In-depth assessment of the situation of the European Footwear sector and Prospects for its Future Development

(Contract No ENTR/2010/16, Lot 2)

Task 3: Small and Medium Sized Enterprises

Final Report

prepared for

DG Enterprise & Industry

RPA

November 2011

IN-DEPTH ASSESSMENT OF THE SITUATION OF THE EUROPEAN FOOTWEAR SECTOR AND PROSPECTS FOR ITS FUTURE DEVELOPMENT

Task 3: Small and Medium Sized Enterprises

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DG Enterprise & Industry, European Commission

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EXECUTIVE SUMMARY

The Role of SMEs in the Footwear Sector

Maintaining the competitiveness of small and medium sized enterprises (SMEs) is a key factor of the overall performance of the European economy. According to 2008 data from the Eurostat Structural Business Statistics[1], the EU footwear industry comprised 13,500 small and medium sized companies in 2008; 72% of the sector's firms are micro-enterprises. Employment in the footwear manufacturing industry is concentrated in SMEs, which employed approximately 198,000 people in 2008.

Beginning in the 1990s, competition from countries with low labour cost and less-regulated working conditions forced EU footwear production into major restructuring and re-location. While the footwear sector in general is working to adjust to the changing market environment, the economic constraints have had a particular impact on SMEs. Increased competition, together with the economic crisis of recent years, has forced many SMEs out of business.

However, current footwear market conditions can also offer opportunities for SMEs. Reduced numbers of competitors and emerging trends provide companies with the opportunity to increase their market share. Effective business strategies, involving identifying niche markets, upcoming trends and responding to these opportunities in a timely fashion, could help footwear SMEs to take advantage of these opportunities.

To investigate theses challenges and opportunities, we carried out case-studies, involving interviews with individual companies and industry associations, in three regions. These are described in Box 1.

Box 1: The Case-Study Regions
Italy - *There are two main footwear clusters within the region of* ***Emilia-Romagna****; San Mauro Pascoli and Fusignano-Bagnacavallo. Production in the cluster of San Mauro Pascoli is focused on the manufacture of women's shoes for the luxury/premium segment of the market. It has nearly 250 companies with a production capacity of around 15 million pairs per year. The majority (approximately 80%) of products manufactured in Bagnacavallo-Fusignano still target the low priced segment of the market. In 2005 the cluster contained 85 companies, employing 800 people; according to 2011 figures there are 48 companies with about 248 employees[2].*   **Spain -** *The* ***Valencian*** *footwear manufacturing industry includes the clusters of Elda and Elche. These two manufacturing districts account for about 40% of all footwear companies in Spain. Many of the SMEs in Valencia previously focused solely on supplying to the Spanish market. However, the on-going economic problems of the country meant that demand has reduced significantly. Therefore, companies have sought to compensate for the loss of their home market by increasing exports.*

1 Information from Eurostat Structural Business Statistics (2011) downloaded from: http://epp.eurostat.ec.europa.eu/portal/page/portal/european_business/data/database

2 Il Sole 24 Ore (2011): *I Distretti in Caccia di Nuovi Mercati*, downloaded from: http://www.modena.legacoop.it/rassegna/2011/06/pressline20110628_258657.pdf

Box 1: The Case-Study Regions
Romania - *The footwear sector in **Timis** has undergone major changes in the past decades. Prior to 1989 the area was a centre for the footwear and textile industries. Now it has become a hub for Italian manufacturers outsourcing all or part of their manufacturing process. Although 364 footwear companies are registered, many of these are no longer thought to be active. The area offers a cheap and skilled workforce and a competitive infrastructure.*

Challenges and Business Strategies to Address Them

The SMEs we interviewed in the three case study regions faced a number of significant challenges in maintaining and expanding their operations. These included:

- *reduction in demand in the EU market and increased competition from cheap imports;*
- *increasing difficulties in accessing finance, both for investment and to address the cash-flow problems caused by different payment terms for suppliers and customers (in Emilia-Romagna and Valencia);*
- *difficulties in recruitment and retention of skilled labour (in Emilia-Romagna and Timis) including particular problems with succession planning for family firms, which comprise a high proportion of firms in Valencia and Emilia-Romagna;*
- *limited access to technology, particularly IT tools both for production planning and e-commerce; and*
- *increasing costs of raw materials allied with unfavourable payment terms to suppliers.*

In response to the problems they face, the SMEs we interviewed in the three case study regions have adopted various business strategies. These include:

- *seeking new markets, either by moving to higher quality and price segments or expanding exports (Emilia-Romagna and Valencia);*
- *strengthening brand identity, either for individual company brands or through benefiting from industry campaigns such as 'I love Italian Shoes' (Emilia-Romagna and additional examples from Valencia);*
- *rationalisation, including stopping production of low-performing product lines, and outsourcing production either within the region, in the case of Valencia, or to a lower-cost country, in the case of Romania; and*
- *new marketing approaches, including e-commerce.*

Footwear enterprises in both Valencia and Emilia-Romagna work in traditional industrial clusters, composed of manufacturers, suppliers and other participants in the supply chain. The footwear industry in Romania is more fragmented; even though the area of Timis hosts a large number of enterprises, these are mostly involved in the *lohn system of production[3], thereby limiting their scope for developing local partnerships. Such clusters can play a key role in assisting SMEs to address the challenges they face, by establishing partnerships. Where a cluster of footwear manufacturers can negotiate with a supplier, this may also result in better payment terms and potentially lower prices.*

The supporting services most frequently used by SMEs within the three case study regions to help them maintain and develop their businesses include:

- *access to technology and educational centres: SMEs in Emilia-Romagna and Valencia have formed partnerships with regional centres to develop training programmes and on research and innovation projects but in Timis there seems little scope for such collaboration and the majority of the vocational schools have now closed;*

- *export assistance services: companies in Valencia in particular had taken advantage of subsidies available to attend export fairs to identify new markets; and*

- *industry-led campaigns in Spain and Italy, to promote locally-manufactured products, were valued by SMEs as a useful contribution to their marketing and brand identity efforts.*

Conclusions

The footwear industry in the EU has faced significant challenges in recent years, from increased competition from low-cost manufacturers outside the EU and the impacts of the financial crisis. The latter has led to reduced domestic demand and difficulties in accessing finance. The challenges are likely to increase in future, with the growing importance of issues such as the environmental aspects of production, new supply chain organisation, the growth of 'fast fashion' and a demand for customisation, new developments in materials, IT and robotics.

Because of their more limited resources, SMEs are likely to be most impacted by changes in market conditions. In all three regions covered by the case study, the number of footwear SMEs has contracted significantly in recent years due to reduced demand and increased competition. They are also faced by rising costs for raw materials, which SMEs are required to absorb because their sales are often on fairly long-term fixed contracts, whilst their raw materials are purchased on a spot basis.

The regions covered by the case study are rather different in economic terms. Emilia-Romagna and Timis are among the most advanced regions in their country (with a

[3] Under this system, a foreign investor takes ownership of the manufacturing site and limits the operation to the actual manufacturing process. The foreign owner undertakes sourcing and selection of raw materials, components and other accessories. When the products are completed, the owner re-imports the finished merchandise.

relatively low unemployment rate, high or rising incomes) while Valencia is not. A number of lessons for the rest of the EU footwear industry may be learnt from these differences:

- *it is possible for footwear clusters to address the current challenges by focusing production on high value brands and exports (San Mauro, Elche) and by outsourcing of production (San Mauro); and*

- *districts are only successful for a certain period if they do not adapt to market changes (as in the case of Bagnacavallo and Timis). Timis experienced initial success from the inflow of foreign, particularly Italian, capital. However, this may quickly come to an end if there is no upgrading of companies (i.e. in the fields of design, marketing, distribution etc., both to local and export markets).*

SMEs in all regions need to continue developing to meet the current challenges, but the form may differ according to the characteristics of the region and/or the type of business strategy adopted by the company:

- *in the more advanced regions, this could focus on strategies for the development of "top" brands, high price segments and exports. This is likely to require modernisation of IT in production planning and order processing, process flexibility, training of a skilled labour force and better links with customers. Other companies that wish to strengthen their capabilities in exporting need better information about markets and ways in which to access them;*

- *in other regions, development may take the form of improved functional capability, increasing productivity through modern machinery and better training of the workforce; and*

- *to recover their home market share, SMEs needs to enhance their capabilities in providing a flexible response to customer demands through developing skills in marketing, logistics and distribution.*

Recommendations

The key recommendations of the study, based on the problems faced by SMEs and the potential solutions, are:

- *industry associations, national and regional governments, and educational institutes should assist SMEs to develop new export markets by providing information on potential markets, export credit guarantees, financial support to attend trade fairs, tailored training in export management and encouraging SMEs to develop partnerships with existing footwear exporters to take advantage of their networks;*

- *industry associations and research institutes should work with SMEs to develop their capability in e-commerce and provide support in predicting future customer requirements (e.g. fashion trends) and developing supply chain networks;*

- *industry associations, national and regional governments should provide support for the development and enhancement of footwear industry clusters, including 'virtual' clusters for SMEs located separately from the main industry locations;*

- *the European Commission, national and regional governments, and industry associations should work together to provide better information for SMEs on available finance sources, including access to training and consultancy services. Existing schemes offering financial support to the footwear industry and/or SMEs, should examine the potential for reducing administrative requirements for smaller funding requests and provide categories of funding specifically targeted at footwear SMEs;*

- *similarly, existing funding mechanisms for training should be evaluated by their deliverers to make sure the training supported is properly targeted at the training needs of SMEs. Educational institutes, industry associations and trade unions should work together to encourage partnerships with SMEs to deliver customised training. This could also focus on greater involvement of staff in SME company decision-making;*

- *succession planning for family firms could be assisted by the development of information platforms designed to bring together firms with potential investors and buyers. Regional governments could also supply risk capital to help with the funding of management buy-outs of such firms, while educational institutes could also provide management training to footwear students and encourage them to set up their own businesses; and*

- *research institutes and industry associations should continue to work to develop partnerships with SMEs to provide improved access to newer, more productive technologies and new materials. This may be best achieved through clusters, due to the limited resources of SMEs. Together with national and regional government, they should also provide information on the availability of new equipment, e.g. through leasing. SMEs could also be encouraged to negotiate with suppliers through clusters, to obtain better payment terms and cheaper prices.*

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LIST OF ABBREVIATIONS

ANCI	Italian National Footwear Manufacturers' Association
AVECAL	Valencia Regional Footwear Association
CBI	Confederation of British Industry
C2I2	Calzado, Componentes, Investigación e Innovación
DMY	Dimethyl terephthalate
ERDF	European regional development Fund
EU	European Union
FICE	Federation of Spanish Footwear Industries
GDP	Gross Domestic Product
ICE	Italian Institute for Foreign Trade
ICEX	Spanish Institute for Foreign Trade
ICT	Information and Communications Technology
IFEMA	Trade Fair Institution, Madrid
IMPIVA	Institute for Small and Medium Industry of the Generalitat Valenciana
INCDTP	Leather and Footwear Research Institute, Romania
IT	Information Technology
ITS	Istituto Tecnico Superiore
IVEX	Valencia Institute of Export
INESCOP	Technological Institute for Footwear and Related Industries
MEG	Monoethylene glycol
MICAM	Milan International Footwear Exhibition
nd	no data available
OECD	Organisation for Economic Cooperation and Development
PTA	Purified terephthalic acid
PYMES	Pequeña y Mediana Empresa (small and medium enterprises)
REACH	Regulation (EC) No 1907/2006 concerning the Registration, Evaluation, Authorisation and Restriction of Chemicals
R&D	Research and Development
RPA	Risk & Policy Analysts Ltd
SACE	Italian insurance and financial group
SATRA	Shoe and Allied Trades Research Association
SMEs	Small and medium sized enterprises
TCCIA	Timisoara Chamber of Commerce
US	United States of America

1. INTRODUCTION

1.1 Background

The European footwear industry has been subject to an elongated period of transition since the early 1990s, following increasing competition from China, Brazil and Indonesia. During these years, EU manufacturers have maintained their competitiveness by outsourcing the most costly production processes to Asia or to Eastern European countries, as well as through a number of bilateral trade restrictions on imports of footwear. Nonetheless, industries in the Far East have gained a competitive advantage by way of lower labour costs. Consequently, European manufacturers have been forced to introduce cost cutting measures, which have contributed to a reduction of employment within the sector.

In response to the challenges the footwear industry is facing, the European Commission has contracted Risk & Policy Analysts (RPA) to undertake an assessment of the situation in the footwear sector in the EU and prospects for its future development. The assessment focuses on the current trends in research and innovation, restructuring, education and training and on small and medium-sized enterprises (SMEs), with specific focus on selected EU regions. The main goal of the study is to better equip stakeholders, including national/regional authorities, as well as social partners and the business community, to respond to a potential crisis and minimise its socio-economic consequences, particularly in the less-favoured regions which are heavily dependent on footwear manufacturing.

The study comprises seven tasks:

- Task 1: EU survey;
- Task 2: Research and Innovation Centres;
- Task 3: Small and Medium-sized Enterprises;
- Task 4: Restructuring and Modernisation;
- Task 5: Training;
- Task 6: Research and Innovation; and
- Task 7: Preparation of a Synthesis Report.

This report sets out the findings of Task 3.

1.2 Objectives

The objective of Task 3 of the study is to assess the main difficulties faced by small and medium-sized enterprises and the prospects to overcome these difficulties. The assessment should:

- characterise footwear SMEs operating in three selected regions;
- identify the main problems the SMEs are facing;
- analyse the incidence of these problems by type of enterprise;

- analyse how the problems have been solved/minimised and suggest innovative practices that could be transferred to other regions/countries;
- assess to which extent clusters have been developed;
- assess the extent to which SMEs use support services, either footwear-specific or more horizontal;
- identify success factors;
- assess footwear SME objectives and their short- and longer-term business strategies; and
- suggest what types of additional public support initiatives could be undertaken to improve footwear SME competitiveness.

1.3 Approach to Task 3

In agreement with the Commission, three regions were selected as case studies under Task 3. These are:

- Emilia-Romagna, Italy;
- Valencia, Spain; and
- Timis, Romania.

Brief descriptions of the three regions are given in Box 1.1.

Box 1.1: The Case-Study Regions
Italy There are two main footwear clusters within the region of **Emilia-Romagna**; San Mauro Pascoli and Fusignano-Bagnacavallo. There are other enterprises spread out in and around Bologna, Rimini and Ravenna. Production in the cluster of San Mauro Pascoli is focused on the manufacture of women's shoes for the luxury/premium segment of the market. It has nearly 250 companies with a production capacity of around 15 million pairs per year. The majority (approximately 80%) of products manufactured in Bagnacavallo-Fusignano still target the low priced segment of the market. In 2005, the cluster contained 85 companies, employing 800 people; according to 2011 figures there are 48 companies with about 248 employees[4]. **Spain** The **Valencian** footwear manufacturing industry includes the clusters of Elda and Elche. The two industrial districts are within one hour's travelling time from one another and both play a key role in the region's economy. These two manufacturing districts account for about 40% of all footwear companies in Spain. Elda houses INESCOP, one of the most prominent footwear research centres in Europe and many of the component manufacturers including ICT technology providers are located in the city. Elche is the third largest city in the Valencian Community. **Romania** The footwear sector in **Timis** has undergone major changes in the past decades. Prior to 1989, the area was a centre for the footwear and textile industries. Now it has become a hub for Italian manufacturers outsourcing all or part of their manufacturing process. Although 364 footwear companies are registered, many of these are no longer thought to be active. The main advantage of the region remains the competitiveness of its products on the international market. The area offers a cheap and skilled workforce and a competitive infrastructure.

4 Il Sole 24 Ore (2011): *I Distretti in Caccia di Nuovi Mercati*, downloaded from: http://www.modena.legacoop.it/rassegna/2011/06/pressline20110628_258657.pdf

Interviews were conducted with representatives of national and regional industry associations as well as individual enterprises in the three case study regions. The discussions were undertaken using a semi-structured format and focussed on gathering details on company objectives, business strategies, challenges, regional clusters, available support and future trends. Table 1.1 lists the number of enterprises interviewed in each region.

The number of enterprises and associations contacted is also summarised in Table 1.1. Due to a relatively high number of company closures in Romania and lack of information on the contact details of the active companies, we needed to contact a higher number of enterprises in order to organise the interviews.

Table 1.1: Number of Enterprises and Industry Associations Contacted and Interviewed in the Individual Case Study Regions

Case Study Region	Number Contacted	Number of Enterprises Interviewed
Emilia-Romagna, Italy	12	4
Valencia, Spain	19	5
Timis, Romania	36	5
Total	**67**	**14**

1.4 Structure of this Report

The remainder of this Report has been organised as follows:

- Section 2 gives a brief overview on the status of SMEs within the European footwear sector, potential business strategies and the challenges that they face;
- Sections 3 to 5 describes the case studies undertaken in three selected regions;
- Section 6 provides our key findings on the main difficulties faced by SMEs and strategies to overcome these difficulties; and
- Section 7 provides the conclusions and recommendations of the study.

2. SMEs IN THE EUROPEAN FOOTWEAR INDUSTRY

2.1 Introduction

2.1.1 Definition of SMEs

The definition of SMEs is provided in Commission Recommendation 2003/361/EC[5], as updated. The current definitions are set out in Table 2.1.

Table 2.1: Definition of Small, Medium and Micro Enterprises

Company Size	Number of Employees	Maximum Annual Turnover (€ million)	or Maximum Annual Balance Sheet Total (€ million)
Medium	<250	50	43
Small	<50	10	10
Micro	<10	2	2

Source: European Commission, DG Enterprise and Industry, Small and Medium-Sized Enterprises

SMEs are the backbone of European industry. According to a 2009 report by the European Commission[6], there are 20.7 million enterprises in the EU (excluding the financial service sector). SMEs generated the majority of value added (57%) and employed most (67%) of the workforce in the non-financial business economy. Micro enterprises also played an important role, making up almost 92% of SMEs and providing employment to nearly as many people as large enterprises. Table 2.2 shows the distribution of EU enterprises by size.

Table 2.2: Size Distribution of Enterprises in the European Union (2008)

	Micro	%	Small	%	Medium	%	Large	%
Number of enterprises	19 058 000	92	1 424 000	6.9	226 000	1.1	43 000	0.2
Number of employees	39 630 000	30	27 652 000	21	22 665 000	17	43 414 000	33

Source: European Commission, DG Enterprise and Industry (2009): ***European SMEs under Pressure****, Annual report on EU small and medium-sized enterprises.*

2.1.2 SMEs in European Footwear Manufacturing

The global footwear manufacturing industry has a low concentration level. Similar to most manufacturing sectors, the sector is made up primarily of SMEs, as the high labour intensity of most of the sector's production lends itself toward small operations. While large scale manufacturers do operate in the industry, SMEs

5 Commission of the European Communities (2003): **Official Journal of the European Union**, L 124, p36 of 20 May 2003.

6 Directorate General for Enterprise and Industry (2009): **Annual Report on EU Small and Medium-sized Enterprises**.

generate most of the revenue; the four largest footwear producing companies in the world accounted for only around 7% of sector revenue in 2010[7].

According to 2008 data from the Eurostat Structural Business Statistics[8], there are 22,501 footwear manufacturing enterprises in the EU; 72% of them are micro enterprises. Table 2.3 shows the number of enterprises by size while Table 2.4 gives the number of employees by size. When compared with Table 2.2, it can be seen that companies operating in the footwear sector are characteristically larger in size, in terms of number of enterprises, than the average sized SMEs in the EU.

Table 2.3: Number of Enterprises by Size within the Footwear Sector in the European Union, Spain, Italy and Romania (2008)

	Micro	%	Small	%	Medium	%	Large	%	Total
European Union	16,304	72	4,995	22	1,069	5	133	1	22,501
Spain	3,034	76	885	22	NA	-	NA	-	3,977
Italy	7,109	74	2,282	24	231	2	17	0	9,639
Romania	753	49	457	30	273	18	49	3	1,532

Source: Eurostat: Structural Business Statistics
Note: NA = data not available; marked 'confidential' in Eurostat table

Table 2.4: Number of Employees by Size of Enterprises within the Footwear Sector in the Spain, Italy and Romania[1] (2008)

	Micro	%	Small	%	Medium	%	Large	%	Total
Spain	6,975	24	17,867	61	NA[2]	-	NA[2]	-	29,335
Italy	12,784	16	39,572	49	20,226	25	7,630	10	80,212
Romania	2,225	3	11,114	17	29,036	45	22,351	35	64,726

Source: Eurostat: Structural Business Statistics
Notes:
1 No data are available for the EU as a whole
2 NA = data not available; marked 'confidential' in Eurostat table

Beginning in the 1990s, competition from countries with low labour cost and less-regulated working conditions forced EU footwear production into major restructuring and re-location. An example of this was Italian companies outsourcing their production to Eastern European countries such as Romania, which offered tax incentives and cheap labour. Those Italian companies that relocated production benefited from cost savings. The outsourcing of production was also beneficial in the short-term to Romania, as foreign investors created jobs, but in the longer-term it limited the growth of the sector as the system did not allow local companies to take part in strategic decisions or to make business plans.

