

We are all geopoliticians now

There are quite a number of people who can remember sitting in the office of Lew Frankfort, the president of Coach in the 1980s, to be told that never ever would Coach contemplate having products made outside the USA. Identical articles—Coach makes high quality leathersgoods and some shoes—made in its US plants had been consumer tested with various different labels of origin attached. The responses were so clear that the only conclusion to be drawn was that the Coach customer would only buy US-manufactured products.

Go back to the same era and a similar message was emanating from the boardroom of Clarks in the UK. Where do these companies stand in 2005? Coach began to move production overseas in the mid-nineties and, allied with great design and marketing, has been a leading growth stock without a break ever since. Clarks announced the closure of their last UK plant in early 2005. This completed a cycle to bring its structure much closer to the virtual organisation Nike demonstrated to the world some decades ago, with marketing, design and logistics held at home, but all manufacturing outsourced.

For a short while Griggs felt they had beaten the outsourcing formula and bought up redundant Clarks' factories to produce its Doc Martens. As demand for its multi-eyelet boots has waned, it too has become a company outsourcing 100% of its products.

The experiences of Coach and Clarks are interesting. Their global reach, market share and profitability have steadily increased as they moved production overseas and paid more attention to the brand, marketing, design and product quality. Clarks has become a formidable presence in the US. Coach's global business has nearly trebled in just four years. Sales in 2001 were \$600.5 million, while its latest 2005 prediction is to pass \$1.67 billion.



Not everyone likes outsourcing

Outsourcing was an issue in the 2004 US presidential election and remains a constant source of complaint by unions and workers throughout the West. Speaking on CNN in March this year, Elaine Chao, the US labour secretary, argued that of 148 million US jobs only 300,000 were outsourced in the last twelve months. With about 180,000 to 200,000 jobs being created monthly she wanted to ensure voters did not get matters out of proportion. The Bush Administration used these figures throughout the election and also noted that an additional nine million US jobs were provided by overseas employers.

All this misses the point that the US and Europe have lost hundreds of thousands of jobs to Asia and Latin America in footwear manufacture, tanning, garment making and textiles over the last thirty years as manufacturers and retailers have chased lower costs and

cheaper production around the world. Time magazine recently quoted that WalMart alone held inventory of \$18 billion worth of goods made in China in 2004, proving that the USA is now a major consumer of goods rather than a producer. \$18 billion represents a great number of manufacturing jobs.

Understanding the situation

Western voters worry because they struggle to understand how an economy can survive without manufacturing and as to how the huge number of lost jobs can be replaced. The sudden rush of additional imports into the USA and Europe since the start of 2005 has led Rossano Soldani, president of the Italian footwear industry (ANCI), to ask EU Trade Commissioner Peter Mandelson to intervene. He wants Mandelson to take urgent action to save 320,000 European footwear jobs from what he describes as Chinese "currency, social ►

WORLD FOOTWEAR

and environmental dumping", through a 600% increase in footwear imports into Europe in the first 40 days of the year. In the USA, the battle is also on to save the 35,000 remaining textile industry jobs, with appeals to President Bush for emergency protection.

