relocation is most likely where special factors such as US military/political need for local suppliers or high value/quality products such as Church's shoes are involved.

To put it in context, whilst these increases in production in developed countries are heart warming in that it helps to prolong shoe manufacturing in Europe and North America, they are relatively small in quantity compared with the developments of Kingmaker, Young One and Huajian where 15 to 20 million pairs may be involved.

To enable shoe production to move back to the developed countries will require several "sine qua non" such as equipment for greater flexibility, ability to produce smaller runs, quicker response especially for fashion footwear, greater range of styles, innovative design, ability to serve niche markets such as very high quality, safety and industrial footwear, military footwear, specialised sports and making use of new sales channels.

EUROPEAN RE-EXPORTS

One of the more recent problems in tracking the flow of global production of footwear is the phenomenon of re-exporting and triangulation whereby footwear is sent to one country only to be shipped on to a final destination for whatever reason. Among the worst instances of this phenomenon is Europe where countries that have virtually lost their footwear production capability entirely have become leading exporters of already imported footwear.

In volume terms, some of the largest re-exporters in Europe in 2013 included Belgium with 196 million pairs, followed by Germany with 185 million, Netherlands 156 million, UK 141 million and Slovakia 95 million. So, a total of 773 million pairs of shoes were exported just from these countries alone although they actually produced no more than 36 million in total themselves. Although it can be surmised with some degree of probable accuracy that the bulk of these re-exports will have originated in China, it nevertheless tends to 'muddy the waters' when tracking the production supply line globally.

INCREASED FREE TRADE?

Whilst Free Trade areas have been with us for many years it does appear that ever newer ones are arising with the potential to have a greater impact on global trade. Perhaps the one that is causing most concern at present is the TPP (Trans Pacific Partnership) and, with Japan joining in 2013, covers 12 countries with a total population of 792 million, a combined GDP of USD 45.2 trillion, which represents 40% of the world economy.

The countries covered are the United States, Canada, Australia, Mexico, Malaysia, Singapore, Chile, Peru, New Zealand, Vietnam, Brunei and Japan. At present China is an obvious omission but the Chinese have stated that they are interested in joining if issues such as intellectual property rights can be resolved. China is also in discussions with the US about a bilateral investment deal if it can be decided which industries should be excluded. There is substantial resistance to TPP, however, with fears that, for example, multinationals could sue governments and become over dominant.

There are many other regional free trade areas as, for example, ASEAN, the Association of South East Asian Nations. This was set up in 1967 and has 10 members including Vietnam, Thailand, Indonesia, and Cambodia. These and other developments are all pointing to stronger regional free trade which may well impact on the global footwear industry over the next few years.

THE NEXT 5 YEARS

The top ten shoe producers in the world manufactured around 1.7 billion pairs in 2013 or, put another way, 7.5% of global shoe production. Whilst there has been a move to larger production units, especially in China and Brazil, typical manufacturing companies are still small- to medium-sized. This is likely to remain so as the increasing diversity of consumer demands and preferences makes flexibility of the manufacturing and supply chain a key necessity.

There is also talk of more vertical integration so that shoe companies can better control supply of raw materials, components and completed footwear right up to retail. Again this can happen but only to a limited

extent and involving relatively few companies as smaller ones lack the financial resources to create such a complex structure.

In the retail sector, the diminishing status of independents and the growth of non-specialist shoe retailers is almost inevitably set to continue. In particular, the impact of on-line retailing of footwear in common with so many other consumer items is likely to go from strength to strength as it combines both choice and convenience.

Finally, the rise of the BRIC economies—Brazil, Russia, India and China—has not gone quite as smoothly as was once envisaged with Russia and Brazil both experiencing some problems, China at an interesting stage and India still not realising its full potential. The world's footwear manufacturing is therefore still extremely fluid and is likely to remain so for the foreseeable future. We live in a very uncertain world.

A report published in November 2014 by BSG, the Boston Consulting Group, entitled 'Apparel at a Crossroads', questioned whether the demand for 'fast fashion' would mean the end of the seemingly endless search for ever cheaper labour costs. The report suggests that buyers are beginning to understand the inefficiencies in sourcing from further and further away are beginning to outweigh the cheap labour costs.

In the apparel sector, retailers are desperate to have key 'sell-out' and time scale between the emergence of catwalk trends and mass dissemination reduced from a year to as little as three to four weeks. A delay can now mean the difference between a gross margin of 50% and one of only 5%. Using far-flung supply chains can also mean taking a hit on transportation, write-offs, time delays and losing customer loyalty and confidence.

The conclusion was that countries like the UK and Spain with the lowest adjusted labour costs in Europe could take advantage of 're-shoring' as has the US', particularly in high end manufacturing. While it has not happened so far, there is no reason why it could not in the future. 

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