As Table 2.5 shows there were reductions in the number of enterprises in the tanning and dressing of leather; manufacture of luggage, handbags, saddlery, harness and

7 IBIS World Industry report (2010): **Global Footwear Manufacturing**

8 Information from Eurostat Structural Business Statistics, downloaded from: http://epp.eurostat.ec.europa.eu/portal/page/portal/european_business/data/database . 2009 data are incomplete and appear inconsistent with 2008 data, so have not been included

footwear sectors throughout the last eight years. The only exceptions are, for example, Belgium (primarily an importer) and Bulgaria. Information from national and regional industry associations suggest that increased competition, together with the economic crisis of recent years, has forced many SMEs out of business.

Table 2.5: Number of Enterprises in the Leather, Footwear and Related Sectors (2004-2008)

	2004	2005	2006	2007	2008
Austria	212	207	207	181	185
Belgium	153	153	149	160	160
Bulgaria	505	502	511	500	532
Cyprus	77	66	64	61	59
Czech Republic	1,040	884	888	nd	nd
Denmark	66	59	55	48	nd
Estonia	72	71	65	70	60
Finland	nd	nd	nd	nd	nd
France	2,305	2,218	2,148	2,197	1,961
Germany	1,299	1,131	1,126	1,099	985
Greece	1,333	1,333	1,325	1,311	nd
Hungary	880	793	730	686	663
Ireland	19	16	19	18	nd
Italy	20,470	19,589	19,164	18,853	18,050
Latvia	73	83	74	73	60
Lithuania	98	172	186	159	nd
Luxembourg	nd	nd	nd	nd	nd
Malta	nd	nd	nd	nd	nd
Netherlands	305	310	210	315	294
Poland	5,803	4,202	4,409	4,436	3,606
Portugal	nd	3,668	3,465	3,357	3,211
Romania	nd	2,086	2,057	2,049	nd
Slovakia	nd	nd	nd	nd	nd
Slovenia	273	234	239	217	212
Spain	6,293	6,061	5,848	5,613	5,558
Sweden	405	403	409	406	403
United Kingdom	806	776	753	725	791
European Union	nd	**45,000**	**44,000**	**43,655**	nd

Source: Eurostat: Annual detailed enterprise statistics on manufacturing subsections DA-DE and total manufacturing (NACE Rev.1.1 D) [sbs_na_2a_dade]
Notes: nd = no data available

The influx of cheap Asian imports directly affected the producers of low to medium level price range footwear, but also had a knock-on impact on the whole EU footwear industry, as major retailers forced manufacturers to reduce prices. The overall performance of footwear manufacturing in the EU has been deeply affected by this growth in global competition. As the majority of EU manufacturers are part of a vertically disintegrated supply chain, the reduction in demand has also affected raw material suppliers as well as component manufacturers.

2.2 Product Categories

Footwear manufacturing sub-categories can be defined in a variety of ways, including end-user, the materials used the type and the price of the products, as shown in Table 2.6. The different market segments can require different manufacturing processes and timescales; for example, for higher priced footwear the manufacturing process might involve more manual labour hours and a different marketing approach compared to a medium to low price range products.

Table 2.6: Footwear Market Segmentation

End user	Type of footwear	Price	Material
Women	Casual	Super premium segment	Leather
Men	Formal	Premium segment	Textile
Children	Evening	Medium Segment	Plastic/rubber
	Sport	Lower Segment	Other
	Safety/protective		

Note:The categories are independent and should not be read horizontally

It should be noted that there appear to be no clear-cut definitions of the various price segments, even in the academic literature. Everyone talks about price segments, and the terms seem to be well understood in the industry, but without further explanation. Price segments seem to be part of the un-written practice of the sector; as such, many believe that they are stable over time, in orientating the company's strategy, but rather fluid at certain moments in time. The definition is also tied to national markets; thus what is meant by 'low' and 'medium' price varies between Member States depending on domestic purchasing power, consumer behaviour, competition in domestic markets and even currency exchange rates. Therefore, price segments cannot be determined in terms of Euro ranges at the EU level.

No statistical data are available on the breakdown of production in different categories by company size. However, the case studies indicated that the majority of SMEs focus on the production of one or two closely related sub-categories, where the production process and the supply chain dynamics are very similar. Therefore, the challenges faced and strategies implemented by the individual companies can vary based upon the specific market segment they are operating in. Not all Member States collect primary statistics on the outputs of the different sub-sectors however some associations (such as in Italy) do gather such information. These are presented at the individual case study sections in the report.

2.3 Business Strategies for SMEs

Business strategies are generally developed with the intention of achieving a well-defined goal. This goal might be as broad as to enter a new market or to reduce costs in general; it can also be more focused on the type of products, target market and timing the enterprise will adopt.

Business strategies adopted by SMEs can complement the activities of large firms, bringing advantages of flexibility and lower transaction costs to customers and to the supply chain alike. Their competitive advantages lie in their ability to interact more closely with consumers and to respond more quickly to their demands, while large enterprises can exploit the advantages of large scale production. Competitiveness for SMEs lies in their ability to identify existing and upcoming market trends, to find opportunities to use labour skills and to combine this with flexibility and the advantages of specialization[9].

However, not all SMEs have the ability to adopt these approaches and to contribute to productivity enhancement. While certain patterns of specialisation, such as clusters focusing on particular types of product (like sports shoes), can be highly beneficial to productivity growth, others may not be as innovative, and mainly continue customary activities in stagnant markets[10]. Therefore, a business strategy of finding market niches and forecasting future trends in design and related business services, then adapting these to the skills and technology of a particular company, can prove to be significant in terms of the competitiveness of SMEs.

An important part of such a strategy is the ability to innovate. Both multinational corporations and SMEs are incubators of innovations, but the processes can be very different. Larger organisations often seek to invest in research and innovation with a focus on specific themes, such as the quality of materials, and consequently build up a network of collaborators to introduce new products by a given time. Smaller enterprises often struggle to find the financial backing to plan and invest years ahead for the launch of a specific product. Therefore, it is often a single idea that drives innovation and it is the entrepreneurship of SMEs, fostered by the local and regional environment, which provides the added value.

Whereas a business strategy constitutes an overall direction, the role of the supply chain is of key importance for footwear manufacturing. Manufacturing is strongly linked to the availability and price of supply materials; therefore, developing a viable and cost-effective supply chain is a critical objective. This needs to take account of the factors and market trends influencing decisions of suppliers.

2.4 Challenges faced by SMEs

While the footwear sector in general is working to adjust to the changing market environment, the economic constraints have had a particular impact on SMEs. This is because SMEs often work with geographically constrained supply chains, which can leave them without the option to relocate their production. SMEs which adopted a low-cost business model were therefore particularly affected by the economic crisis.

9 UNIDO (2006): **Productivity Enhancement and Equitable Development: Challenges for SME Development**, United Nations Industrial Development Organisation

10 UNIDO (2006): **Productivity Enhancement and Equitable Development: Challenges for SME Development**, United Nations Industrial Development Organisation

Without clearly defined strategies or access to niche markets, many of them were unable to continue production.

According to the 2011 Plimsoll financial analysis, which looked at the performance of the top 350 companies in the industry, over half of the companies analysed recorded a drop in sales during 2010, of up to 16%. An average company in the footwear manufacturing sector is currently experiencing a sales reduction of 3.7% per year, while one in three companies can expect to see an average increase of 10% in their sales[11]. However, although the size categories in the report are not the same as those used to define SMEs in the European Union (see Table 2.1), the report concludes that the sharpest decline in sales was experienced by companies with an annual turnover above $33.5 million (mainly medium and above companies), while enterprises with $1 to $17 million turnover (mostly small and micro firms) registered the smallest reduction in sales. Table 2.7 shows data on the annual growth by company size in 2010.

Table 2.7: Annual Growth by Size of Company (2010)

Turnover Quartiles	Median Annual Growth	Median Total Sales (thousand $)	Number in Quartile
Above $64.6 million	-4.5	121,355	88
$64.6m>$33.5m	-7.7	45,683	87
$33.5m>$17.6m	-2.3	24,811	88
$17.6m>$1.0m	-0.6	6,591	87
All companies	-3.7	33,313	350

Source: Plimsoll (2011): ***The Footwear Manufacturers European Industry***

Data on sales and production from national associations also suggest that the industry has managed to stabilize output levels following the steep drops in 2008 and 2009. Short-term economic indicators from the Italian National Footwear Manufacturers' Association (ANCI) indicate that the value of production increased by approximately 4% in 2010 compared with the previous year[12].

The results of the survey undertaken for Task 1 of this study show that the majority of manufacturers do not own their own-brand stores, but instead sell their products via multibrand stores or wholesale buyers. This was consistent with the findings of the CBI Report[13] that footwear is supplied in most EU countries through the specialised distribution route, which is from manufacturer to importer/wholesaler to retailer. With an increase in the quantity of imports entering the EU market, distributors and retailers therefore have the potential for greater leverage in bargaining with EU manufacturers. This affects manufacturers who otherwise would not be in direct competition with cheaper Asian products because of the different price range of their products.

11 Plimsoll Worldwide Business Intelligence (2011): **The Footwear Manufacturers European Industry, a Comprehensive Financial Analysis of the top 350 companies in Europe**.

12 ANCI Servizi Srl (2010): **The Italian Footwear Industry**, preliminary results.

13 CBI Market Survey (2010): **The Footwear Market in the EU**.

This mirrors the findings of Rabelotti[14], that Italian footwear companies faced different types of increasing competition:

- competition from low priced imports from outside the EU;
- competition within the EU from new forms of organization in the value chain, for example:
  - from vertically-integrated large fashion companies such as H&M or Zara (the medium price segment), or large distributors such as Deichmann or Reno (low to medium-priced segment). In addition, a new low priced segment has emerged outside the specialist footwear retail sector, with low-price supermarkets such as Aldi or Lidl, which sell very low-price imported shoes; or
  - in the luxury segment by high value fashion brands, which added shoes to their product range in the 1990s.

The trend of sourcing footwear from low labour cost countries, together with price pressure on EU manufacturers, has enabled customers in the EU to benefit financially. Over the period from 1997 to 2005, the average retail price of footwear sold in the EU increased by an average of only 1%, and in the UK actually fell by an average of 3.8%. The increase was significantly less than the prevailing rate of inflation, thus there was a fall in real terms.

Within this context, cost competitiveness has become one of the most critical drivers of the sector, focusing attention on efficiency in the management of the supply chain as well as internal production mechanisms. In addition to cost savings, a more efficient supply chain can help reduce gaps in production, thus making businesses more flexible and better adapted to customers' demands.

The internal and external challenges faced by SMEs are summarised in Table 2.8.

Table 2.8: Challenges Faced by SMEs in the Footwear Sector

Internal challenges	**External Challenges**
Lack of market strategies	Increased competition
Inability to influence the market	Reduced demand
Limited networking abilities	Shortage of available, skilled staff
Low use of IT services	Increased costs
Failure to train staff	Lack of access to finance
Succession planning	Location: local business environment

Similar to large companies and to SMEs in other market sectors, SME footwear manufacturers face key challenges related to accessing long-term capital, increasing production capacity, effective marketing strategy, modernisation and expansions and availability of highly skilled labour at an affordable cost. Location can also limit the

14 Rabelotti, R (2004). *How globalization affects Italian industrial districts: the case of Brenta*. In H. Schmitz (ed), **Local enterprises in the global economy - Issues of governance and upgrading**.

expansion of the enterprises, as the limited availability of business support mechanisms and proximity of supply chain partners can hinder development.

However, current market conditions also offer opportunities. Reduced numbers of competitors and emerging trends provide companies with the opportunity to increase their market share. Effective business strategies, involving identifying niche markets, upcoming trends and responding to these opportunities in a timely fashion, could help footwear SMEs to take advantage of these opportunities.

3. CASE STUDY: EMILIA-ROMAGNA

3.1 Introduction

3.1.1 Background

With an area of 20,124 km² and about 4.3 million inhabitants, Emilia-Romagna is one of the richest and most developed regions in Europe and has the third highest GDP per capita (€31.900 in 2008) in Italy[15]. The region has a high proportion of small and medium-sized enterprises, with one enterprise for every ten inhabitants. These companies have an average of just over five employees per business and employ around 76% of the total labour force (about 1.8 million people)[16]. According to OECD figures, by 2011 the Italian economy has passed the deep recession triggered by the global crisis and seems to be set for a gradual recovery[17].

Regarding the economy in general, Emilia-Romagna is the fifth strongest region of Italy in terms of exported goods and materials. In 2010, the total value of exported products reached €448 million, a 10% increase compared with the year before. Exports have become especially important for enterprises within the region, as local demand has been reducing. The main non-Italian markets for regional exports are in the European Union. Over half (approximately 55%) of the total regional exports are directed towards EU countries, (especially Germany, France, and Great Britain). Other important markets include North America, Asia and non-EU Eastern European countries (e.g. Russia).

The region is also the sixth largest in terms of imports; in 2010 these were valued at €189 million, a 12% rise from 2009[18]. More than 60% of the enterprises in the region are also importers. In the majority of cases (37%) imports are of raw materials, but 33% is made up of final products; intermediate goods and components account for 20% and industrial machines for 7% of imports. The companies most involved in importing are in the chemical, plastic, and rubber sectors, which have their key markets within EU borders.

3.1.2 Recent Trends in the Italian Footwear Industry

Similar to other manufacturing sectors, the footwear industry in Italy has experienced a significant decline in production value and quantity, with an 18% reduction in the numbers of pairs produced between 2007 and 2009[19]. In 2010 both the number of pairs produced and the value increased slightly. This information is summarised in Table 3.1.

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15 Information from Eurostat: Regional gross domestic product (PPS per inhabitant), by NUTS 2 regions

16 Unioncamere Emilia-Romagna, information downloaded from http://www.ucer.camcom.it/

17 OECD (2011): **Economic Survey of Italy**, Economics Department

18 Ermeneia, (2011): **2010 Annual Report**, National Footwear Manufacturers' Association (ANCI)

19 ANCI Servizi Srl (2010): **The Italian Footwear Industry**, preliminary results.

Table 3.1: Production, Exports[1] and Imports by the Italian Footwear Industry (2007-2010)								
	2007		**2008**		**2009**		**2010**	
	Value (€ million)	**Quantity (million pairs)**	**Value (€ million)**	**Quantity (million pairs)**	**Value (€ million)**	**Quantity (million pairs)**	**Value (€ million)**	**Quantity (million pairs)**
Production	7,470	242	7,319	225	6,468	198	6,730	202
Exports	6,880	245	6,915	222	5,815	192	6,707	224
Imports	3,202	390	3,350	353	3,184	310	3,707	356
Trade balance	**3,678**	**-145**	**3,565**	**-131**	**2,631**	**-118**	**3,000**	**-132**
Source: ANCI The Italian Footwear Industry Preliminary Results 2010, L'industria Calzaturiera Italiana 2008 *Notes:[1] Includes exports to and imports from other EU countries*								

With regard to consumption of footwear products, the Italian market was valued at €6.2 billion in 2008, or 279 million pairs, which is a reduction of 0.1% per annum on average since 2004[20]. At the same time, consumption per volume has grown by 18% from 2004 to 2006 while value of footwear sold increased by 2% indicating that consumer's preference has turned towards cheaper footwear. Between 2006 and 2008 the value of footwear sold dropped by 2% in the country, while the volume sold reduced by close to 6% (see Table 3.2).

Table 3.2: Footwear Consumption in Italy			
	2004	**2006**	**2008**
Value, € million	6,203	6,321	6,195
Volume, millions of pairs	248	295	279
Source: CBI Market Survey (2010) The Footwear Market in Italy			

The number of shoe manufacturing companies reduced by 3.7% (224 factories closed) between 2009 and 2010. The number of employees also reduced, by an average of 3.3% (2,754 jobs lost) compared with 2009. The number of direct employees (employed at the footwear manufacturing companies) is estimated to have fallen to 80,153 (a 3.3% drop from December 2009). The economic strains have also been felt throughout the supply chain; in 2010, 452 companies in the leather sector closed down, reducing their overall number to 22,459 (a 1.8% drop from 2009)[21].

According to the Italian National Footwear Manufacturers' Association (ANCI), the industry is now experiencing signs of recovery, with an estimated increase in the value of production of around 4% or around €6.73 billion. Production capacity is currently at around 80%.

[20] CBI Market Survey (2010): **The Footwear Market in Italy**

[21] ANCI Servizi Srl (2010): **The Italian Footwear Industry**, preliminary results.

The sector has been introducing innovations as well as increasingly targeting the higher price ranges. There were increases of exports by value and volume into all leading markets, including France (14.9% in value), Germany (16.8%), Russia (13.9%) and the United States (23.4%). ANCI expects production to increase by one percent by the end of 2011, due to increases in foreign demand.

There were increases in exports across all product categories and sub-sectors in 2010; however, below average growth was recorded for shoes with leather uppers (11.7% growth in value and 9.6% in volume). One of the strengths of the Italian industry is that shoe producers have access to a wide and experienced domestic supplier base, offering a diverse range of leather, synthetic materials and components, coupled with a flair for innovation and design. However, the very nature of the supply industry, with many relatively small companies, means that the downturn in Italian footwear production inevitably affects materials and component suppliers.

The main export markets for Italian footwear remains the European Union; in 2010 intra-EU trade was worth over €3,700 million. Within the EU the most significant market are France, Germany the United Kingdom and Spain while important extra-EU markets include the United States (with an export value of $558 million in 2010), Switzerland (€419 million) and Russia (€409 million).

Figure 3.1 summarises information on the main export markets for Italian footwear.

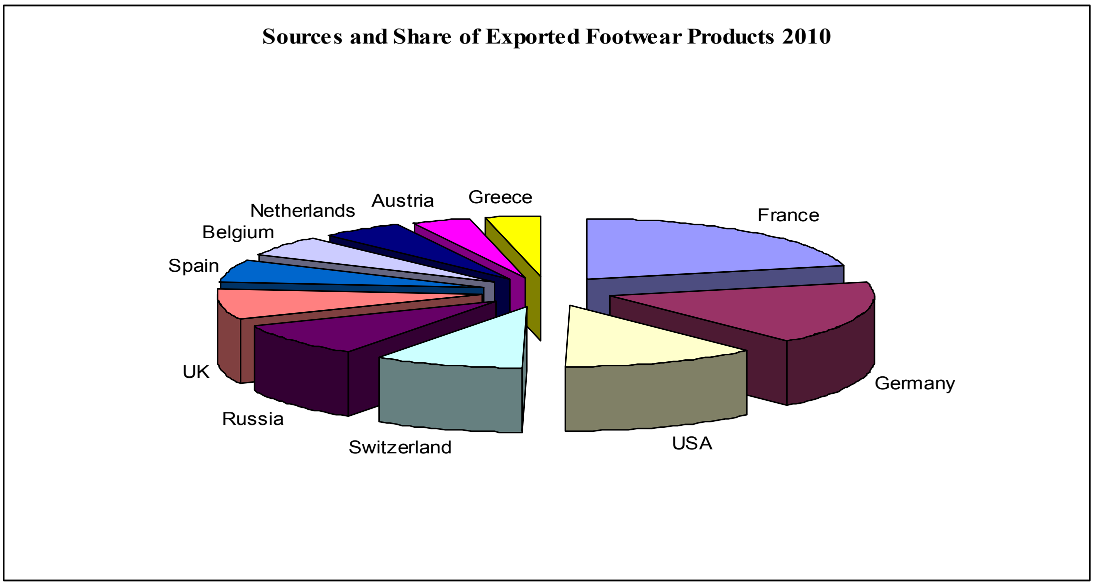

Figure 3.1 Destinations and Share of Exported Footwear Products to Italy 2010

Based on the figures provided by ANCI, the average price per footwear product sold in the EU market can be estimated at €24.78; in external markets such as the USA the average price is €50.68, in Switzerland it is €44.02 and in Russia €73.71.

China remains the most significant country of origin for imported footwear products, with a value of €731 million import in 2010. Other significant sources of imports include Romania, Belgium, Vietnam and the Netherlands. Altogether in 2010 over €1,500 million worth of imports for Italy came from other EU Member States, although some of these (for example those from Belgium) were originally sourced from outside the EU. Figure 3.2 provides information on the main sources and value of footwear imports into Italy.