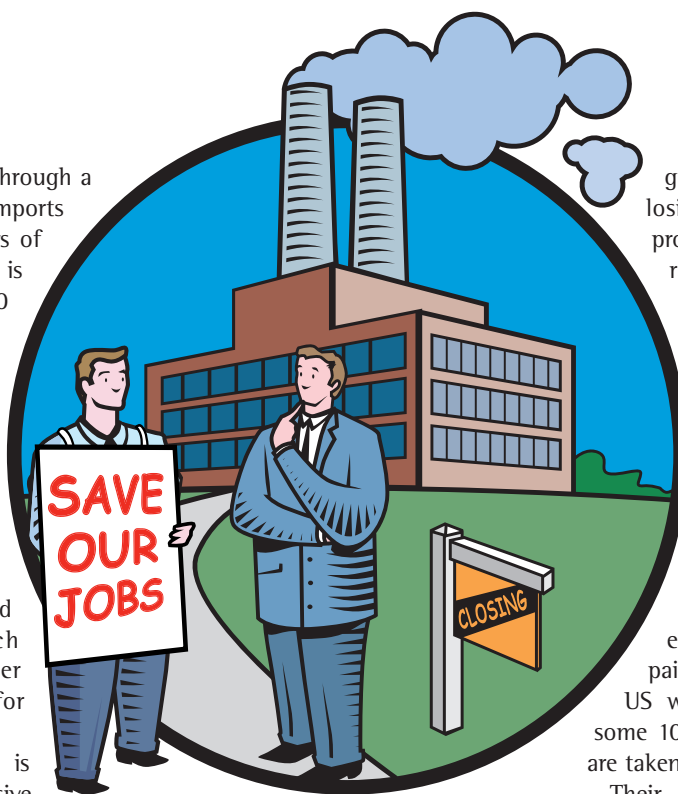
These complaints relate to unfair competition, but behind this lies the power of globalisation and, like water in a cistern, work flows to where it can be carried out most efficiently and economically, making rich economies consumers and lower cost ones the manufacturers for the world.

Since footwear manufacture is labour rather than capital intensive and the skills can be easily transferred, it has naturally been subject to extensive outsourcing for many years. The political issues are important to understand and manage as part of a company's corporate social responsibility, but the reality is that outsourcing has been implemented, defined and refined within the footwear industry for four decades and in the glove industry for a century.

Learning to outsource

What are the issues involved with a move to outsourcing? They essentially revolve around decisions of the 'where', the 'how' and the 'what'. Taking the 'how' first, a decision is needed as to whether to use intermediates or not. Studies on the Brazilian footwear industry regularly indicate they succeeded in keeping in touch with the world via utilising a large number of US nationals and residents as links into the US footwear and retail business. Compare this with Mexico, which has remained more insular; satisfied with the local market and which lacks these same strong intermediate links.

Such individuals often work as consultants and advisers to the US brands, helping them with quality and pricing and smoothing the logistics. In some instances entire businesses are set up to provide a sourcing solution. The best example in the textile industry is Hong Kong-based Li and Fung, which reported an 11% increase in turnover for 2004 at \$6.05 billion and profits up by 25%. They forecast increasing sales to \$10 billion by 2007.



Companies such as Marks and Spencer also use outsourcing companies, which build up a variety of levels of expertise depending on the customer's needs. These needs do have to be carefully considered and comprise the 'what' of outsourcing. The outsourcer has to decide whether the outsourcing should involve buying from a catalogue or having a product made to a design and specification that they will supply. Will they decide the components and how will the specifications be checked and approved?

Sometimes the brand chooses the leather but leaves the sourcing of the other components to the shoemaker. A brand may also run a hybrid policy where some product lines are more tightly specified than others, or where certain geographic regions are given autonomy to add to the centrally co-ordinated range through independently sourced shoes suited to their specific markets.

Mostly, however, the main footwear companies keep their design and marketing in-house as they consider them key elements in the brand. Yet many US fashion brands license footwear to companies like Stride Rite in the US which manages Tommy Hilfiger, or alternatively, outsource design along with procurement to smaller US specialist businesses.

Protecting intellectual property

Increasingly coming under the spotlight is just how far a company can

go with outsourcing without losing too much intellectual property, and a debate is now raging on whether research and development should be outsourced to facilities in third world countries. The US Chamber of Commerce argues that every overseas outsourced job losing the US \$1, returned \$1.12 or more back into the US economy through giving the country cheaper and better ways of doing things and freeing up the economy for the growth of better paid jobs. In any case, by 2010, the US will have a worker shortfall of some 10 million even before skill levels are taken into account.

Their thought process implies that knowledge-based economies such as the US should do the R&D and someone else the metal bashing. But, if China, Taiwan, India and Malaysia grab the R&D as well as the manufacturing, what does the West become other than a tourist park and retirement home for a declining elderly population? The definition coming to the fore—and recently quoted in *Business Week*, is for companies to decide where 'mission-critical research ends and commodity work begins'.