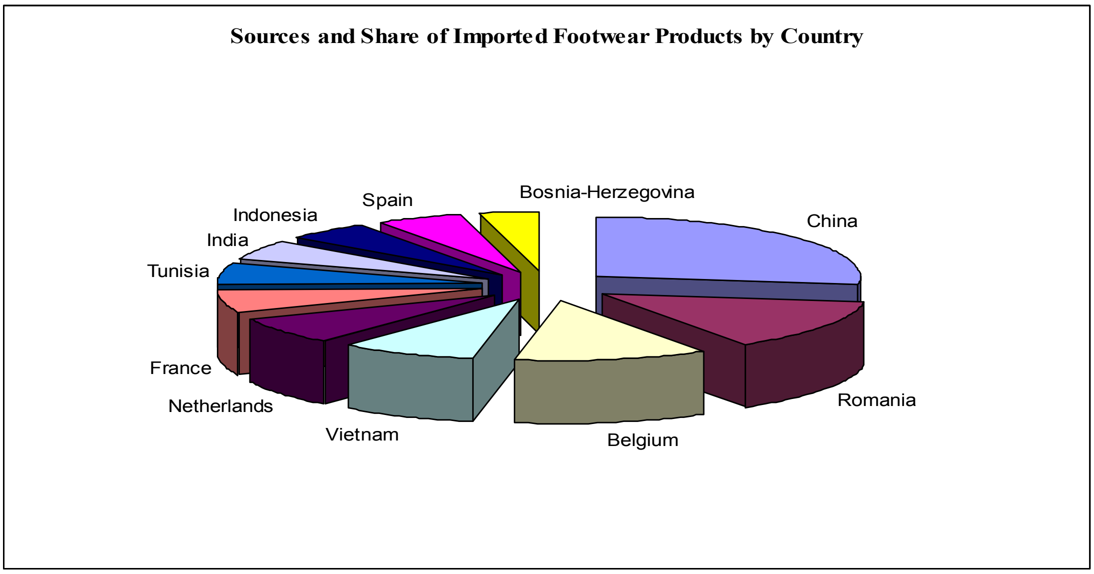

Figure 3.2 Sources and Share of Imported Footwear Products to Italy 2010

While the value of footwear products sourced from France and the Netherlands has decreased by 2.5% and 1.7% respectively, the value of imports from all other registered sources have increased in value; from China by 18%, Romania by 28% and Indonesia by 23%.

Comparison of the export and import figures in Figures 3.1 and 3.2 show similarities with regard to quantitative growth of trade in the industry. Import figures do not distinguish between Italian producers who have outsourced their production (this is particularly the case in relation to Romania, Tunisia and Bosnia) and third country manufacturers.

Comparison of data on the numbers and value of imported footwear products provided by ANCI indicates very different prices per product. In the case of intra-EU trade, the average price per product is €18.43, while Chinese and Vietnamese imports cost on average €4.74 and €11.58, respectively (at wholesale prices).

3.1.3 Size and Structure of the Footwear Industry in Emilia Romagna

The fashion sector in Emilia-Romagna (comprising textile, footwear, leather and component producers and retailers) is made up of almost 13,000 companies[22]. Of these, approximately 550 are footwear manufacturers, employing just over 6,000 people. These enterprises make up about 5% of all footwear manufacturing companies in Italy. The region also hosts about 200 footwear wholesale companies that employ around 650 people, making up nearly 1.5% of all Italian companies in the footwear wholesale sector[23].

The region is home to several industrial clusters, comprising hundreds of specialised and independent small and medium-sized businesses operating in the same sector. Companies in these clusters collaborate, compete and are concentrated in demarcated areas, thus industrial production is organised in numerous highly-specialised productive districts[24].

Within the region there are two recognised footwear clusters:

- the footwear cluster of San Mauro Pascoli or “Basso Rubicone”, which comprises production facilities located in the provinces of Forlì and Cesena, across the municipalities of San Mauro Pascoli, Savignano del Rubicone and Gatteo; and
- the footwear cluster of Fusignano-Bagnacavallo, close to Lugo in the Ravenna province.

Companies in the clusters have been impacted to a different degree by increasing competition and the economic crisis. While enterprises in San Mauro Pascoli have managed to maintain their competitiveness (the 250 enterprises in the area employ 3,300 people[25]), the majority of manufacturers in Bagnacavallo were forced out of business. While the area was home to approximately 200 companies and employed 3,000 workers in the 1980s, by 2011 the number of companies had reduced to 48, employing 254 workers and exporting footwear products in excess of €25 million[26].

Apart from these industrial clusters, footwear manufacturing enterprises operate in several cities, mainly Forli Cesena, Bologna, Reggio nell'Emilia, Rimini, Ravenna, Parma, Modena, Ferrara and Piacenza[27].

22 Regional Investment Agency, of Emilia-Romagna, downloaded from: http://www.investinemiliaromagna.it/

23 Regional Investment Agency, of Emilia-Romagna, downloaded from: http://www.investinemiliaromagna.it/

24 Regional University Industry Strategies Network (2006): **Emilia-Romagna Regional Report**, downloaded from http://www.ruisnet.net

25 Information from the website of the Italian Trade Commission, downloaded from: http://www.italtrade.com/countries/europe/regnounito/focus/5468.htm

26 Il Sole 24 Ore (2011): *I Distretti in Caccia di Nuovi Mercati*, downloaded from: http://www.modena.legacoop.it/rassegna/2011/06/pressline20110628_258657.pdf

27 ANCI Servizi Srl (2010): **The Italian Footwear Industry**, preliminary results

The majority of the companies operating in the region are small and medium-sized, family owned businesses. However there are multinational investors in the region such as Louis Vuitton Moet Hennessy Sa (via the companies Calzaturificio Ma.Fra Srl Manifattura Ferrarese Srl, Baldinini Srl, Omas Srl, G.F.M. Industria Spa, and Casor Spa) as well as PPR Sa (via its share in Sergio Rossi).

3.2 Characteristics of Footwear SMEs in Emilia-Romagna

3.2.1 Introduction

The footwear sector in Emilia-Romagna is strongly based on SMEs, many of which are organised into networks and clusters. Collaboration within and between these industrial clusters is well established and has been functioning effectively at both the official and informal level. Table 3.4 sets out the number of companies and number of employees within the region; the average number of employees per company is just over 10 for footwear manufacturing and less than three for the wholesale trade.

Table 3.3: Footwear Manufacturing Companies in the Region (2006)

	Number of Companies	Number of Employees
Footwear manufacturing	551	6,016
Footwear wholesale trade	213	588

Source: Regional University Industry Strategies Network (2006): ***Emilia-Romagna Regional Report***.

The businesses operating in the region cover all aspects of the supply chain, manufacturing raw materials, components and accessories. This includes:

- leather preparation and tanning;
- footwear manufacturing (the manufacture, installation, repair and maintenance of textile machinery used for textile processing, knitting, sewing, leather and footwear manufacturing);
- manufacture of components;
- retail of footwear and accessories, treated and untreated leather; and
- design and styling services[28].

While the region relies in large part on the skills and production capacity within the San Mauro Pascoli cluster, there a number of enterprises spread out in and around Bologna, Rimini and Ravenna.

[28] Regional Investment Agency, of Emilia-Romagna, downloaded from: http://www.investinemiliaromagna.it/

3.2.2 Types of Products

Enterprises in the region are primarily focussed on the manufacturing of women's and men's fashion footwear. The SMEs that remain in the Bagnacavallo district mainly manufacture low and medium price range products, while enterprises in the San Mauro Pascoli cluster are more focussed on the medium to high price range footwear.

Companies in the Forli-Cesena area specialise in the production of luxury shoes, firms in the region of Emilia (around Bologna) produce mostly men's shoes while in the area of Bagnacavallo, manufacturers produce low priced women's, men's and children's boots and casual footwear.

3.2.3 Main Markets

Despite the strong international trade presence, fewer than half of the manufacturing enterprises in the region are involved in foreign trade. This has been attributed partly to the presence of industrial districts. Small enterprises are usually oriented towards sub-supplying activities inside the district, leaving exporting to bigger enterprises[29]. However, one of the SMEs we interviewed exports its high-quality products to South Africa, Japan, the USA, the Middle East and China. Another sold most of its products within other EU member States (primarily the UK, France and Germany) while a third, although Italy accounted for 90% of its sales, had growing sales in China and was beginning to sell to Russia and Korea.

Based on data from ANCI, the value of footwear goods imported into Emilia-Romagna increased by 11.8% from 2009 to 2010 (unfortunately, no longer time series data are available). The majority of footwear-related imports to Italy arrive from China, Romania, Belgium (mainly Chinese and Vietnamese products imported initially into Belgium[30]) and Vietnam. In the same period, exports increased by just over 10%

Data for individual provinces within the region for 2009-2010 show that province of Forli-Cesena (which produces luxury shoes) had the highest value for exports, at, €215 million for 2009 and €209 million for 2010 (43.6% of its total production in 2010). This province suffered the only drop in exports in the region, around 9%. Exports account for nearly 21% of production in Bologna and these increased by 34% between 2009 and 2010.

The value of imported footwear accounts for between 5% and 32% of the total production value of the provinces. The sharpest declines took place in Forli Cesena where imports have reduced by nearly 18%, double the reduction in exports, and Bologna (6%).

29 Unioncamere Emilia-Romagna, downloaded from http://www.ucer.camcom.it/

30 TBS Group http://www.tbsgroup.com.vn/news_event.html?id=31. Belgium is one of the most important footwear export markets for Vietnamese manufacturers; in the first quarter of 2010 Vietnam exported $54.7 million worth of footwear products to Belgium, which is an increase of 27.5% from the year before

Figure 3.3 shows the % change of the value of exported footwear products from the various provinces within the region for 2009 to 2010 (no earlier data are available). The figure shows that all but one province had increased the value of exported footwear goods; in the case of Forli Cesena there was a minor reduction.

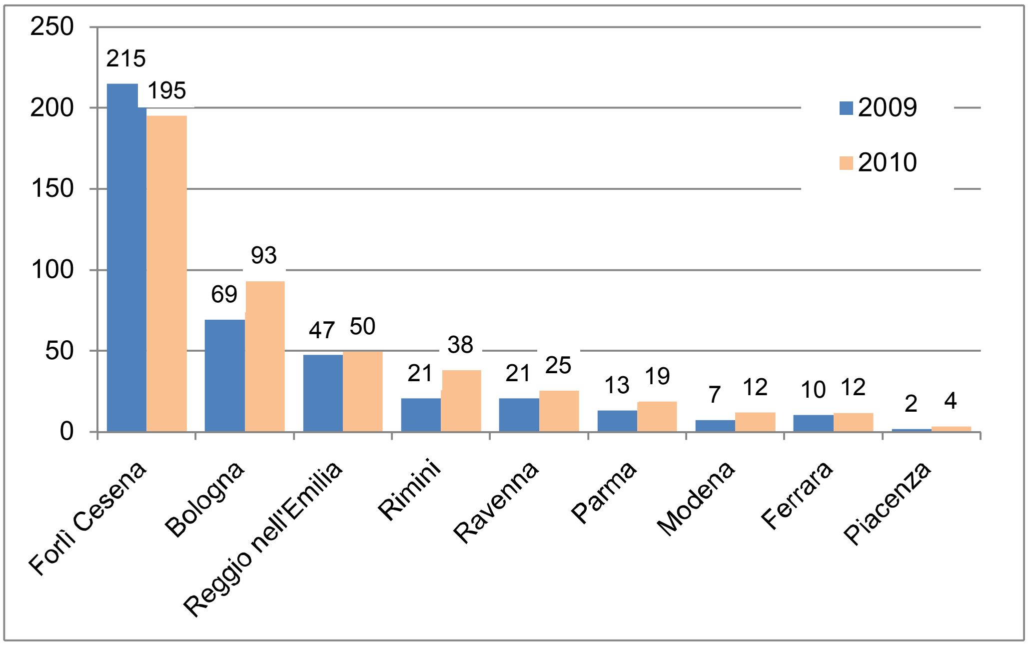

Figure 3.3: Value of Footwear Exports (in € millions) from the Provinces of Emilia Romagna, 2009-2010

Data on the value of imported footwear products show a more varied picture. Figure 3.4 shows, the value of imports increased in five provinces, most noticeably in Piacenza (by 207%). While other provinces (Ravenna and Rimini) had experienced no change, the provinces of Bologna and Forli Cesena saw a reduction in the value of imports.

The data collected by ANCI do not specify the value of intra-EU trade; however, regional data[31] indicate that the main EU markets for the footwear products of Emilia-Romagna are France, Germany and the United Kingdom.

[31] Regione Emilia-Romagna: **Le Eccelenze della Filiera della Moda in Emilia Romagna**, 2006 downloaded from http://www.investinemiliaromagna.it/wcm/investiner/pagine/specializzazioni_produttive/moda/Filiera_Moda.pdf

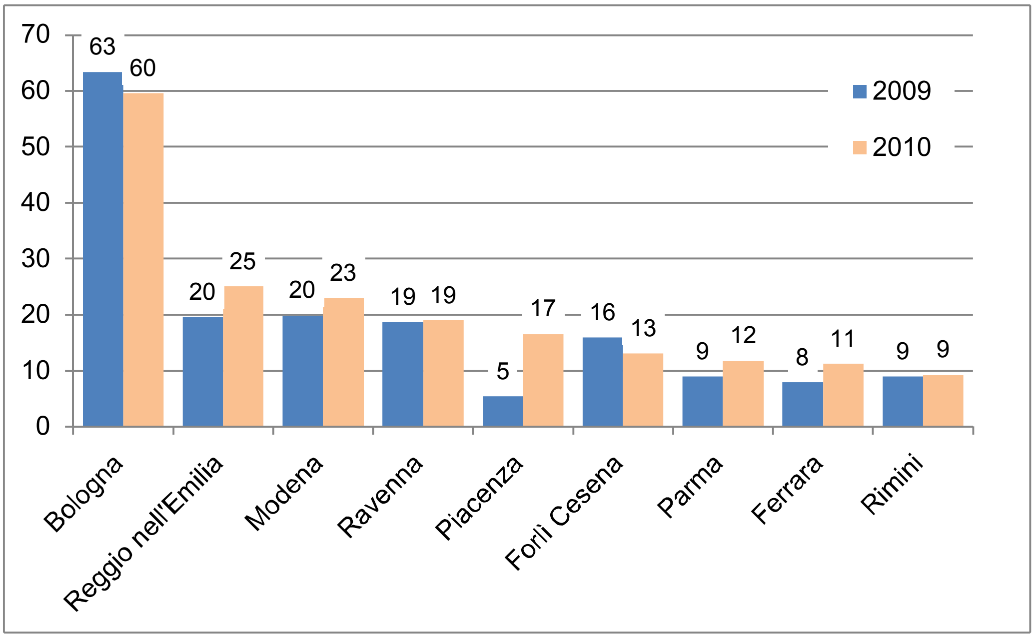

Figure 3.4: Value of Footwear Imports (in € millions) into the Provinces of Emilia Romagna, 2009-2010

3.2.4 Business Models

The main focus for SMEs in the region over recent years has been on maintaining their competitive position in their markets, in the face of growing Asian imports and the financial crisis. To balance the losses and seek ways to improve the effectiveness of their operation, most small and medium-sized enterprises have been increasingly looking to expand their exports as well reducing costs of the business.

The majority of the companies in the region produce their own brands and use the voluntary industry "Made in Italy" mark as a way to increase perception of quality among their consumers. Outsourcing of operations was not common amongst SMEs in the region, mostly due to their strong links to the well established supply chain.

All of the SMEs we interviewed produce their own-brand footwear and export at least some of their products. The companies had adopted very different business models, as described in Box 3.1.

Box 3.1: Examples of Different Business Models Adopted by SMEs in Emilia Romagna
Focus on high quality/low volume production One SME interviewed manufactures 25 pairs of hand-made shoes per day, using traditional methods. Generally shoes take two to four weeks to complete. The shoes are sold in the EU, South Africa, Japan, China, the Middle East and USA for €800-€1000, mostly though boutiques. ***Maintaining competitiveness in the low price segment*** Another SME interviewed focuses on the other end of the market, making cheap polyester shoes with a sale price of €10-€17. The company remains competitive, although cheap imports from Asia target the same price range, because of its quick response to orders from the EU market, the reliability of quality and guaranteeing that their products do not contain colorants.
Source: Interviews with SMEs in Emilia Romagna, May 2015

3.3 Key Problems Faced by SMEs in Emilia-Romagna

3.3.1 Reduction in Demand

According to ANCI, many Italian manufacturers focus on both national and external markets. This is certainly the case for the SMEs we interviewed. Markets for higher price range footwear products, such as Russia and the United States, experienced sharp drops in demand during 2009 (-34% and -26%, respectively). However, by 2010 market trends were reversing and exports are increasing with a few exceptions, such as the Arab Emirates and Greece[32].

The downward trend in the market, which began in 2007, impacted SMEs although to a very different extent in the varying sub-categories. Footwear manufacturers we interviewed that operated in the medium price range segment were affected the most, while SMEs in the luxury segment and to a lesser extent those that operated in the low-price range sector remained relatively unaffected.

One SME representative we interviewed noted that, although the Italian footwear manufacturing industry has suffered its heaviest losses in 2008-2009, the company itself (which focused on the lower price range segment) has seen a rise in demand as buyers appreciated their more consistent quality and better ability to respond rapidly to orders than Asian imports. Following many years of stagnation, the company hired new staff in 2008.

Case study interviews underlined the differences with regard to target markets of different price ranged products. While one manufacturer of lower priced products targets the UK (50%), France (40%) and Germany (10%), another manufacturer listed EU, South Africa, Japan, USA, Middle East and China as its main markets.

[32] ANCI Servizi Srl (2010): **The Italian Footwear Industry**, preliminary results.

3.3.2 Access to Finance

Companies that we interviewed, as well as ANCI, explained that private lending institutes are crucial in ensuring the sustainable development of footwear SMEs in Emilia-Romagna. The companies that we interviewed indicated that access to finance is important to maintain the liquidity of companies to:

- cover the rising costs of raw materials (especially synthetics);
- to bridge the gap between invoice cycles of the supply chain (payments from buyers arrive after 4-6 weeks whilst payments to raw material providers must be made immediately); and
- finance further investments and access to new markets.

However, the recent financial crisis has severely impacted access to loans and credits. With the mergers of local banks, which used to be the sources of smaller loans, SMEs are now faced with more stringent requirements which may ultimately result in cash flow problems. These are further amplified by late payments from customers and/or limited access to alternative sources of finance. The problem is compounded by the fact that these enterprises generally lack information on available sources of finances.

3.3.3 Regulation

None of the SMEs we interviewed identified regulation as a problem area, nor was this identified as an issue by ANCI.

3.3.4 Availability of Skilled Labour

Finding skilled workers in the region has been another challenge for SMEs. In particular, some of the small, family owned businesses have been struggling to find and retain skilled staff. Box 3.2 provides an example of this.

Box 3.2: Problems with Availability of Skilled Labour
A family owned company specialises in hand made leather shoes, primarily for men although it does have designs for women as well. The biggest problem the company is facing is the lack of skilled workers in the area. The company is therefore forced to train the staff itself. It takes on interns- from a school in San Mauro Pascoli; the difficulty is to convince people to stay with the company after their internship finishes, due to the poor image of the industry and relatively low wages. The company is trying to offer an incentive to potential employees, by making employers shareholders and offering a skill for life.
Source: Interview with SME in Emilia Romagna, May 2011

In response, some companies have established partnerships with local or regional education institutes but, as discussed in Box 3.2, these do not always result in the recruitment of permanent staff. Other companies are hiring unskilled workers and providing them with in-house training. However, this is not considered an adequate solution to fill design-related roles, as this requires a particular flair. The continuing difficulties suggest a need for better HR planning in the companies. However, the availability of other employment opportunities in the region (which, as noted in Section 3.1.1, is one of the most developed in Italy), with potentially higher salaries and a better image, is a constraint that it is difficult for SMEs to address.

3.3.5 Lack of Succession Planning

A large proportion of the SMEs in the region are family businesses. In one SME, for example, the founder of the company still works at the factory, cutting the most valuable leather. His wife designs and produces paper patterns and his sons manage the company.

A report conducted in 2008 for the European Commission on issues for family businesses[33] contained a case study on family businesses in Italy. According to the report, family firms in Italy represent 93% of the all companies. The report identifies two distinctive types of family business; these are described in Table 3.4. The family businesses we interviewed both followed Model 1.

Table 3.4: Types of Family Businesses in Italy

Model 1	**Model 2**
The family is closely involved in the business (managerial control). The entrepreneur works 40% in management, 35% in commercial operations and 25% on organising production. Close family members are involved; up to 55% in commercial roles, 45% in production roles and 26% in managerial roles. 90% of family businesses adopt this model.	The family is the owner of the business; it is not involved in the operational activities but it is involved financially. Partners take 95% of the administrative and 5% of the management roles. Of these family businesses, 56% are micro, 38% small and 5% medium sized enterprises while 1% have more than 250 employees.

Source: European Commission DG Enterprise and Industry (2009): ***Overview of family business relevant issues research, networks, policy measures and existing studies****.*

Family businesses can, however, face potential problems with succession planning. One SME we interviewed noted that the company is now being run by the second generation of the owning family, but the next generation has shown little interest in taking over and the family does not know what will happen to the business in future.

33 European Commission DG Enterprise and Industry (2009): **Overview of family business relevant issues research, networks, policy measures and existing studies**.

Valuable skills and knowledge are being lost in the industry as traditional family firms are going out of business because younger generations do not wish to take over the businesses. One company we interviewed noted that this is an issue not only for the manufacturing industry, but also for suppliers. Lack of succession planning by providers of raw materials means that manufacturers need to seek out alternative contacts, and can face difficulties in finding the same quality of raw material produced locally.

3.3.6 Access to IT

Many SMEs in the region cannot fully utilise the advantages of web commerce as knowledge and experience of IT are not spread across organisations, while changing skills requirements and ICT-skill gaps are not considered as key issues[34].

The case study visits underlined the lack of e-commerce activity by companies. Information on the websites of the SMEs we interviewed is often aimed at intermediary buyers and not consumers. In fact, some of the companies were not planning to increase direct selling to consumers and supplied very little information on their websites regarding where their products can be purchased. Interestingly, following our visit and discussion with the owners, one of the companies did update its website to provide specific information for consumers.

3.3.7 Costs of Raw Materials

The rising and unreliable price of raw materials is a major issue for SMEs in the region, as Box 3.2 shows. The problem is a direct effect of increasing oil prices which directly impact the contract prices of synthetic raw materials used to make polyethylene (such as purified terephthalic acid/dimethyl terephthalate (PTA/DMT) and monoethylene glycol (MEG) and polyester chips.

Box 3.3: Costs of Raw Materials
A family owned company was founded in 1966, starting with 5-6 people and manufacturing a range of low price men's, women's and children's shoes including sports, casual and boots. The main problem for the company is the rising and unpredictable price of raw materials. While orders for the shoes and contracts for production are often signed three months in advance – raw materials are paid for as production continues - prices are calculated at the time of purchase. This is contributing to a rather difficult financial situation for the company which does not have the leverage to change contract terms for products or it will lose its customers, therefore it is forced to absorb the difference.
Source: Interview with SME in Emilia Romagna, May 2011

34 E-business watch (2006): **ICT and E-business in the Footwear Industry**, downloaded from http://www.empirica.com/themen/ebusiness/documents/SR02-2006_Footwear.pdf

3.4 Strategies to Address the Problems

3.4.1 Introduction

In order to address these problems, SMEs in Emilia-Romagna have adopted short to medium-term business strategies to support their growth. One of the underlying principles of all of the enterprises we interviewed was to build on the natural advantages of the region. The constraints highlighted by SMEs we interviewed in Emilia-Romagna, and these natural advantages, are set out in Table 3.5.

Table 3.5: Constraints and Advantages of Footwear SMEs in Emilia Romagna

Economic Constraints	Advantages
• reduced access to capital • declining prices for (some) products • rising costs of raw materials.	• the use of the Made in Italy mark • cooperation with other local companies • proximity and reduced lead time to consumers

3.4.2 Seeking New Markets

The SMEs we interviewed had different approaches to seeking new markets. The manufacturer of luxury footwear had steadily expanded into a range of different markets around the world, which had enabled it to maintain sales during the recession. However, the company does not plan to increase its production; instead, it plans to maintain production at the current level and increase prices. Another company has entered into a partnership with six other Italian footwear companies to jointly market their footwear in international markets.

Export strategies and access to new markets are also the focus of most footwear enterprises in Italy. In a survey conducted for ANCI in 2010[35] (survey of a panel of 64 companies comprising 5% large, 50% medium, 41% small and 4% micro enterprise), enterprises listed the strategies they considered to be of primary importance for maintaining competitiveness. The results are shown in Table 3.6.

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35 Ermeneia, (2011): **2010 Shoe Report**, National Footwear Manufacturers' Association (ANCI).

Table 3.6: Most Important Strategies of Italian Footwear Companies Identified by ANCI Survey	
Market and clients	**% of Respondents**
Exploring new markets	60.7%
Product innovation	57.1%
Internationalisation	44.6%
Services innovation	35.7%
New marketing strategies	35.7%
New distribution strategies	32.1%
Reinforcement and re-organisation	
Process and technology innovation	19.6%
Increasing the capital of the company	17.9%
Collaboration with other companies	16.1%
Link to the “Fashion/textile” sector	10.7%
Relocation abroad	7.1%
Merging with other companies	7.1%
Renewal of the management	5.4%
Relocation in Italy	1.8%
Detachment from the company	
Sale of company’s branches	--
Sale of the company	--
Shutting the company down	--
Source: ANCI Ermeneia (2011), ***Shoe Report 2011****.*	

Companies responding to the ANCI survey listed access to new markets, as well as product and process innovation, as their most important strategies. Cost cutting measures were identified by few companies, with relocation was listed as a viable strategy by just over 7%. The survey was conducted during the Lineapelle fair in Bologna.

3.4.3 Rationalisation

In contrast to the findings of the ANCI survey, one of the key strategies adopted by SMEs we interviewed is rationalisation to reduce costs. This difference may be due to differences in the sizes of companies responding to the ANCI survey. However, reduction of costs may not be possible in all cases. Flexibility of operation was a major theme for several of the enterprises interviewed as they seek ways to reduce variable costs such as marketing and administrative costs to a minimum. An example of this approach is given in Box 3.4.

Box 3.4: Rationalisation to Cut Costs
One small company grew dynamically in the 1980s, up until 1989. At its peak, it operated two factories with a combined workforce of 60 people. Competition from Eastern Europe, as well as mismanagement of financial resources, affected the company severely and was forced to close down one of its factories. Currently it operates with a staff of 15 people. The type of product the company manufactures did not change following the reorganisation and it remained true to the original concept of minimal design and minimum price. The quantity of output, however, has declined sharply following the closure of the second factory. Currently the company does not invest in marketing and maintains only a modest office. Today demand for its products is growing; the company attributes this to its consistent quality and ability to respond more rapidly to orders than non-EU competitors, so that retailers have turned away from cheaper imports with unreliable quality. In fact, the company is now working at full capacity on its production line and has orders up until December 2011.
Source: Interview with *SME in Emilia Romagna, May 2011*

Cost reduction strategies alone are not expected to provide an overall response to increased competition and reduced markets. Therefore, additional measures need to be implemented to secure the market position of these companies. Increasingly, enterprises have begun to evaluate their operations in order to improve their market reach and make better use of their resources.

3.4.4 Strengthening Brand Identity

Strengthening brand identity provides a way for SMEs to expand their markets. This includes both high-end and lower price range brands. For example, one family owned business we interviewed, which manufactures men's shoes for the high end segment of the market, focused on maintaining low production quantity and establishing a strong brand, as shown in Box 3.5.

Box 3.5: Increasing Profitability by Maintaining Quality
A family owned company manufactures hand made leather shoes. The company's production is becoming increasingly export driven (new markets include China); however, it is limited to 25 pairs a day even though the company is supplying to a growing market. The company has a loyal customer base for which additional services such as personalised models are available. The company's strategy is to maintain its current production capacity and to increase prices and thus profit, and as the high quality and the strong perception of the 'Made in Italy' mark continues to ensure high demand for its products.
Source: Interview with *SME in Emilia Romagna*

Another SME we interviewed is a low-cost manufacturer which strongly relies on the 'Made in Italy' mark and uses it on its products. The company considers that such labels reflect of the high quality of its products; industry buyers choose this Italian manufacturer's lower price ranged products over those of Asian competitors, because of the quality guarantees offered by the manufacturer.

Brand awareness has also been the basis for campaigns for consumers, such as the *"I Love Italian Shoes"* campaign organised by ANCI, which believes it can have significant impact on the demand for European products.

3.4.5 Reducing Profit Margins

SMEs we interviewed operating in the low to medium price range for products have been required to implement more pro-active strategies. These companies, producing footwear in the range of €10 to €30 per pair, have been subject to increasing competition throughout the past two decades. Following the earlier influx of cheaper Eastern European products, imports from Far East Asia have continued to negatively impact this sub-sector. Box 3.6 provides an example of a successful business strategy for this sector.

Box 3.6: Responding to Competition by Reducing Profit Margins
SMEs in the region producing low-price footwear in direct competition with the Asian imports have been forced to limit their profit margins while cutting back on costs in relation to marketing and even design. A recent trend has been the return of previous customers and industry buyers, who have found the quality of products manufactured in Asia to be unsatisfactory. Thus higher quality, a quick response to orders while maintaining a low profit margin remains a strong competitive advantage for enterprises manufacturing in the region.
***Source: Interview with** SME in Emilia Romagna, May 2011*

This example highlights one way in which European manufacturers can compete with cheap Asian imports. Comparing costs with a competitor can only be relevant if both companies are competing with identical strategies, skills and resources. However, the experience of the company described in Box 3.6 shows that while imported products can be price competitive, they may be of lower quality than those of the European manufactured footwear products.

Although managing costs is essential, many Italian manufacturers have realised that the low-cost, low-price model is not a strategy that can be sustained in the long run as there will always be lower cost ways of manufacturing products outside Europe.

3.5 Development of Clusters

3.5.1 The Role of Clusters in the Supply Chain

Industrial clusters can play a key role in preserving skills and knowledge within a geographical area as well as assisting regional and local companies in establishing industrial relationships. While horizontal clusters contain businesses with similar functions, vertical clusters house different types of companies belonging to the same supply chain. There are examples of both horizontal and vertical industrial clusters within the region of Emilia-Romagna, which is home to over 1,000 tanneries as well as footwear manufacturers (although this number has reduced by 1.8% since 2009[36]).

Proximity to others in the supply chain can provide competitive advantages in terms of low transportation costs of raw materials and other components, as well as the potential for cooperation between manufacturers for price cutting through bulk orders etc. It was noted throughout the case studies that small and medium-sized companies rely extensively on their network of suppliers, who are themselves often located in the same region and/or industrial cluster. Nevertheless, external contacts are also crucial for sharing up-to-date knowledge on industry trends, access to raw materials and information on new markets.

SMEs that we interviewed for the study identified a number of advantages of being located in clusters, but these were mostly informal rather than formal collaborations. For example:

- one SME noted that the remaining local manufacturers have a good relationship and often point out to each other the best sources of raw materials. However, many of the companies the SME could have collaborated with have unfortunately now disappeared;

- another SME collaborates with a local training institute; it has informal links with other footwear companies in the region but has not undertaken any real collaboration;

- a third company indicated that there was considerable informal networking between companies and it made use of personal contact. It had entered into partnership with six other companies to develop a joint marketing approach.

San Mauro Pascoli Cluster

Production in the cluster of San Mauro Pascoli is focused on the manufacture of women's shoes for the luxury/premium segment of the market; relevant data are given in Table 3.7.

[36] Infocamere-Movimprese (2010): **Annual Data,** downloaded from **http://www.infocamere.it/movimprese.htm**

Table 3.7: Production Data for the Industrial District of San Mauro Pascoli	
Number of enterprises (2009)	248
Number of enterprises with below 50 workers (2008)	192 (94%)
Number of workers (2008)	3,369
Change in number of enterprises (2009/2007)	+12%
Change in number of enterprises with <50 workers (2008/2007)	-9%
Change in employment (2008/2007)	+3%
Source: http://www.osservatoriodistretti.org/node/278/distretto-calzaturiero-di-san-mauro-pascoli	

There are nearly 250 footwear companies operating within the cluster of San Mauro Pascoli, employing over 3,300 people. The production capacity of the area is approximately 15 million pairs per year, two thirds of which are destined for export, mostly to the European Union, Russia and the Far East, with an average annual turnover amounting to € 200 million[37].

The success of the region is also demonstrated by the brands of the companies which work in the area, which are among the most important in the world in the sector of women's luxury shoes. These include Gimmi Baldinini, Sergio Rossi, Vittorio e Alberto Pollini, Vicini and Quinto Casadei. There are also a large number of companies involved in the production of semi-finished materials and components, from heels to soles, as well as producers of uppers, cutters and patternmakers and design studios supplying to prestigious brands such as Prada, Louis Vuitton, Versace, Dolce & Gabbana and Gucci.

Bagnacavallo-Fusignano Cluster

The footwear cluster of Bagnacavallo-Fusignano was established after World War II; the materials used were of low quality and hand-made production dominated the process of manufacturing. The 1960s and 1970s saw a strong growth of the industry within the district, including an efficient system of subcontracting that made the companies tightly integrated within a dynamic business structure. The development of the cluster was supported by the regional Government through the grant of tax relief and by the emergence of small local businesses, as a result of a process of specialisation and decentralisation policies implemented by the companies themselves to reduce production costs, and greater flexibility through numerous spin-offs favoured by the availability of specialised skilled workers[38].

The cluster was strongly focused on exports, particularly to the European countries, the Eastern European market and in the United States, but not towards the improvement of processes and quality systems. Indeed, the district focused heavily over the years on low value-added products, which meant that competencies in the

37 Italian Trade Commission: **Luxury Footwear? Made in Italy!** information downloaded from http://www.italtrade.com/countries/europe/regnounito/focus/5468.htm

38 Information from the Regional Development Programme of: District and Local System Enhancement through Sharing Knowledge downloaded from http://www.desk.ecipar.it/contattaci.htm

production of high-end products were not developed. Moreover, the tendency to focus on large retail chains and a fixed customer base also reduced the bargaining power of footwear manufacturers and their capability to identify new markets and products. These facts gradually reduced the competitiveness of the district and it began to decline during the 1980s. The number of firms and employees dropped, as lack of development progressively exposed the cluster to strong international competition in low added value products.

Currently, the majority (approximately 80%) of products manufactured in the district still target the low priced segment, while the remainder are aimed at the medium price market. In order to retain competitiveness and to take advantage of lower labour costs, some companies relocated production abroad, particularly to Romania, Albania and Brazil[39].

However, the decline could not be stopped and while in the early 1980s the cluster was home to more than 200 companies employing 3,000 workers, in 2005 there were only 85 companies remaining, employing 800 people[40]. According to an analysis on data supplied by *Servizi Studi e Ricerche – Intesa San Paolo*[41] there were 48 companies remaining in the district in 2011, employing 254 workers and exporting footwear products in excess of €25 million[42]. Table 3.8 provides production data for the Bagnacavallo-Fusignano cluster.

Table 3.8: Production Data for the Industrial District of Fusignano-Bagnacavallo	
Number of enterprises (2011)	48
Number of workers (2011)	254
Change in number of enterprises (from 2005 to 2011)	-43%
Change in employment (from 2005 to 2011)	-68%
Source: http://assemblealegislativa.regione.emilia-romagna.it/, http://www.modena.legacoop.it/rassegna/2011/06/pressline20110628_258657.pdf	

3.6 Use of Supporting Services

3.6.1 Financial Support

A range of financial support is available to footwear SMEs in the region. These include national incentives aimed at facilitating access to finance for micro enterprises.

The European Investment Fund has recently allocated €1 million in PerMicro, an Italian financial institution specialised in micro-credit, and acquired 20.4% of its

39 http://www.desk.ecipar.it/distretti/fusignano.pdf

40 Emilia-Romagna regional portal:downloaded from http://assemblealegislativa.regione.emilia-romagna.it/

41 Intesa SanPaolo (2010): **Monitor dei distretti**, Servizio Studi e Ricerche Intesa SanPaolo, October 2010

42 Il Sole 24 Ore (2011): *I Distretti in Caccia di Nuovi Mercati*, downloaded from: http://www.modena.legacoop.it/rassegna/2011/06/pressline20110628_258657.pdf

shares. It is expected that this investment will attract further resources, amounting up to a total of €3 million that would be made available in support of micro-businesses and micro-entrepreneurs in Italy. No information on the take-up of micro-credit by companies from the region of Emilia-Romagna has been made public.

However, none of the SMEs we interviewed for the study had made use of these financial incentives, and did not appear to be aware of them. Instead, they relied for finance on their own resources and on bank loans.

3.6.2 Export Assistance

SMEs in the region can also benefit from support mechanisms to further develop export markets. An example of this is given in Box 3.7.

Box 3.7: Support for Marketing Provided by ANCI

The National Footwear Manufacturers' Association (ANCI) organises annual conferences for member companies to introduce new markets, such as the Russian high-end markets and the increasing Chinese and Indian middle class.

ANCI also organises visits to these emerging markets for 30-50 young entrepreneurs, out of a current membership of approximately 180. These market visits are part of a wider educational course that includes four to five seminars.

While Italian companies are also trying to reach consumers in North America, that market has proved difficult for many of the companies. The US market requires a long-term strategy and specific products that Italian companies cannot or are reluctant to make.

Source: Interview with ANCI, May 2011

None of the SMEs we interviewed had been involved in the programme of visits organised by ANCI, but they had attended conferences and fairs which enabled them to meet potential new customers.

3.6.3 Support for Innovation

The Government's strategy identifies networks of firms, innovative finance and Industrial Innovation Projects as new tools to ensure strategic repositioning of Italian industry. None of the SMEs we interviewed had taken advantage of financial and innovation support, but they did take advantage of footwear industry networks. The reason given by SMEs we interviewed for not participating in these programmes was because they did not believe this would provide any benefits for them. This may be linked to other comments made by the SMEs about the high level of bureaucracy involved in Government schemes (although this was not explicitly stated).

Under the framework of Industria 2015, the Government has created a new support scheme for research, development and innovation addressed to SMEs. It allows them to choose both the type and the form of financial support most suited to their needs, as part of activities ranging from industrial research and experimental development to the definition of prototypes and demonstration plants for the construction of new products and services ready to compete on the international markets. The eligible categories of support are:

- support for R&D projects;
- support for technical feasibility studies;
- support for expenses related to industrial property rights;
- support for young innovative enterprises;
- support for process and organizational innovation in services;
- support for advisory services and innovation support;
- support for the provision of highly qualified personnel; and
- innovation clusters[43].

As the above categories do not explicitly include all aspects of footwear manufacturing, industry representatives have been lobbying to extend this support scheme to the research that companies undertake in fashion and design and to manufacture of shoe prototypes[44].

Support for companies in Emilia-Romagna is also available through the European Regional Development Fund (ERDF), which allocates €347 million support to enterprises of all sectors in the region. The specific objectives of the projects eligible for funding include research and development, knowledge society and sustainable development. Projects under the ERDF fund include the setting up of a venture capital fund, supported by €14 million. This is aimed at encouraging innovative start-up companies, particularly those working in high technology (academic spin-offs, and corporate research firms), supporting development strategies and innovative investment companies that can assure growth and employment for existing companies. Again, the SMEs we interviewed had not obtained support through the ERDF. The companies indicated that this was because they believed that seeking such funds would impose an administrative burden which they could not support.

While some enterprises do rely on centralised support, the SMEs interviewed for the case studies also wish to build on their own informal relationships and networks to collaborate. Therefore a mechanism targeting clusters and their development, as well as collaboration between clusters or supply chain participants, could have added value for local and regional development of these enterprises and strengthen their involvement in innovation and training programmes.

3.6.4 Support for Increased Networking

While there are no regional incentives targeting the development of the footwear manufacturing sector specifically, a number of incentives have been underway to facilitate the development of the industries in the region.

43 Ministero dello Sviluppo Economico, downloaded from http://www.industria2015.ipi.it/

44 Ermeneia, (2011): **2010 Shoe Report**, National Footwear Manufacturers' Association (ANCI)

Collaboration within the industry and extending the networks of the supply chain can also support small businesses by way of sharing resources, technology and even costs (e.g. bulk orders) and thereby improving their competitive advantage.

Projects receiving regional support include the processes of technological and organizational change, acquisition of technological know-how as well as processes of production specialization and/or service delivery aimed at increasing the competitiveness of companies.

3.6.5 Trade Fairs

Industry events at both local and international scale are of crucial importance for enterprises in the footwear sector, to enable them to keep abreast of new trends and to exchange information. The SMEs we interviewed identified attending trade fairs (they did not exhibit at the fairs) as a key resource for meeting suppliers as well as potential customers. However, some other SMEs with greater financial resources also exhibit at the fairs.

Two of the most important industry trade fairs: Lineapelle and Simac, are held in Bologna. Both of the fairs, along with Micam, which probably is the largest industry fair held bi-annually in Milan, bring together a host of manufacturers, buyers and suppliers from all over the world. Table 3.9 lists the number of visitors at MICAM in recent years. The vicinity and accessibility of the fairs for manufacturers in Emilia-Romagna are a vital part of the competitiveness of the region and that of the country.

Table 3.9: Attendance Figures for MICAM

	March 2010	Sept.2010	March 2011
Number of exhibitors	1,597	1,592	1,623
Number of foreign exhibitors	591	585	607
Number of visitors	36,623	42,329	38,812
Number of international visitors	18,936	21,103	19,588

Source: www.micamonline.com
Note: No separate data are available on the proportion of SMEs amongst exhibitors or visitors, as they receive no preferential treatment

3.7 Potential for Additional Support

3.7.1 Introduction

The companies we interviewed identified a number of areas where additional support would be welcomed, including:

- easier access to finance;
- simplification of administrative procedures;
- increased support for the use of e-commerce tools;
- succession planning; and
- targeted support.