Clearly any manufacturer or brand moving to outsourcing and no longer owning the plant in which its products are made must consider the intellectual property side of things. In most of the developing world education is more highly valued than in the West and there are many bright people who quickly understand the intricacies of a product, its development and its manufacture.

A new conundrum

This has put an interesting framework around the whole global sourcing picture. On the one hand, those who would prefer to keep their manufacturing in the West often struggle to find people who are willing to do hands-on factory style work. Employment in a shoe shop seems for many youngsters more attractive than sewing leather, however advanced the shoe factory. At the same time, the quality, precision and dependability of overseas manufactured goods has become much higher and is often ahead

of what can be achieved in the traditional location.

This creates a conundrum. As wages rise elsewhere, it will become more interesting to bring some outsourced work back. This might prove difficult if staff cannot be found, high quality levels cannot be achieved or people in the West do not value their educational opportunities and keep ahead. An example of a successful footwear manufacturing balance between outsourcing and domestic manufacturing is FootJoy which, as previously reported in these columns, has maintained and now rebuilt its welted footwear plant in Brockton Massachusetts while continuing to purchase other models overseas.

One reason that some previously outsourced jobs gain potential for repatriation is new developments in what we call mass customisation or higher levels of individual customer service. Getting a personalised article, be it in

size, design or with some form of club or personal logo, or a high value pair of shoes on a specific last, is the sort of task better done nearer the point of sale.

In the fashion world, the fact that companies like Zara commit to only a proportion of what they expect to sell in a season, looking to fill in with items that are selling well or are new, creates greater interest in local sourcing for certain items. This may mean keeping jobs at home or even repatriation. The most likely result, however, will be improved opportunities for locations closer to the main markets: Mexico, Central America and the Caribbean for the USA and Eastern Europe and North Africa for Western Europe.

Geographics

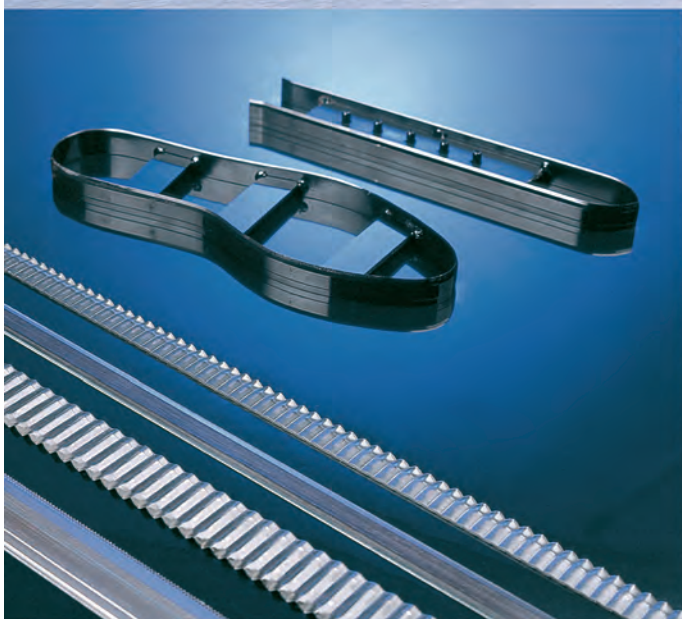
Geography raises a further aspect in terms of how many eggs you might wish to risk in one basket. As manufacturing rushes to mainland China, how comfortable will a major brand be in

having all its production coming from one somewhat unpredictable source? Will the Chinese revalue their currency over the next three years? What are the implications of the recently passed law about Taiwan and the associated ongoing strengthening of the Chinese military? Perhaps it is no wonder that some who have been making shoes for Europe in Vietnam have decided to stay loyal to good suppliers there and not move everything to China as tariffs and quotas ease.

Most of those we speak to who work in China are delighted with the quality and service they obtain. However, we have no doubt that every major company involved in sourcing is sitting with a real or mental world map on the table looking at the costs, benefits and most of all, the risks involved in the many areas they could choose for outsourcing.

Whether we like it or not, we all have to be geopoliticians now. 

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