Box 3.8 summarises the results of a study undertaken by ANCI[45] (a survey of a panel of 64 companies). In the survey, manufacturers identified a number of support measures that, in their view, could effectively target their current problems. No further information is available on how respondents envisaged that such measures would work, but we understand that they were directed mainly at the Italian Government.

Box 3.8: Support Measures Identified as Effective by Footwear Manufacturers Responding to ANCI Survey
Support through fiscal measures: o Tax relief measures for the introduction of technological innovation in the production process; o Tax relief measures for research related to design and fashion; o Tax relief measures for the promotion of commercial initiatives; o Tax relief measures for the capitalisation of enterprises; and o Tax relief measures for the promotion of co-operation between companies. **Support through stricter control:** o Increased control on unfair competition; o More effective control to check and ensure the safety of the materials used in the imported shoes; and o Stricter payment terms for invoices. **Supporting internationalisation:** o Strengthen the commitment of the I.C.E. (Italian Institute for Foreign Trade) regarding promotion of the product categories instead of the main brands (already able to promote themselves); o Setting up an advisory body inside the I.C.E. to lobby for the footwear sector; o To focus the activities of the I.C.E. on countries regarded as more important for exports; o Certainty regarding the available resources for the activities related to promotion; and o To lobby for the approval of the "Made in" regulation. **Training Support:** o To guarantee a social safety net for a longer period; o To extend the social safety net to the subcontractors to keep in the cluster the skills needed; and o To facilitate the entry into the sector of young workers[1].
Source: Ermeneia, (2011): ***2010 Shoe Report****, National Footwear Manufacturers' Association (ANCI)* *1. No detail was provided in the report on the types of measures envisaged to achieve this objective*

[45] Ermeneia, (2011): **2010 Shoe Report**, National Footwear Manufacturers' Association (ANCI)

The survey highlighted that footwear manufacturers welcome initiatives aimed at developing training within the sector, such as the development of a secondary level training institute, such as ITS (Istituto Tecnico Superiore) within clusters, as well as efforts to bring new technologies into the manufacture and design of products. At the same time, companies would prefer more specific funding allocated for economically challenging periods as a kind of "flexicurity", in order to help them maintain skilled employees in the clusters. Denmark first introduced implemented the concept of flexicurity a combination of a flexible labour market, liberal rules on hiring and firing, and substantial social benefits in 2006. Workers who lose their jobs receive generous benefits, almost as high as the worker's wages themselves, but they are also required to aggressively search for a new position. If that fails, the Danish government pays to retrain the workers in a new field. The aim is that companies remain competitive by having the best possible workers[46]. Flexicurity has also been integrated into EU level policies. The Communication from the Commission of June 2007[47] aims to clarify the position of the Member States and facilitate the implementation of a common strategy. On 5 December 2007, the Employment and Social Affairs Council adopted the common principles of flexicurity, subsequently validated by the European Council of 14 December 2007, and called on the Member States to take them into account in drawing up and implementing "national flexicurity pathways".

Companies responding to the ANCI survey also indicated that they would like to strengthen relationships with the Italian Institute for Foreign Trade (ICE), as well as with SACE. (the insurance company supporting Italian business throughout the world, owned by the Ministry of Economy and Finance) in order to adopt a common credit rating system for footwear manufacturing SMEs in order to help them to access private credit.

The measures identified in the table are directed at action by the national Government. Some of them concern areas where the EU has competence, such as payment terms (via the Late Payments Directive), requirements concerning the safety of imports (through REACH, for example) and the social safety net. However, the focus of the measures identified in the table is on implementation and enforcement, which is a national responsibility.

3.7.2 Easier Access to Finance

The SMEs we interviewed indicated that the invoice gap (between making payments to suppliers and receiving payments from customers) is a significant problem. They are required to use their own financial resources to pay suppliers, until they receive payment from their buyers. Measures such as encouraging negotiation through clusters to obtain more favourable payment terms could provide an additional support for manufacturers in overcoming some of the difficulties in relation to the gap in the invoice cycle.

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46 Centre for Strategic and International Studies (2006): **Flexicurity- Denmark style**, available at http://csis.org/files/media/csis/pubs/future_watch_10-06.pdf

47 Commission of the European Communities (2007). **Towards Common Principles of Flexicurity: More and better jobs through flexibility and security**. Communication

Furthermore, better information on available sources of finance, which could support the development of enterprises, could benefit small and medium-sized companies directly. The SMEs we interviewed relied primarily on bank loans and their own resources for financing.

3.7.3 Simplification of Administrative Procedures

The SMEs interviewed during the case study visits were reluctant to take advantage of EU or regional financial support mechanisms. This was primarily due to the fact that participation in these programmes is seen as bringing a heavy administrative burden which these companies do not have the resources to undertake. Simplification of procedures would therefore assist the SMEs to take advantage of existing national and EU support mechanisms.

3.7.4 Increased Support for the Use of E-Commerce Tools

Initiatives such as the e-commerce project of the Italian Footwear Association can play a crucial role in encouraging use of internet in commerce and management. This is described in Box 3.9.

Box 3.9: Initiative to Support E-commerce by Footwear SMEs
Many of the smaller footwear manufacturing firms in Italy do not have websites or lack the knowledge to use them efficiently. The National Footwear Manufacturers' Association (ANCI) is therefore developing an e-commerce project that includes an online platform where member companies could sell their products. Under a common platform, these companies would be able to market themselves and find new customers; at the same time, they would represent the Made in Italy label. ANCI has noted, however, that efforts to standardise last and size measurements could further boost on-line sales.
Source: Interview with AVCI, May 2011

3.7.5 Succession Planning

In order to maintain the competitiveness of the sector and preserve the skills and knowledge contained in family owned businesses, it could be useful to review the extent to which artisanship in the sector is threatened due to a lack of succession planning.

One possible approach would be to develop a succession planning programme, including assessing the skills and management needs as well as the recruitment challenges to prepare the next generation of business leaders and manufacturers.

3.7.6 Targeted Support

There are a number of incentives for businesses in the region targeting their technological as well as human resource development. However, these funds are not specific to the footwear manufacturing industry.

An example of such regional funding is the regional government programme supporting the building of networks between companies, aimed at increasing the current level of effective collaboration. These programmes, however, are not specific to the footwear manufacturing sector. The companies we interviewed indicated that funding for general improvements to business activities is useful, but these often target specific aspects such as IT improvement, management training, etc. Whilst the footwear manufacturing industry could benefit from these types of improvements, its key problems are related to matching the ability of enterprises to forecast what the distributors will require in relation to styles, quantities and sizes in time to tool up, purchase materials and make these before the fashion changes.

As the survey undertaken for the National Footwear Manufacturers' Association indicates, representatives of enterprises in the sector realise the importance of access to new markets and innovation. At the same time, most small and medium-sized companies decide not to engage in regional or national support programmes. Therefore programmes such as the above, targeting the footwear manufacturing industry specifically would be crucial for the further development of the sector.

3.8 Summary

Emilia-Romagna is one of the traditional footwear manufacturing regions in Italy; it has two main clusters, San Mauro Pascoli and Bagnacavallo-Fusignano. The two clusters have very different competitive positions: while companies in San Mauro Pascoli have managed to maintain their competitiveness, the majority of manufacturers in Bagnacavallo have been forced out of business.

Most of the footwear manufacturing companies in the region are small and medium sized enterprises, many of them are family owned companies and only half of them are involved in foreign trade.

The problems faced by SMEs in the region include the availability of skilled labour (in a region where other sectors can offer higher salaries), difficulties in accessing finance following the credit crunch and a lack of succession planning have been identified. Along with the rising cost of raw materials and limited usage of IT within businesses, these challenges have caused serious difficulties for SMEs in the region in recent years.

Nevertheless, the SMEs had adopted a variety of successful strategies to remain in business. Some had focused on the top end of the market, selling high quality products at high prices worldwide. Others had been able to remain competitive in low-price production through reducing profit margins, maintaining quality and responding flexibly to the needs of customers.

Although a range of national and regional support mechanisms are available to firms in the region, the SMEs we interviewed had taken little advantage of these, because they were seen as not focused on their specific needs and as imposing too much of an administrative burden. However, the companies did take advantage of the informal relationships with other firms within the cluster.

Potential areas for further assistance identified by the SMEs we interviewed included easier access to finance, simplification of administrative procedures to access support services, support for the use of e-commerce tools and succession planning.

4. CASE STUDY: VALENCIA

4.1 Introduction

4.1.1 Background

Spain's economy is the fifth largest in Europe and in 2009 Spain's Gross Domestic Product (GDP) was valued at US$1.46 trillion, according to the World Bank. In 2009, Spain's economy shrunk by 3.6% in real terms, national demand fell by 6.4% and employment was down by 6.7%[48].

The manufacturing sector is mainly made up of small and medium-sized enterprises operating in traditional industrial sectors, with a few knowledge-intensive companies. There are close to 3.5 million enterprises in the country, and over 99% of them are small and medium-sized; in fact 94% of all companies (3.2 million)[49] are micro enterprises.

The region of Valencia is situated on the eastern coast of Spain with an area of approximately 23,000 square kilometres and more than 4.5 million inhabitants, representing 10.5% of the population of Spain. It is one of 17 autonomous regions which make up the Spanish State and is divided into the provinces of Castellon, Valencia and Alicante. The region has an average per capita GDP of €20,465[50] in 2010. In Valencia there are over 350,000 companies and 99.85% of those have fewer than 200 employees, while 93.8% of them can be categorized as micro enterprises.

4.1.2 Recent Trends in the Spanish Footwear Industry

In 2010, the Spanish footwear industry produced about 95 million pairs of shoes with a value in excess of €1.5 billion, with an average price of over €16 per pair. .

Figure 4.1 (over page) compares production and consumption of footwear in Spain for the period 2007-2010 (comparable data are not available for earlier periods). The period saw a year-on-year decline in production of over 5%, in terms of both volume and value. Production reduced from 108 million pairs in 2001, with a value of nearly 2 billion Euro, to less than 95 million pairs in 2010 with a value of €1.6 billion. This period also saw a decline in both the numbers of pairs and value of footwear purchased; although decline was reversed in 2010.

The footwear market is also becoming more rapid; in place of the previous two collections per year it is not uncommon to have four collections in one year, each with a smaller production run than previously. This requires a more rapid response to demand and has not offset the overall decline in production.

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48 Spanish National Institute of Statistics, downloaded from http://www.ine.es/en/welcome_en.htm

49 Cierval (2008): Guia para la financiacion de PYMES

50 Spanish National Institute of Statistics, downloaded from http://www.ine.es/en/welcome_en.htm

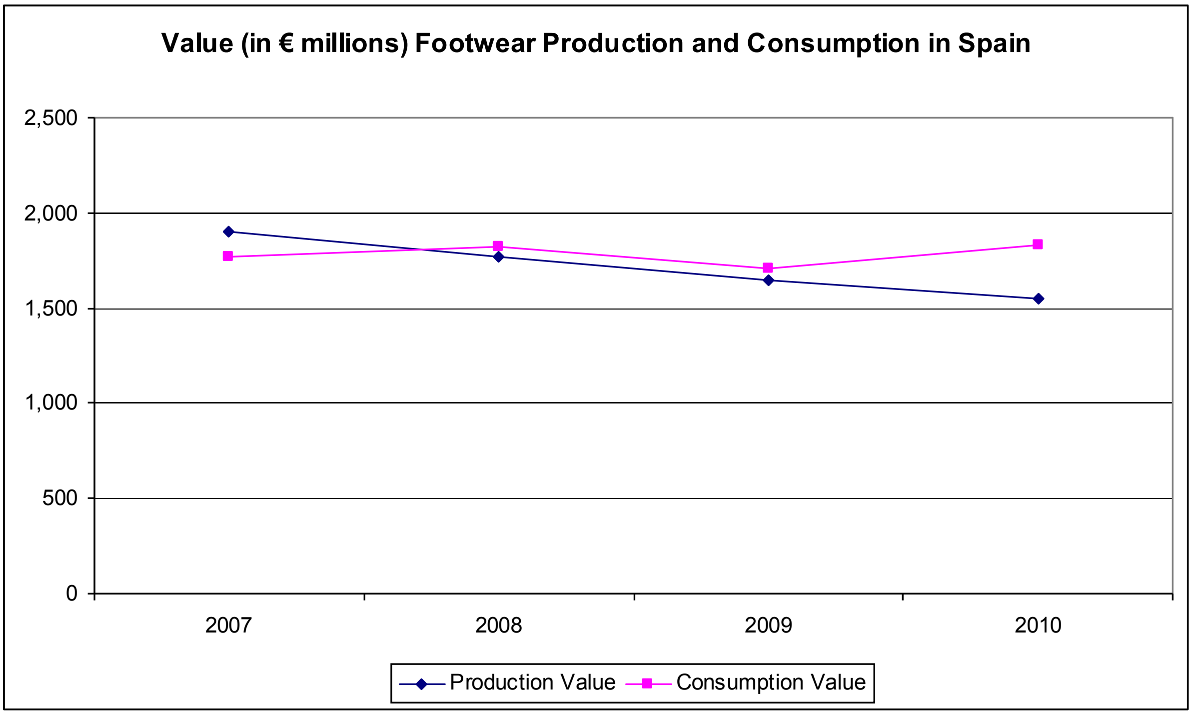

Figure 4.1: The Value of Footwear Production and Consumption in Spain

The main footwear producing regions in Spain are Valencia (65% of production), the Community of Castile-La Mancha (10.6%), the Community of La Rioja (7.8%), Aragon (4.51%), the Balearic Islands (4.40%), Murcia (2.89%) and Andalucía (1.27%)[51]. Table 4.1 sets out the numbers of footwear companies in each region for the period 2005 to 2009.

Table 4.1: Number of Footwear Companies by Region (2005-2010)

Footwear Regions in Spain	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**% change 2009/2010**
Valencia	1542	1504	1362	1200	1130	942	39
Castilla-La Mancha	245	237	222	198	184	151	38
La Rioja	159	172	156	144	135	125	21
Aragon	106	92	85	81	78	69	35
Balearic Islands	104	102	87	79	76	68	34
Murcia	93	87	76	52	50	39	58
Andalusia	29	27	27	23	22	19	34
Others	63	62	58	55	54	49	22
Total	**2341**	**2283**	**2073**	**1832**	**1729**	**1462**	**38**

Source: FICE (2010) Annual Report for Footwear

[51] Federation of Spanish Footwear Industries (FICE) (2010): **Annual Report.**

Table 4.2 shows that there was a significant reduction in the number of footwear companies in Spain between 2005 and 2010, with over 800 companies (nearly 38%% of the total) going out of business during the period. Our interviews indicated that one reason for this decline was the reduction in demand for footwear within Spain between 2007 and 2009, as a result of the economic crisis (although, as Figure 4.1 shows, this decline appeared relatively limited and has now been reversed).
Spanish footwear companies have taken a number of steps to adapt to the challenges arising from globalisation, by focusing on innovative design and fashion, brand image, distribution control and environmentally-friendly manufacture as the main strategies for maintaining their competitive edge and differentiation in the market place. However, pressure from low labour-cost economies, together with the general global downturn, remains a challenge for Spanish footwear manufacturers.

Following years of declining sales, export markets have been showing a gradual growth, as Table 4.2 indicates. In 2010, over 110 million pairs of shoes with a value of €1,848 million were sold outside Spain by Spanish companies[52] showing a 10% increase in volume and a 9% increase in value in relation to figures of 2009[53]. Furthermore, data for the first quarter of 2011 show a 10% growth compared to the year before and more than 10% growth compared to 2009.

Table 4.2: Main Export Markets for Spanish Footwear

Countries	**1st quarter 2010**		**1st quarter 2011**	
	Export quantity (million pairs)	**Export value (€ million)**	**Export quantity (million pairs)**	**Export value (€ million)**
Belgium	0.9	20	1.1	23
France	8.4	128	8.8	135
Germany	3.0	55	3.3	57
Greece	1.4	22	1.1	17
Italy	4.1	71	4.3	78
The Netherlands	0.8	16	1.1	22
Portugal	4.0	44	5.6	49
United Kingdom	1.8	35	2.0	41
Japan	0.4	9	0.6	12
Russia	0.2	7	0.4	11
USA	0.6	21	0.7	26
Total	**25.6**	**428**	**29**	**471**

Source: *Panorama del Calzado, March 2011 (figures rounded)*

52 There is some inconsistency in these data, as the figures for exports are equivalent to the figures for production in Table 4.1. FICE notes that "*Information is available on what our companies produce in Spain, but not on what they produce outside the country. The statistics tell us about footwear exports made from Spain, but not about operations by Spanish companies selling from another country to a third country, without entering the Spanish market. This all forms part of the business volume of the companies but it cannot be quantified. In short, it is important to analyse the figures in detail, with an awareness that they are more a guideline than they are explanatory and are more of a reference than a reflection of the actual situation"*

53 Federation of the Spanish Footwear Industries (FICE) (2010): **Annual Report**

Table 4.2 indicates that the EU Member States have remained the most important export markets for Spanish footwear products, with only limited success in trading outside the EU. This may be the result of the availability of product alternatives in the local market. This differentiation in the markets is reflected by the average per pair value of the products. The United States is the fifth largest export market in terms of value but only the ninth in terms of quantity, showing that it is the higher price range products (€34.4 per pair average value) that meet the requirements of that market. Demand for higher price ranged products is also apparent in the case of Russia; even though is ranked eleventh in terms of both value and quantity, the average value per pair of exported products is €27.51, the second highest of all the export markets following the USA.

Imports have continued to play a significant role for the Spanish market with €2,125 million worth of imported footwear (385 million pairs) entering the country in 2010, a 21% growth from the previous year in value and 18% growth in volume of imports. Consequently the trade balance for the sector in terms of value is a significant negative of €276.8 million[54].

Like those in many other European Member States, Spanish manufacturers are conscious of the importance of the global market; hence, some have started to outsource their production capacity to other countries, such as China. This has enabled them to take advantage of the cheaper manufacturing base and to attempt to penetrate the substantial domestic Chinese market. However, the high-end design, development and branding elements are maintained in Spain[55].

4.1.3 Size and Structure of the Footwear Industry in Valencia

Valencia has a long tradition in footwear production and almost two-thirds of Spanish footwear firms are based in Valencia (1,130 firms in 2009)[56]. Valencia manufacturers are located predominantly in the areas of Elche, Elda, Petrel and Villena. This is essentially the hub for women's' footwear design and manufacture in Spain. According to the Spanish Footwear Association, FICE, in 2009 Valencia accounted for 65% of all footwear manufacturing companies in the country (see Table 4.1 above).

However, the industry in the region has contracted in recent years. The number of companies has reduced by 27% since 2005. One of the most significant drops in the number of enterprises took place between 2006 and 2007, when approximately 10% of the companies went out of business, since then the rate of reduction has been slowing down. According to the recently-formed regional footwear association, AVECAL, the impact of the economic crisis was significant and has forced more than 25% of regional manufacturing companies out of business during the last five years, with approximately 30% of the remaining regional enterprises facing serious difficulties.

54 Federation of the Spanish Footwear Industries (FICE) (2010): **Annual Report**

55 SATRA (2009): **Spain country profile.**

56 Federation of Spanish Footwear Industries (FICE) (2010): **Annual Report**.

Companies in Valencia have historically focused on the Spanish market. However, with the stagnation of this market in recent years and increased competition from low-priced imports, they have been under increasing pressure to identify new markets. To address this issue, there have been on-going regional and national incentives to support manufacturing companies representing themselves at industry fairs and exhibitions.

4.2 Characteristics of Footwear SMEs in Valencia

4.2.1 Introduction

Of the 1,130 footwear companies operating in Valencia in 2009, the majority are SMEs; most of the member companies of the regional industry association, AVECAL, are family businesses. The companies we interviewed for the study ranged in output capacity from 80,000 to 600,000 pairs per year, with employee numbers ranging from 16 to 40, and included both family businesses and those run by un-related partners.

SMEs in the area undertake a wide range of footwear-related activities, from raw material supply (including tanneries), component supply, design, footwear manufacture and support services such as IT. The number of suppliers is significantly larger than the number of footwear companies; for example, AVECAL's member companies have around 3,500 employees within the footwear sector and 9,000 in total, including suppliers. This indicates a ratio of approximately three suppliers to every producer within the cluster, assuming the same average numbers of employees per company.

4.2.2 Types of Products

Footwear SMEs in Valencia operate in a variety of product segments. Box 4.1 gives examples of the product ranges of SMEs interviewed for this study.

Box 4.1: Main Product Types produced by SMEs in Valencia

The SMEs interviewed for the study produced a range of footwear types:

- High quality slipper (house shoes) for men and women, (price €30 - €50 retail);
- Outdoor comfort shoes for men and women (price €70 - €220 retail);
- Children's and teenagers shoes and boots;
- Women's fashion shoes (price €45 - €50 retail); and
- Women's high quality fashion shoes for the 20+ age group (price €125 - €300 retail).

Source: Interviews with SMEs in Valencia, May 2011

It is notable that none of the SMEs currently manufactures products for the lower cost footwear segment. Two companies previously had low-cost brands (one for men's shoes and one for women's) but have withdrawn from this market as they were unable to remain competitive. According to the regional industry association, AVECAL, most of the companies in the region who have managed to survive the turmoil of recent years produce footwear in the medium to high end segment of the market, where cheap imports prove to be no threat.

4.2.3 Main Markets

Many of the SMEs in Valencia previously focussed solely on supplying to the Spanish market. However, the on-going economic problems of the country meant that demand has rapidly reduced. Therefore, companies are looking to compensate for the loss of the home market with increasing exports. According to information from AVECAL, approximately 25% of its member companies (who are predominantly SMEs) were forced out of business as a result of contraction in the domestic market (see Table 4.1). Meanwhile, those who were able to maintain their operations registered an 11% growth in exports over the last year.

Table 4.3 gives examples of the main markets for some of the SMEs interviewed for this study.

Table 4.3: Main Markets for SMEs in Valencia

Spain	Other EU	Outside EU	Notes	Market Segment of
65%	35%		EU is the main non-Spanish market; outside EU markets include the US and China	House shoes (slippers) for men and women, premium price segment
70%	25%	5%	Main EU markets are UK and Greece, markets outside EU include Australia	Children's shoes, medium price segment
50%	15%	35%	Main non-EU markets are in Asia	Women's shoes, medium price segment
Data not provided			37% of sales are to Italy; the remainder is to Hong Kong, China, Japan, Spain, UK and US.	Women's shoes, premium price segment

Source: Interviews with SMEs in Valencia, May 2011

It is interesting that one of the most important emerging markets for SMEs in Valencia, after the EU, is Asia.

4.2.4 Business Models

SMEs in Valencia have adopted a variety of different business models. The ways in which they have changed their business strategies, in response to the economic and competitive pressures that they face, are discussed in Section 4.4.

All of the companies we interviewed produced their own-brand footwear. In addition, 10% of one company's output was for other brands. Many of the companies undertake at least some outsourcing of production. For example:

- one company orders and receives raw materials which they send out to local companies to cut and stitch; they employ staff for administration and for lasting, finishing and dispatch of their products; and
- another company completely out-sources every aspect of production. It maintains quality by overseeing the manufacturing process and approving prototypes.

4.3 Key Problems Faced by SMEs in Valencia

4.3.1 Reduction in Demand

One of the key issues faced by SMEs in Valencia is the reduction in domestic demand for their products, due to both the impacts of the economic crisis on consumer spending and the impacts of competition, particularly at the lower end of the price scale. All of the companies we interviewed had experienced a reduction in domestic demand, though the impacts on their overall business varied.

One SME indicated that it has a very stable position in its particular market niche (slippers and comfort shoes). While it had been impacted by the financial crisis, which had resulted in a 10% drop of orders and sales, the company has not been forced to implement any measures to reduce the number of employees.

Another (producing children's shoes) was forced to cut back on production by around 30% in response to shrinking demand especially during 2010. It sells shoes mostly in Spain (70%), Europe (25% mostly UK and Greece) and 5% outside the EU, including Australia, mostly through multi-brand shops for around €45 retail price.

A third company, producing women's fashion shoes, noted that the influx of cheap Asian products and, later on, the economic crisis has resulted in a notable contraction in demand, as people have started to switch to cheaper products. This had also resulted in a general downward pressure on prices. Companies with lower profit margins could not respond to this and were forced to close down. The regional and national market has contracted significantly and demand has shrunk. As unemployment in Spain is one of the highest in Europe, the company considers that the Spanish market is unlikely to grow in the next few years. In response, the company was forced to move and extend its client base outside Spain, to the rest of the EU and markets in Asia.

A fourth company had not been able to compete in the face of reduced prices in the men's shoes market and had to stop production of this product range. Even though the market demand for women's shoes is more stable, the company is seeking to introduce measures that cut the cost and the prices of its brands. Despite these measures, the company finds it increasingly difficult to maintain competitiveness.

4.3.2 Access to Finance

The local footwear industry association, AVECAL, indicated that lack of access to finances is the main problem for its member companies, affecting all types of firms but with a particular impact on SMEs, which tend to have fewer resources. Banks simply do not lend the same amounts of money as before. They often renegotiate mortgage conditions and even successful companies tend to have cash-flow problems. An example of the problems companies face is given in Box 4.2 (over page).

Another area of concern for the liquidity of footwear companies is that supply chain payments are not continuous. While companies are contractually obliged to pay their raw material suppliers within 60 days, distributors often make it a condition of trade that they will have 90 days to pay and manufacturers are forced to make up the missing period of one month from other sources.

Box 4.2: Difficulties with Access to Finance
The biggest problem the company manufacturing women's shoes in the medium-priced segment is facing is access to finance. The merger of local banks means that they are no longer able to receive financial support from different banks in smaller amounts; they have to turn to larger banks for a larger sum which comes with stricter conditions. In the past, the Spanish banking market was roughly divided between two top-tier banks, some small-to-mid-size banks and 45 cajas (savings banks), which accounted for around 50 percent of the financial system. Through mergers and takeovers, the savings banks branches have shrunk by about two-thirds, at a cost of around €11.2 billion from the government-backed restructuring fund (FROB). Cajas that received public funding for mergers are expected to close between 10 percent and 30 percent of branches and cut staff by 11 percent to 27 percent[57]. This problem is also affecting retailers, and many of them were forced to shut down their business. It has also been the case that orders through buyers were not paid or payment was delayed, bringing cash flow problems. The company is waiting for the Spanish economy to pick up as well as for the banks to change their policy regarding loans. Lack of financing has a direct impact on the company's competitive position, as one of its targets is to increase its presence in foreign markets. Representation at trade fairs is a crucial element in building relationships with foreign markets; however, attending industry events can become expensive and cash flow problem make it difficult to afford.
Source: Interview with SME in Valencia, May 2011

A recent research study[58] assessing financing innovation in SMEs within the region of Alicante emphasized that the ratio of own capital is rather high in Spain compared to other countries in Europe. Spanish banks only accept real estate for liabilities, therefore financing through mortgage is an important issue. As mortgage financing is

57 Barcelona Reporter: **Spain's caja overhaul will spark further bank mergers**, http://www.barcelonareporter.com/index.php?/news/comments/spains_caja_overhaul_will_spark_further_bank_mergers/

58 Handke, M (2009): **Flexible Finanzierung in Industriedistrikten Spaniens? Das Beispiel Alicante**. Zeitschrift für Wirtschaftsgeographie / The German Journal of Economic Geography 53, pp 1-13,

long-term, the most pressing issue for SMEs is how to finance short-term financial needs which can be crucial in the footwear sector for pre-financing a new collection. Therefore, the availability of short-term credit is of key importance. Another challenge for the companies appeared to be a lack of know-how regarding the best available financing options. This view was supported by the SMEs we interviewed. All the companies indicated that access to finance was a significant problem, making the cash-flow problems that arise from time to time more difficult to address.

4.3.3 Regulation

None of the companies we interviewed identified regulation as a particular problem area, although the regional industry association (AVECAL) expressed concern that enforcement of compliance with regulations such as REACH by imported goods was not adequate, and that this could lead to an un-level playing field for Spanish producers which did comply with the legislation.

4.3.4 Availability of Skilled Labour

Availability of skilled labour did not appear to be a particular problem for SMEs in the region. It was not highlighted as an issue by any of the companies we interviewed, nor by the regional industry association. Indeed, one company had been able to retain access to staff even though it could not employ them continuously, as shown in Box 4.3. This is likely to be because of the lack of alternative jobs in the region.

Box 4.3: Access to Staff Despite Non-continuous Operation
The company had responded to decreasing demand by reducing the number of production days for the last few years and only operating for nine months of the year. Production comes to a complete halt during the remaining three months and the staff are released. However, most of the staff return when the company starts up production again. The company believes this is because employment is very difficult to find in the region.
Source: Interview with SME in Valencia

4.3.5 Access to IT

Two of the companies we interviewed indicated that they would like to make better use of e-commerce, but were limited by lack of finance. The children's shoe manufacturer does not currently sell shoes via the internet, but if it had funding, this is an area where it would like to expand.

Another company does maintain a website, but currently this is reserved for its commercial buyers. The company would like to extend the website to create an on-line sales portal and would welcome public funding to support this activity, as it currently cannot afford to do so.

Not all footwear products can be sold over the internet, however. For example, selling children's' footwear in this way goes against recommended good practice. Children's' feet need to be measured by a trained foot fitter to ensure that the shoes will not cause damage.

4.3.6 Costs of Raw Materials

One company we interviewed indicated that its main problem is the high cost of raw materials. This is exacerbated by the current Euro/US dollar/Yuan exchange rate, which makes it difficult for the company to plan for the costs of exporting. In response, the company is investigating the design of shoes with cheaper raw material inputs, as well as sourcing cheaper raw materials by changing its suppliers.

4.4 Strategies to Address the Problems

4.4.1 Introduction

According to the regional industry association, AVECAL, approximately 30% of its member companies do make formal business plans and have effective business strategies. These strategies often include setting production targets and identifying new markets. Even though most of the member companies are family businesses, they do have an internal management structure and about 40% of them closely follow industry trends.

This finding implies that 70% of SMEs do not have formal business plans. However, they may still have informal strategies to manage the future of their businesses. Nevertheless, the finding implies that a considerable proportion of footwear SMEs in Valencia may be operating on a day-to-day basis, without longer-term plans.

This is not an unusual position for SMEs. For example, research by a business insurance comparator of 400 British entrepreneurs indicated that 54 per cent of firms have no written business plan and more than two thirds of entrepreneurs make decisions on gut instinct alone (Simply Business, 2010). However, lack of a business plan may make it more difficult to obtain loan finance, exacerbating the problems identified in section 4.3.2.

In response to the problems they face, SMEs in Valencia have adopted a number of different strategies. These include:

- seeking new markets;
- strengthening brand identity;
- rationalisation;
- outsourcing; and
- new marketing approaches.

Innovation also plays an important role in maintaining competitiveness. According to AVECAL, the two main lines of research focus on the quality of the materials used, e.g. waterproof leather, and environmentally friendly production and products. Cooperation between SMEs and the regional technology centre is discussed in section 4.6.2.

4.4.2 Seeking New Markets

A key strategy adopted by all of the SMEs that we interviewed was seeking to offset the decline in domestic sales by expanding their sales elsewhere. Most companies considered that the Spanish market was unlikely to expand in the near future.

The companies were targeting markets both within and outside the EU, using a variety of sales methods including e-commerce. Markets outside the EU being targeted by SMEs include North America, Asia and Eastern Europe. Box 4.4 describes the strategy adopted by the manufacturer of slippers and comfort shoes.

Box 4.4: Strategy for Seeking New Markets
The manufacturer aims to counterbalance the loss of demand in the Spanish market by increasing sales in North America and in China. It is also looking to enter the Indian market. Its plan is to reverse its current sales figure from 65% Spain and 35% export to 35% Spain and 65% export. The company had found that it takes approximately two years (four seasons) to establish its brand and presence in a new market. In addition, 2% of its production is now sold through e-commerce.
Source: Interview with SME in Valencia

However, entering new markets does involve risks. Box 4.4 indicates that it can take some time before a brand can become established and profitable in a new market. The example Box 4.5 shows that, although expansion into new markets can help companies to maintain capacity, it does bring additional costs.

Box 4.5: Benefits and Costs from Expansion into New Markets
A manufacturer of women's fashion shoes that previously focused only on the Spanish market now also sells its products to Italy, Japan, the UK and Israel. It hopes to expand into Germany as well. The company has now managed to achieve a 50-50% split between Spanish and foreign markets. Sales to export markets are helping the company maintain its operational capacity. During the last 2-3 years the turnover of the company decreased but it has now managed to make up for that loss by extending their foreign client base. However, increasing exports brings additional costs in connection with insurance payments related to the transported goods.
Source: Interview with SME in Valencia

There are also risks that distribution chains in new markets will not prove effective, as Box 4.6 shows.

Box 4.6: Risks Related to the Distribution Chain
An SME fashion-shoe company entered the US market about five years ago but found that its chosen distribution approach, of selling through boutiques, was not providing it with the expected income. It therefore decided to pull out of the market. However, one year (two seasons) ago, the company decided to attempt to re-enter the market, using the same distribution approach. This is because the company anticipates that to the increased use of online sales by the boutiques should help it to achieve better sales this time. The company hopes that the strategy of seeking new markets will help to meet its target of increasing turnover by nearly 50%.
Source: Interview with SME in Valencia

One company noted that FICE is helping to fund expansion of footwear manufacturing by trying to network customers with producers. Moreover, in 2010 the national footwear association (FICE) and the Valencia Institute of Export (IVEX) signed an agreement[59] allocating €40,000 for the implementation of promotional activities aimed at further strengthening the presence of the Valencia footwear products in the key export markets.

4.4.3 Strengthening Brand Identity

The SMEs interviewed noted the importance of a strong brand identity in expanding sales, and a number had closed down poorly-performing brands (see section 4.4.4.). One company with two brands operating in very different market segments had spun off one of its brands into a separate company, as shown in Box 4.7.

Box 4.7: Spinning-off Brands into Separate Company
A company specialising in the production of successful brand of slippers also manufactured a brand of outdoor comfort shoes. The market for slippers is relatively stable, whereas that for outdoor comfort shoes is more dynamic, with more frequent changes in design and style. The company therefore decided to separate out the comfort shoes brand from its mainstream business and disposed of the brand off by creating a spin-off company in 2008. This spin-off company operates from the same factory as the main brand, and currently employs five people.
Source: Interview with SME in Valencia

59 Asociación Valenciana de Empresarios del Calzado: El Ivex destinará 40.000 euros a la promoción del Calzado Valenciano en el mercado internacional, downloaded from http://www.elcheshoes.com/

4.4.4 Rationalisation

Another strategy adopted by SMEs in response to reduced markets and increased competition is rationalisation. For example, one company decided to abandon plans for a men's line and concentrated solely on women's shoes. Another decided to pull out of production of an under-performing brand, as described in Box 4.8.

Box 4.8: Rationalisation of an Under-Performing Brand
A company decided to close down one of its three brands five years ago, as this brand was in direct competition with cheaper Asian imports and the company could not maintain its position on the market. Due to this reorganisation 40 staff were made redundant and part of the operation capacity was switched to manufacture the company's higher-priced brand, which is produced in a lower volume. The reorganisation of the company and the fact that they recognised that it had to cease part of the production was considered a success, as the remaining part of the company has been able to maintain its strategic position in the market.
Source: Interview with SME in Valencia

4.4.5 Outsourcing

The regional industry association, AVECAL, indicated that outsourcing is an important aspect of cost-cutting by SMEs in response to market pressure. AVECAL indicated that parts of its members' production processes were being outsourced, mainly to Romania or North Africa. However, the companies we interviewed had also outsourced part of their processes to other companies within the region, as shown in Box 4.9.

Box 4.9: Outsourcing within the Valencia Region
A fashion shoe company has changed in recent years from manufacturing to only designing shoes. It has subcontracted the manufacturing process; it purchases raw materials, which are then sent out to other local companies who make the shoes for them. This resulted in a reduction in the number of employees. The company further reduced the number of employees in 2008, losing 58 people who used to deal with management and logistics. By purchasing a business management software package, the company was able to simplify procedures and reduce the amount of paperwork needed. Currently, the company employs only 16 people.
Source: Interview with SME in Valencia

4.4.6 New Marketing Approaches

Another strategy adopted by SMEs to address their problems is the adoption of new marketing approaches. This is designed to assist the companies to reach new customers and/or to command a higher price for their products.

One company we interviewed plans to rely increasingly on on-line sales. Currently about 10% of its revenues come through internet sales. The company sells through the main internet sites such as Amazon (US) as well as similar sites (Prevalia, Buy VIP, etc.).

Another company is introducing the option of a la carte ordering for its buyers, which allows them to select the sole, colour and the material for the products. Altogether the company has 40 different models for women's footwear. Even though this requires the company to stockpile materials, it believes that such differentiation will allow it to charge a higher price.

One company adopted the approach of moving its products up to a higher quality/higher price bracket to survive. By attending shoe fairs, the company has received orders for this new type of product.

These examples are interesting in that they illustrate the different approaches adopted by different SMEs to expand their markets. The approaches combine new routes to approach potential customers (using the internet or attending shoe fairs) together with changes to products to make them more attractive and thereby command a higher price (through improved quality or customization).

4.5 Development of Clusters

4.5.1 The Role of Clusters in the Supply Chain

It is clear from our discussions that the clusters of Elda-Elche within Valencia are of critical importance to the footwear industry. AVECAL noted that, with the increasing pace of change in trends, the importance of clusters is increasing. Buyers are now demanding four seasons instead of the previous two; this puts greater demands on manufacturers. The proximity of component manufacturers within a cluster allows companies to respond more quickly. As this trend is likely to increase in the future, the importance of clusters will continue to grow.

All of the SMEs we interviewed work closely with other companies within the cluster. One SME indicated that almost all of its suppliers and its main partners were from within the region – and this was seen as a definite advantage of the cluster, as Box 4.10 demonstrates.

Box 4.10: Value of the Cluster for Proximity to Suppliers
The company uses outside companies in the area to cut and stitch its shoes; the company only finishes them off in house. The company has its own delivery vans to deliver to and collect from these outside suppliers. Materials are sourced 90% locally and 10% from Portugal and Italy. They had sourced some leather from China but had problems with chrome content and quality. However, the company noted that it is are having problems obtaining Spanish materials as lots of small suppliers are suffering and closing due to the economic downturn.
Source: Interview with SME in Valencia

Another company also identified the main benefits of the cluster as the proximity of components manufacturers. The company works with local suppliers from the area which were also affected by the reduction in domestic demand. The number of local raw material suppliers has decreased, as many closed due to the financial crisis.

The regional cluster is very important for a third company we interviewed, as it also uses subcontractors from the region for the manufacturing process. The proximity of these companies makes it easy to control specific aspects of the production or to implement changes. The company also designs handbags to complement its shoes, which it sub-contracts to other companies in the cluster. However, the company feels that local suppliers cannot always deliver the required quality of the materials for its products and currently it buys most of the decorations for its shoes in India, China and Pakistan.

4.5.2 The Role of Clusters in Innovation

Local organisations within the regional cluster also play a significant role in encouraging innovation by SMEs. There are two organisations that work with SMEs in the region on research and innovation, as outlined below.

C2I2 a.i.e. (Calzado, Componentes, Investigación e Innovación)

This is an industry group for technological innovation, set up and funded by footwear companies. It does not undertake R&D itself but provides representation for companies engaged in R&D. Most of its members are companies based within the cluster and its purpose is the promotion and implementation of national, European and international action in the footwear and components industry. One of its key activities was to assist in the founding of the Cluster Calzado Innovación (see below).

Cluster Calzado Innovación

This non-profit association was founded in Elda in 2008 by the regional research institute (INESCOP), the Spanish Federation of the Footwear Industry (FICE) and C2I2aie. It has a wider stakeholder base than C212 a.i.e. and it undertakes R&D. Its main aim is the development and promotion of the footwear cluster of Elda-Elche, especially through co-operative projects in R&D and innovation. Examples of such projects are listed in Box 4.11.

Box 4.11: Examples of Innovation Projects by Cluster Calzado Innovación
Under the Framework Programme of the Ministry of Industry, Tourism and Trade the association worked on: • "Zapateria virtual" project: digitizing the shape of the shoe and of the feet of consumers in shops and other strategic points, the developed system identify the shoes that best fit and make it easier for users to purchase shoes through the web channel or through a traditional physical store remodeled. • "Structure and function of an Integration Competences Centre"; • "Identify Innovation opportunities from the company"; • "Future trends for the Footwear Industry". Projects with IMPIVA (Institute for the small and medium industry of the Generalitat Valenciana) included: • "Dynamization of the Footwear Cluster"; • "Promotion of the Footwear design".
Source: Interview with SME in Valencia

4.6 Use of Supporting Services

4.6.1 Availability of Supporting Services

A range of supporting services is available to SMEs within the region. These include:

- a technology centre (INESCOP);
- export assistance services;
- promotional campaigns;
- support for innovation; and
- a regional industry association.

4.6.2 Technology Centre

The Technological Institute for Footwear and Related Industries (INESCOP) is the most important footwear sector research institute in the region. Formed by local companies, INESCOP began its activities in 1971 and works as a non-profit organisation, with more than 600 footwear related companies as members.

Several of the SMEs interviewed for this study had collaborated with INESCOP on research and innovation projects:

- the slipper and comfort shoe manufacturer uses INESCOP for testing of its products and has also cooperated with INESCOP in developing soles. The soles and their design have been patented;

- the children's shoe manufacturer has worked with INESCOP to develop a management software programme that aids the organisation of its manufacturing process as well as on product development, for example a washable footbed; and

- the fashion shoe company worked together with INESCOP in the past to develop 3D design software. As the company's main focus is design, the result of this collaboration is seen by the company as very important.

However, another fashion shoe SME we interviewed said the company has no involvement in research and development.

Given the difficulties encountered by research institutes in engaging with SMEs (see Task 2 report), this indicates both that SMEs in Valencia have a significant interest in research and development and that INESCOP has developed effective ways of interacting with SMEs. This is a potentially significant factor in helping SMEs in the region to address the challenges they face, particularly given the focus on customisation and improved quality to expand markets, which was described in Section 4.4.6. Nevertheless, the fact that one SME had no interest in research and development indicated that there is scope for further action by INESCOP to engage with SMEs. The significance of R&D to footwear companies will be explored further under Task 6.

4.6.3 Export Assistance Services

As the exporting capacity of footwear SMEs in Valencia increases, access to information on foreign markets, including trade barriers, local trends, the state of the industry and local competitors is increasingly important.

One form of support, cited by a number of SMEs, was that provided by IVEX (Valencia Export Institute) and ICEX (Spanish Institute for Foreign Trade). The agencies offer a wide range of financial help and services, such as:

- financial help to attend fairs abroad (50% reimbursement of costs);
- training courses for the management team;
- business partner research;
- market surveys; and
- logistic support.

The form of support most widely mentioned by SMEs we interviewed was the financial assistance with companies' presence at international fairs. Given the focus of SMEs in Valencia on increasing exports to offset falling domestic sales, this is a very important form of support. The SME manufacturing children's shoes noted that representation at international fairs is of key importance to it; therefore it has used

IVEX and ICEX funds to support it in exhibiting at fairs in Milan, Madrid, Hong Kong, Tokyo and London.

The general opinion of SMEs was that these agencies do have an effective mechanism to support representation in trade fairs; the process of tendering for these funds is easy and transparent. However, companies that cannot afford to finance the remaining sum can have difficulties. One company noted that even with 50% cost reimbursement, coming up with the remaining sum can be difficult. In the absence of full funding, this company had been forced to showcase its products to Japanese clients in hotel rooms.

This point was confirmed by the local footwear industry association, AVECAL. Some companies are struggling to represent themselves at key trade fairs, even though there is potential demand and such fairs are basically the only way to gain new markets. Further support is needed to cover costs of representation at these fairs.

The national association, FICE, also organises events and stands at international fairs to represent member companies. One SME noted that FICE had helped it to enter the Chinese market, through providing consulting services and contacts with agents.

4.6.4 Promotional Campaigns

Several of the SMEs that we interviewed mentioned the value of promotional campaigns for the 'Made in Spain' label. Manufacturers rate the strength of the label between that of the Italian and the Portuguese labels. One believed that the label could lead to an increase in sales, as customers have a higher perception of quality attached to the label.

The national footwear association, FICE, organises events and stands at the international fairs to promote the 'Made in Spain' label. These are aimed at both industry stakeholders and consumers. Table 4.4 provides examples of two campaigns; unfortunately, no data are available about the success of these campaigns in terms of deals concluded or increased sales. However, the SMEs we interviewed considered that they were valuable initiatives.

Table 4.4: Examples of Promotional Campaigns	
Industry events: MODACALZADO and IBERPIEL	**Consumer event: Zapatos de España**
The industry fair for footwear and leather takes place biannually in March and in September in Madrid. The event is organized by IFEMA, the Trade Fair Institution of Madrid. This event attracts a variety of international raw material providers, manufacturers and buyers alike. Last year the event had close to 8,000 visitors, of which 85% were domestic and 15% foreign. The number of international visitors has been increasing, with Portugal as the main country of origin and an increase in professionals from more distant countries such as Canada, Chile, China, Colombia, Belarus, Croatia, Georgia, Kazakhstan and Serbia.	This communication campaign is run by the National Association, FICE and is directed at the consumer. Its objective is to promote the image of Spanish footwear and broaden awareness of the brands within the domestic market. The campaign is supported by the Ministry of Industry, Commerce and Tourism. It began its second phase in 2008 with the collaboration of the Ministry of Science and Innovation, the Department of Industry, Trade and Innovation of the Generalitat Valenciana. In its second phase the campaign is aimed at familiarising consumers with the many aspects of manufacturing and making them aware of the craftsmanship behind the production process and also presenting the innovations and the new lines of research.

4.6.5 Support for Innovation

Many of the companies in the region have also benefited from funding from IMPIVA, (Institute for Small and Medium Industry of the Generalitat Valenciana). This is a regional public entity attached to the Ministry of Industry, Trade and Innovation. Its remit is to develop policies for promoting innovation among small and medium enterprises in the fields of Technology and R&D, Design, Quality and Environment, Organisation and Management, Training and Business Co-operation. However, none of the companies we interviewed mentioned receiving funding under this initiative.

IMPIVA has been successful in helping SMEs in Valencia to fulfill the requirements for the registration of industrial property rights in the Spanish Office of Patents and Trademarks. It can also certify that a company is involved in R&D projects, in order that it can benefit from tax relief measures.

4.6.6 Regional Industry Association

Formerly, there were several regional associations in Valencia. However, the reduction of the number of footwear companies operating in the region meant that membership of these associations had shrunk and they were no longer sustainable.

AVECAL is now the only regional footwear industry association in Valencia. It was formed in 2010. It has 235 member companies, representing 65% of the members of FICE, the national footwear association. The majority (90-95%) of its members are SMEs. Member companies have around 3,500 employees within the footwear sector and 9,000 in total, including suppliers.

AVECAL offers assistance to members with legal advice, training programmes (for the unemployed) and also obtain funding for companies who employ young people and over 45 year olds. They provide information on customs and tariffs, as well as contacts in third countries, to assist exporters. One SME we interviewed indicated that AVECAL had been helpful in identifying contacts with potential customers. AVECAL also represents the industry at government level.

4.7 Potential for Additional Support

4.7.1 Introduction

The companies we interviewed identified a number of areas where additional support would be welcomed, including:

- further assistance with export promotion;
- targeted funding from the EU; and
- greater protection from counterfeiting.

4.7.2 Further Assistance with Export Promotion

The financial assistance available to attend fairs abroad (see Section 4.6.3), such as Linea Pelle or MICAM, is considered insufficient by some SMEs. This is because, even though they cover 50% of the costs, some small companies are unable to cover the rest.

The companies believe that additional help in this area would be cost-effective, as there is an export market for their products and greater exploitation of this market would enable them to offset the reduction in the Spanish market (due to cheap imports and the Spanish economic crisis). Information from manufacturers with a stand in these industry events suggest that participation can result in 20% increase in orders.

Further campaigns to support the Spanish footwear manufacturing industry and raise awareness among consumers would be beneficial in Europe, especially in the Eastern European, Balkan and Baltic countries, where many of the companies interviewed did not have commercial contacts. Within these countries, consumers can easily get information on the manufacturers and even have direct access to their products through on-line sales, whereas campaigns for third country markets are more efficient if targeted at intermediary buyers and the industry stakeholders.

4.7.3 Targeted Funding from the EU

Some SMEs considered that generally European projects providing support to SMEs are not effective for the footwear sector, as it cannot compete with other sectors in terms of technology and innovation content. Instead, the companies would like to see specific targeted projects for the footwear industry. They would also like to see more projects focused on transferring existing technologies in other sectors into the footwear production process.

The companies also suggested that there should be a two-step procedure for the tender, with a first step asking for simpler requirements - similar to an expression of interest, as small companies have difficulties in allocating the time to meet the specifications following which those selected could provide a more detailed report on the activities supported. Furthermore, they suggested that European companies should be favoured generally in EU level public procurement procedures; however, this is considered impractical.

4.7.4 Protection against Counterfeiting

Another area of additional support suggested by SMEs concerned counterfeiting protection. SMEs did not feel that patenting their research results is an effective way to protect them, mainly because the results of their research general constitute minor design developments rather than major technological breakthroughs. The SMEs considered that taking action against a counterfeit product is very expensive and it often not worthwhile for a small company. This is because in the increasingly fast-paced fashion sector, by the time action is taken, collections will have changed and the product will no longer be on the market.

4.8 Summary

Valencia is one of the most significant footwear producing regions in Europe, accounting for 65% of the Spanish footwear production and almost two-third of all footwear manufacturing companies. The industry has undergone severe changes in recent years; the number of companies has reduced by 37% since 2005

Companies in Valencia have historically focused on the Spanish market; much of their current challenges arise from the impact of the economic downturn on consumption as well as competition from cheap imports. As a result, the SMEs in the region have been forced to extend their consumer base outside Spain, to other EU markets as well as penetrating markets in the EU and Asia.

A number of national and local initiatives are available for companies; this includes support for their attendance at international fairs which SMEs have found valuable to identify potential customers outside Spain. Companies have identified access to finance (including through support mechanisms) as the foremost obstacle to maintain their market positions and to reach new markets. The clusters of Elda-Elche within Valencia are of critical importance to the footwear industry. The close cooperation between enterprises in the clusters, and with the research institute and industry associations, has helped SMEs to respond to the increasingly fast pace of changes in the market.

5. CASE STUDY: TIMIS

5.1 Introduction

5.1.1 Background

Timis is one of the western-most counties of Romania; counties are responsible for the main administrative functions and management at local level. According to information from the Chamber of Commerce, Timis is one of the most important counties in Romania with regard to its contribution to the economy: it is the third largest exporter and also ranks third in per capita GDP (after Bucharest and Ilfov). The county has a population of over 600,000 people. Currently the main industrial sectors, both in terms of investment and employment, are auto manufacturing, chemicals and agriculture.

Timisoara, the capital of Timis County, is Romania's fourth largest city with a population of approximately 332,000 people and is one of the most developed cities in the country. The local authorities attribute its economic and social progress to its geopolitical position, the well-developed support structures compared to other regions of Romania, trained staff and a high degree of cultural and social cohesion. Local industry is diversified and comprises various sectors, including machinery, electrical engineering, chemicals, wood processing, printing, leather goods and textiles[60].

Timisoara hosts the Politehnica University and the West University, specialising in the fields of engineering, mathematics and natural sciences. The development of the city has benefited from its strategic location, including proximity to Serbia and Hungary, as well as national and local initiatives aimed at stimulating enterprise and collaboration in the city. These include the development of industry parks located just outside of the city and business incubator projects undertaken in collaboration with the local council, the Politehnica University and the German Government. Currently there are about 7,500 companies funded by foreign capital in the region. The most important foreign investors according to the number of companies are listed in Table 5.1.

Table 5.1: Sources of Foreign Investment in Timis

Country of Origin of Investment	Number of Companies Receiving Investment	Percentage of Companies Receiving Investment
Italy	2,977	40
Germany	1,514	20
Austria	542	7
Hungary	275	4
France	268	4
Others	1,924	25
Total	**7,500**	**100**

Source: Timis Chamber of Commerce, Industry and Agriculture, TCCIA

60 Declan Murphy (2006): **The Timisoara strategy for entrepreneurship development**, Romania, OECD.

5.1.2 Recent Trends in the Romanian Footwear Industry

Prior to the political changes of the 1990s, Romanian light industry was developed with the aim of achieving national industrialization. The textile and garment industries were the country's second largest employers. The garment industry was characterised by large, vertically integrated production facilities, some of which remain today, especially in Bucharest[61].

However, privatisation altered the sector completely; factories were bought up and then sold on, with the national government focussing on increasing foreign investment and attracting high technology industries. At the same time, the liberalisation of trade increased competition for Romanian manufacturers and energy prices were increased. These factors had led to a restructuring of the leather and footwear industries, which included:

- replacement of under-performing technologies and equipment with new, more modern and more flexible ones, where this could be financed;
- reorganisation of work processes and more efficient management of the workplace;
- modernisation of tanneries, especially the finishing sector;
- significant changes in raw hides/skins processing, by reducing the use of local raw materials and increasing imports of finished leathers for uppers and leather goods; and
- since 1994, about 80% of shoe production has been carried out under the *lohn*[62] system, drastically reducing the demand for domestic finished leather[63].

The Romanian footwear industry has now become the hub for Italian and German manufacturers who have outsourced their manufacturing processes partially or completely. These companies rely mainly on component manufacturers that have also relocated their operation from Italy and therefore provide little boost to Romanian SMEs. Within the footwear manufacturing sector, the ten largest companies are all foreign owned, mostly by Italian enterprises but with one (Reiker) owned by a German company, as shown in Table 5.2.

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[61] Schoppmeyer D (2004): **The Influence of Competitiveness, Efficiency and Profitableness on Economic Growth in Garments Manufacturing Sector**.

[62] The *lohn* system is where foreign owners of companies supply the raw materials, designs and technology while the Romanian plants supply staff and premises only.

[63] INCDTP – Leather and Footwear Research Institute (2005): Bat Theory and Practical Reality in Romanian Tanneries.

Table 5.2: Foreign-Owned Footwear Manufacturers in Romania		
Italian-owned companies: • Bontimes; • Calzaturificio Torre; • Eclipsia Shoes; • Formificio Fioretti;	• Orizo Sport; • Primos; • Ro Alto Gradimento; • Technic Development; and • Witext.	***German-owned company:*** • Rieker Romania.
Source: Camera de Comert, Industrie si Agricultura Timis		

Romanian Footwear production increased gradually between 2004 and 2006 (see Table 5.3); however, by 2008 both the value and quantity of output has reduced slightly, mainly due to reduced demand in the EU market and increasing competition from Asian producers.

Table 5.3: Production of Footwear in Romania, 2004-2008		
Year	**Value (€ billion)**	**Volume (million pairs)**
2004	1,302	83
2006	1,486	91
2008	1,455	89
% Change 2004 - 2008	**11.7%**	**7%**
Source: CBI Market Survey- The Footwear Market in Romania (2010		

The impact of increasing competition is illustrated by the data on imports. In 2008, Romania's imports of footwear were valued at €467 million, or 91 million. This represents an increase of nearly 11% since 2004 pairs (see Table 5.4). Exports of footwear in 2008 exceeded imports in value, at €1000 million, but were lower in volume than imports (51 million pairs). In contrast to imports, the value of exports is reducing. Nevertheless, in 2008 Romania still had a trade surplus in footwear.

Table 5.4 Total Value and Volume of Romanian Footwear Imports and Exports [1]						
Total Footwear Imports				**Total Footwear Exports**		
Value in 2008 (€ million)	**Total Change in value 2004-2008**	**Quantity (million pairs in 2008)**	**Change in volume 2006-2008**	**Value in 2008 (€ million)**	**Annual Change in value 2004-2008**	**Quantity (million pairs in 2008)**
467	+10.9%	91	+910%	1000	-1.8%	51
Source: CBI Market Survey (2010) The Footwear Market in Romania *Note 1: Unfortunately, it has proved impossible to obtain data on a consistent basis for both imports and exports*						

More than 22% by value, or €105 million (88% by volume or 80 million pairs), of Romania's imports in 2008 came from developing countries, with China supplying the majority (59%) of all developing country imports in terms of value and 90% in terms of volume. With regard to exports, there is a large amount of re-exporting from Romania, as there is a significant trade in footwear parts. This highlights the fact that much of the increased production in this period was for the local market[64].

64 CBI Market Survey (2010): **The Footwear Market in Romania**

Although data are only available for a short time series, this indicates that Romania is increasing imports of low-cost footwear, with an average price in 2008 of only €5. Together with the reducing value of exports, which had an average price of nearly €20, this indicates that Romania is finding it increasingly difficult to compete in the market on price alone.

With regard to consumption, the Romanian footwear market in 2010 was valued at €759 million (50 million pairs) in terms of retail sales, registering an average annual increase of 2.4% since 2004[65]. The average price is therefore €15 per pair and the average consumption was €35 per person per year. This below average consumption for the EU can be explained by the fact that many Romanian consumers can only afford lower quality items.

According to information from the Romanian Trade Promotion Centre, the leather and footwear industry, which includes the three sectors of leather tanning, footwear and handbag manufacturing, had a substantial share of the nation's industrial output as well as employment. Details of the sector's national contribution are shown in Table 5.5.

Table 5.5: The Leather, Footwear and Related Sector's Share of National Industrial Output

% of the total value industrial export	1.2
% share of the total value of manufacturing industry output	1.5
% share of industrial employment	5.4
% share of manufacturing employment	6.2
% share Country specific total exports	4.4

Source: Romanian Trade Promotion Centre

There is conflicting information regarding the number of companies and employees in the footwear sector in Romania. According to the Romanian Trade Promotion Centre, the footwear manufacturing industry in 2007 (the most recent data available) consisted of over 2,000 firms, 38% of which were small and medium sized companies (see Table 5.6).

Table 5.6: Number of Companies in the Footwear Sector According to Romanian Trade Promotion Centre, 2002-2007

	Total number of enterprises within the sector	Small firms (0-49 employees)	Medium Firms (50-249 employees)	Large Firms (250 employees and over)
2002	1868	1403	369	96
2003	1925	1440	392	93
2004	2057	1567	403	87
2005	2086	1605	404	77
2006	2057	315	396	70
2007	2049	343	375	61

Source: Romanian Trade Promotion Centre, 2009

65 CBI Market Survey (2010): **The Footwear Market in Romania**

If the data in Table 5.6 are correct, they indicate a significant reduction in the number of small firms over the period (around 75%); the number of large firms also reduced, by around 36%, while the number of medium-sized firms stayed around the same.

Other data sources, however, suggest that the number of companies in the leather and footwear was significantly lower than shown in Table 5.6. The CBI Market Survey[66] indicated that there were no more than 1,286 companies employing 13,117 people in the sector in 2007. Similar data have been published by the Leather and Footwear Research Institute[67] (see Table 5.7). According to data from the Institute, there were 1,731 companies in the leather and shoe industry in 2005, including about 120 tanneries; the remainder are mostly footwear manufacturers, indicating that there were approximately 1,600 manufacturing businesses in the country in 2005.

Table 5.7: Number of Romanian Footwear Companies According to Leather and Footwear Research Institute (2005)

Size of Company[1]	Total light industry	Leather/shoe industry[2]
Large	364	91
Medium	1352	282
Small	1897	419
Micro	5329	939
Total	8942	1731

Source: INCDTP – Leather And Footwear Research Institute: BAT Theory and Practical Reality in Romanian Tanneries, 2005

1. Based on standard EU definitions set out in Table 2.1

2. Includes around 120 tanneries

Table 5.8 compares the data for 2005 from Tables 5.6 and 5.7. Unfortunately, more recent data are not available from INCDTP. The INCDTP data shows a slightly higher number of large firms than the Romanian Trade Promotion Centre data, but in all other size categories, the number of firms is lower. The overall size distribution of companies is, however, similar between the two data sources, although the Romanian Trade Promotion centre data do not distinguish between small and micro firms.

<table>
<tr><th colspan="5">Table 5.8: Comparison of Data on the Number of Romanian Footwear Companies in 2005</th></tr>
<tr><th>Size of Company</th><th colspan="2">Data from Romanian Trade Promotion centre</th><th colspan="2">Data from INCDTP (includes 120 tanneries)</th></tr>
<tr><td></td><td>Number</td><td>%</td><td>Number</td><td>%</td></tr>
<tr><td>Large</td><td>77</td><td>4</td><td>91</td><td>5</td></tr>
<tr><td>Medium</td><td>404</td><td>19</td><td>282</td><td>16</td></tr>
<tr><td>Small</td><td rowspan="2">1,605</td><td rowspan="2">77</td><td>419</td><td>24</td></tr>
<tr><td>Micro</td><td>939</td><td>54</td></tr>
<tr><td>Total</td><td>2086</td><td></td><td>1731</td><td></td></tr>
</table>

Sources: Romanian Trade Promotion centre, 2009 ; INCDTP – Leather And Footwear Research Institute: BAT Theory and Practical Reality in Romanian Tanneries, 2005

66 CBI Market Survey (2010): The Footwear Market in Romania

67 INCDTP – Leather And Footwear Research Institute (2005). BAT Theory and Practical Reality in Romanian Tanneries

5.1.3 Size and Structure of the Footwear Industry in Timis

Prior to 1989, Timis was a centre for the footwear and textile industries; its skilled workforce and tradition in processing leather and making footwear have been important factors in the development of enterprises. After 1989, restructuring of the industry took place and a number of foreign investors set up footwear manufacturing businesses in Timis. According to the Chamber of Commerce, Italy is the most significant foreign stakeholder within the footwear industry in Timis based on the number of companies invested in (no precise data were provided). These companies collaborate mainly with their mother companies in Italy and less frequently with other firms in the region. By total value of investment in all industry sectors, however, Italy is fourth; behind the United States, the Netherlands and Germany. This indicates that the focus of Italian investment in the region is on footwear, whereas German and US companies invest primarily in the IT and motor vehicle sectors.

Data on the number of firms in the Timis region are also conflicting. There are currently 364 footwear manufacturing companies registered with the trade registration office in Timisoara (registration is compulsory for all companies). However, only 15 are footwear manufacturing companies are members of the Chamber of Commerce. This difference in the number of companies is partially due to the fact that when companies close down their operations, they do not necessarily complete the administrative procedure to make this official. In addition, one of the criteria for being a member of the Chamber of Commerce is to have a positive turnover the previous year.

According to published sources, in 2005 there was a total of 176 footwear companies in the Banat area of Romania (composed of the counties of Timis, Caras-Severein, Arad and Mehedinti) of which 24% were operating with foreign capital. Unfortunately, no more recent data are available on the number of firms in the region. This amounts to between 8% and 10% of the total number of footwear enterprises in Romania (see Table 5.8). There is a strong concentration of companies in Timis county; it has 150 enterprises (84%), located particularly in Timisoara (42%) and Lugoj (10%)[68].

Previously the main Romanian manufacturers located in the Timis area included:

- Guban (now operating at reduced capacity and with foreign investment);
- Filty (still operating with approximately 10% of its employees remaining);
- Banatim (closed down with around 2,000 people made redundant); and
- Pantera (still operating).

The main advantages of the Timis footwear sector remain the competitiveness of its footwear products on foreign markets. The area still offers a skilled and cheap labour force and a competitive infrastructure.

[68] Ramona Işfănescu West University of Timişoara, Romania: Potential Clusters in Banat and Their Role in Regional Economic Development

5.2 Characteristics of Footwear SMEs in Timis

5.2.1 Introduction

The majority of the approximately 150 footwear manufacturing companies in the region are small and medium-sized enterprises. Footwear manufacturing enterprises in the region are comprised of both foreign and Romanian owned companies (no data were available on the relative proportions of these). All of the companies interviewed during the case study visit relied on foreign investment and only one of them was operating independently (outside the *lohn* system).

5.2.2 Types of Products

Footwear SMEs in the region manufacture a wide variety of products, including fashion, sports shoes and ski boots. There are also a number of component manufacturers under foreign ownership in the region. However, according to the case study interviews, leather and other raw materials were almost exclusively sourced from outside Romania.

The enterprises manufacturing in the region usually do not undertake any other activity apart from assembly. All components arrive in bulk and assembly is undertaken at the site, following which the products are transferred to the main location of the foreign parent companies.

5.2.3 Main Markets

Little statistical information is available on markets for footwear from the region. As the majority of companies are foreign-owned, their output is generally delivered to their parent company (mainly in Italy). However, the staff at the SMEs we interviewed did not know the final destination of their products and indicated that only the parent companies would hold this information. Available information from one parent company suggests that products are exported to the United States and Russia as well as being sold within the EU. The exception to this rule was a traditional Romanian manufacturer which is manufacturing independently without the involvement of a parent company. This company's main market is Romania and its products are sold through a chain of small (boutique) retailers.

5.2.4 Business Models

During the case study interviews, we encountered two different types of business model.

Three of the four companies we interviewed were part of the *lohn system* of production, owned by Italian parent companies. Under this system, a foreign investor takes ownership of the manufacturing company and limits the operation of the site to the actual manufacturing process. Sourcing and selection of raw materials, components and other accessories is undertaken by the foreign owner and, following the completion of the products, the owner then re-imports the finished merchandise.

Consequently, the enterprises operating with this system do not develop their strategic and marketing competencies.

SMEs operating in the *lohn* system can also be distinguished according to the operation of their mother company. Companies interviewed for the case study had adopted two different types of business models:

- in the first model, the Romanian factory manufactures the mother company's own brands; and
- in the second model, the Romanian factory manufactures for a third party that orders from the mother company. Box 5.1 gives an example of this system and the uncertainties it can pose for Romanian manufacturers.

Box 5.1: *Lohn* Manufacturing for a Third Party
A factory in Timisoara was working under foreign ownership, manufacturing components of footwear not for its mother company but for a single one of the mother company's clients, which had its headquarters in Italy but also operated a large factory in Timisoara. The operation of the Timisoara company was dependent on orders from the mother company's client; however, this client decided to leave its manufacturing site in Timisoara and cease collaboration with the local supplier. Following the departure of its only client, the Timisoara company changed the types of products it manufactured; it decided to invest in new machinery and began the manufacturing of complete shoes and ski boots. Its new clients were identified through the contacts of the mother company and are located in Italy. Therefore while the product line has changed, its business model remained the same.
Source: Interviews with SMEs in Timis, June 2011

The *lohn* type of contract was adopted by increasing numbers of SMEs in Timis, due on the one hand to the difficulties caused by the reducing domestic supply of raw materials and on the other to the advantages this system can offer. However, the system has implications for development of businesses in the region. The manufacturing company does not make decisions on where to source raw materials, leading potentially to an increase in imports, nor does it make decisions about technology change. High dependence on imported materials makes companies operating under the *lohn* system highly sensitive to currency fluctuations and market shifts. The *lohn* process can also have a negative impact of local raw materials suppliers and component manufacturers, significantly limiting their involvement in the manufacturing process. Most of the Italian owned factories, in particular, prefer to collaborate locally within the region with component manufacturers also owned by Italian entrepreneurs and thereby creating an Italian sub-cluster within the Timis cluster.

A second type of business model found in the region also relies on foreign ownership and involvement, but to a different extent. In this case, the footwear manufacturer retains all decision-making ability and undertakes the complete manufacturing process. One SME that we interviewed had adopted this business model.

5.3 Key Problems

5.3.1 Availability of Skilled Workers

Availability of skilled workers is an ongoing and significant problem for footwear manufacturers in the area. The development of high-tech industry in the region had led to new jobs for skilled workers that are better remunerated than jobs in the footwear industry. In response, many skilled workers from local light industry had either retrained themselves to take advantage of these new jobs or made use of the country's new Member State position in the European Union to leave the area for higher payment offered in other Member States. One reason for the low salaries in the footwear industry is the high level of social costs, discussed in Section 5.3.2. Box 5.2 provides an example of the difficulties this causes for local footwear manufacturers.

Box 5.2: The Problem of Shortage of Workers
A medium sized company employing 220 people is working in the *lohn* system under Italian ownership, producing 150,000 pairs of shoes per year. The enterprise is constantly searching for new employees, as about 50 people leave the company annually. Recruitment is the main problem as there are simply not enough people willing to work in the footwear industry. This is because salaries in the sector are only a little higher than unemployment benefit and are not competitive with those paid, for example, in the automotive industry, which is also present in the area. One reason for these low salaries is the high social costs associated with increasing salaries.
Source: Interviews with SMEs in Timis, June 2011

To exacerbate the problems, many of the footwear-related vocational schools in the area have closed down, with only one school remaining in the city; therefore employers have tended to provide only quick on-the job training. At the same time, the lack of education institutes limits the possibility for further development and training in entrepreneurship.

The shortage of skilled workers is a problem for Romania as a whole, as illustrated through the 2011 Talent Shortage Survey[69] undertaken by Manpower. In this survey, Romania was ranked as having the greatest difficulty finding the right people to fill jobs in the European region, with 53% of employers admitting having difficulty filling critical positions. The reasons for this were listed as:

69 Manpower Group (2011): Talent Shortage Survey results

- candidates lack the necessary experience (28%);
- there are no available applicants on the market (24%); or
- there is a considerable lack of "hard" job skills or technical skills (22%).

5.3.2 High Social Costs

While labour taxes and additional costs are the same for all industries, the high level of taxes and social costs was one of the reasons highlighted by footwear industry stakeholders for the low level of salaries given in the sectors. Box 5.3 provides and example of this.

Box 5.3: Concerns about the Social Costs of Employment

A company working under Italian ownership in the *lohn* system was struggling to find workers. After two years of stagnation, 2011 was the first year that there has been an increase in the salary of the employees (+7%). The company also introduced other benefits, such as free transport to the factory for all the employees.

Additional labour costs were one of the reasons the company refrained from increasing salaries, especially in light of the decreasing demand for its products in recent years. Labour costs in Romania carry additional costs above the income tax and the national insurance contribution of the employees. On top of the net salary employees have to pay the following costs:

- 16.0% income tax
- 10.5% employee mandatory pension contribution
- 5.5% employee mandatory health contribution
- 0.5% employee unemployment contribution

With the above costs a gross salary rate is established. On top of the gross salary the employers are subjected to the payment of the following:

- 0.85% contribution for medical leaves
- 5.2% health fund contribution
- 0.5% unemployment fund contribution
- 0.25% or 0.75% commission for Labour Office
- 0.25% of the salary fund – guarantee fund
- 0.15% - 0.85% work accidents insurance fund

Sources: Interviews with SMEs in Timis, June 2011; additional data from Capital Consulting, http://www.capitaltaxconsulting.com/international-tax/romania/romanian-social-security/

While enterprises are often unwilling to increase their salaries, as it would make production in the country unprofitable in comparison to Albania and the Ukraine, the low wages in the sector is one of the main reasons for the problem of a shortage of skilled staff, discussed in Section 5.3.1.

5.3.3 Limited Availability of Support

Following its accession to the EU, Romania became eligible for EU Structural Funds to support the development of its economy. Between 2007 and 2013, community funds amounting to approximately €29.5 billion are available, of which over €19 billion are structural and cohesion funds.

However, apart from a few examples, footwear manufacturing companies in the area indicated that they were unable to access these funds. They claim this is because the funds are limited to enterprises with Romanian ownership. However, our case study found one example of a company participating in structural funds programmes despite its foreign ownership.

With no additional central support, companies claim that they are unable to finance technological development, even though it was noted throughout the case studies that investment in new machinery was necessary. One company we interviewed claimed that it was promised support for investment, but did not receive it. However, the company was unable to provide evidence to justify this claim, or to provide reasons why the promised support was not received.

As this case highlights, the companies we interviewed feel that their initial investments could be further strengthened by local and national incentives, therefore foreign owned enterprises often request funding support from the Romanian Government. There are examples of local footwear manufacturing enterprises competing successfully for structural funds projects, primarily based on the programmes of the European Social Fund. Box 5.4 gives an example of this.

Box 5.4: Success in Gaining European Social Fund Support
A local company manufactures women's shoes under the *lohn* system for an Italian owner. It has a production capacity of 150,000 pairs per year and employs around 200 people. When the company was established, it received tax reductions as an incentive from the national government. In 2007 it tendered for and won a project under the Romanian Structural Fund which enabled it to launch two projects assessing and implementing ways to improve health and safety conditions for employees in its factory.
Source: Interviews with SMEs in Timis, June 2011

5.3.4 *Lohn* System

Companies working under foreign ownership in the *lohn* system have no involvement in market strategies or investment policies. According to the statistics of the Ministry of Economy and Trade, *lohn* production represented 13% of exports in 1989; by 1996 this number increased to over 31% and by 2005 it was 34%, with the main products manufactured under this process being clothing, textiles, footwear and leather goods. Box 5.5 provides an example of footwear manufacturing under the *lohn* system.

Box 5.5: Footwear Manufacturing under the *Lohn* System
An SME in the Timis region is owned by, and manufactures products for, an Italian mother company. The Romanian manufacturing site has no direct access to the markets for its products. All the raw materials it uses are provided from Italy. Some of the additional components, such as laces, needles and the merchandise boxes are made in the Timis region, but by similarly Italian owned companies. In effect, this constitutes an Italian cluster within the Timis region. Once the manufacturing process is complete, the final products are transported back to Italy.
Source: Interviews with SMEs in Timis, June 2011

One of the concerns about the *lohn* system is its long term instability and lack of integration into the local economies, meaning that the system does not support local development. Foreign owners can rapidly move their production to countries offering cheaper labour and better financial incentives, thereby leaving employees in Romania out of work. For example, Geox sold its facility in Timis in 2009 to a partner. The company indicated that this decision was that the small production volume did not justify owning a factory in Timisoara[70]. In this case, the former Geox staff were re-hired by the new owner.

Additionally, under the *lohn* system, Romanian manufacturers are not involved in setting business objectives, strategies and development. This limits their ability in gaining information on and access to up-to-date technologies; consequently their skills and competences are losing value[71].

As the majority of manufacturers with Italian ownership work under a *lohn* system and have no leverage in determining their supply chain, their networking partners in the industry are selected by the mother companies located outside of Romania. In the majority of cases, these companies collaborate with local component makers that are also under foreign ownership, effectively forming a foreign cluster within Romania; therefore the Romanian supply chain is severely constrained.

5.4 Strategies to Address the Problems

5.4.1 Introduction

The case study interviews highlighted the differences between independently operating companies that can develop their operation and those working in a subcontracting system. The former have the opportunity to respond quickly to changes in the market and to make use of the geographical advantages of their location, while the strategies of the latter are determined by the competitive position of their mother companies.

70 http://www.zf.ro/zf-english/geox-sells-shoe-plant-in-timisoara-4566206/

71 Bugnar M (2008): **Lohn production – an economic or social measure?**

By adapting to market changes in this way, independently-operating companies may also have the opportunity to address some of the other key problems identified, such as the shortage of skilled workers by offering higher salaries. However, companies working within the *lohn* system have limited scope to address the challenges faced.

5.4.2 Reorganisation

In response to the on-going economic crisis and the associated reduction in demand, together with increasing Asian competition, manufacturers are increasingly rethinking their strategies and looking to cut costs. This could further impair the position of the manufacturers in the area. The example of the independently operating Romanian company (see Box 5.6) shows that, while its operation was restructured to focus completely on footwear manufacturing in recent years, the company has managed to develop and maintain modest but solid growth.

Box 5.6: Successful Reorganisation as Part of a Local Business Strategy
The company manufactures of one of the most well known Romanian brands. From its privatisation until 2009, the company manufactured a wide range of products apart from footwear, including leather substitutes and lighting appliances. However, due to increased competition, it withdrew from all other markets and focussed only on footwear manufacturing. The reorganisation had a negative impact; until 2008 the company's turnover was €6,000,000; after closing down its leather substitute production this reduced to €1,500,000. It also resulted in a loss of employees, overall the enterprise was forced to make 270 people redundant. Currently it employs 97 workers with a production capacity of 30,000 pairs/year. The company was forced to restructure its production process by reducing the area of production, thereby obtaining a 75% reduction in costs. The firm has now employed a new designer and is working on extending the range of its products by manufacturing fashion shoes for young women.
Source: Interviews with SMEs in Timis, June 2011

While there are examples of Romanian footwear manufacturers trying to maintain their market position, in the absence of local and national support, many companies succumbed to the pressures of the economic crisis and the increased competition and went out of business (see Section 5.1 and Table 5.5).

5.4.3 Extending the Range of Products

One independently operating company has seen a rise in demand for its products (see Box 5.7). The objective of the company is to keep increasing its turnover by 15% per year until 2015 and to establish mono-brand shops in every Romanian city with more than 100,000 inhabitants. To achieve this, the company is set to expand its line of shoes and hopes to have 100 different models for each season.

Box 5.7: Expansion through Extending the Range of Products
The company only supplies products to the Romanian market. Its main lines of footwear are casual and fashion shoes, mostly for middle aged women. The average retail price of its products is €50-100 (the company has a profit margin of 10-15%). In order to ensure continuous growth, the company has decided to extend the range of its products and introduce a new line of shoes for younger women. This step is considered an important one in the company's history, as it seeks to extend its consumer base as well as to open a line of shops in all major cities in the country. In order to support this growth and the increased production, the company has bought property for a new a factory site.
Source: Interviews with SMEs in Timisoara, June 2011

5.4.4 Training

One way in which SMEs could address the shortage of skilled staff is to train staff themselves. However, one of the companies we interviewed noted that it doesn't invest in any qualification programs; unfortunately almost all local vocational schools have closed down, and the nearest education centre is in Moldavia. New staff are simply introduced to the machinery on their first day of work. However, the company is investing in training of a designer (see Box 5.8).

Box 5.8: Addressing the Issue of Staff Shortages Through Training
In order to ensure continuous growth, a company manufacturing fashion shoes has decided to introduce a new line of shoes for younger women. To assist with this process, the company is working with a young designer fresh out of university. To make sure she develops the necessary skills they take her along to all the major international fairs, in order to familiarise her with the new trends and processes.
Source: Interviews with SMEs in Timisoara, June 2011

5.4.5 Constraints on Strategies

The fact that three of the four case study SMEs were part of the *lohn* system has severely constrained their ability to adopt strategies to address the problems identified in Section 5.3. Not only does the *lohn* system constrain the ability of companies to develop and adopt their own business strategies, foreign ownership also appears to limit their access to financial support for restructuring.

Lohn companies in particular rely on low cost production to remain competitive, especially since their foreign owners have the ability to shift production to lower cost regions outside the EU. Therefore they have limited scope to increase salaries to workers to address the problem of a lack of skilled workers.

Both *lohn* and independent footwear companies suffer from the high social costs of employment and there is little scope for companies to address this problem, which exacerbates the issue of low wages failing to attract skilled staff. The fact that all but one of the footwear-related vocational training schools in the region have closed down is also an issue that SME enterprises find it difficult to address by themselves.

5.5 Use of Supporting Services

5.5.1 Introduction

The case study interviews have not identified any financial incentives specifically targeting footwear manufacturers. However, there are a number of support mechanisms accessible to small and medium-sized companies in the region, to support their development and their growth. These mechanisms include measures introduced by the Romanian Government and the local Chamber of Commerce, as well as support through EU structural and cohesion funds.

5.5.2 Support for Technical Unemployment

In order to maintain competitiveness whilst minimising the loss of jobs, the government of Romania introduced a measure to support companies through the financial crisis in 2009-2010. In 2009 an estimated one million people across the whole of Romania benefited from this measure (no details are available of how many people in the footwear industry received such support)[72].

Enterprises were given the possibility to stop production as opposed to shutting down completely, and to place their workers on a so-called technical unemployment or suspension of employment. Provided this does not exceed a period of three months, employers are exempt from payment of taxes and contributions to the state budget. Regarding the payment of salaries and social contributions during the period of technical unemployment, the Government was supporting employers through Emergency Ordinance no. 28/2009 published in 25 March 2009, according to which[73]:

> *"Article 2. - (1) During the temporary interruption of employer's activity as by art. 53 (1) of Law no. 53/2003 - Labor Code, but not for more than 3 months, the employer and employees are exempt from paying social security contributions related to salaries, and the employees shall receive an allowance of not less than 75% of their basic salary corresponding to their workplace.*
>
> *2) the allowances paid to the employees, of at least 75% of the basic salary corresponding to their workplace, paid during the temporary interruption of the activity as by Article 53. (1) of Law no. 53/2003 - Labor Code, are not included in the income and therefore are not taxable for a period not exceeding 3 months*

72 Information from SeeEurope.net: ROMANIA: Trade Unions Plead for Technical Unemployment, available from: http://www.seeurope.net/?q=node/18912

73 Downloaded from Ascent Group Romania website http://www.ascentgroup.eu/en/ramona-bosinceanu/blog/during-the-technical-unemployment-employers-and-employees-are-exempt-from-payment-of-taxes-and

> *as by the provisions of the Law no. 571/2003 - the Tax Code regarding the income tax."*

This support was utilised by one of the case study enterprises that decided to cease production for three weeks during 2009-2010, due to the loss of demand in the EU market.

5.5.3 Regional Development and Social Fund

Following its accession to the European Union in 2007, Romania became eligible for more than €19 billion of the EU structural and cohesion funds[74].

Investments supported by these funds are aimed to minimise economic and social disparities between the old and the new Member States. While these funds are allocated under main objectives such as increasing competitiveness, and not specifically targeting industries, the funds are accessible by SME footwear manufacturing companies.

One of the challenges highlighted most often by companies we interviewed was that companies operating under foreign ownership have not been considered eligible for submitting tenders for these funds. Therefore, necessary infrastructural development has not been undertaken. An example of this is provided in Box 5.9.

Box 5.9: Problems Caused by Lack of Access to EU Development Funds

A medium-sized footwear company currently has more orders coming in than it can deliver. Therefore it would be beneficial if it could increase its production capacity. The company would also like to buy a permanent site for the factory, as its current location is rented, and to invest in new machinery.

However, as the company is under foreign ownership, it cannot access to EU Development funds, which target Romanian companies. As there are no other sources which offer funding for investment in machinery, the enterprise has been unable to make these investments and consequently the potential to expand the business has been lost.

Source: Interviews with SMEs in Timisoara, June 2011

In contrast to the example in Box 5.9, one Italian owned company we interviewed was able to gain access to the European Social Fund to finance a programme aimed at improving working conditions and health and safety aspects at its workplace.

5.5.4 Chamber of Commerce

Support to increase collaboration and networking of Romanian companies, as well as foreign investors, is available through the regional Chamber of Commerce in Timisoara.

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74 Commission of the European Communities: **Regional Policy Atlas** http://ec.europa.eu/regional_policy/atlas2007/fiche/ro_en.pdf

In order to facilitate interactions with companies from the two neighbouring countries (Serbia and Hungary), the Chamber organises regular meetings between stakeholders. The Chamber of Commerce also serves as a point of contact for foreign owned companies and provides legal advice for them regarding investment opportunities. It is also helping Romanian SMEs by maintaining an EU office to provide information related to trade and incentives on the common market.

It has been pointed out, however, that even though there are 364 footwear manufacturing companies registered with the trade registration office, only 15 are members of the Chamber of Commerce. This is partially due to the fact that registration for membership at the chamber requires companies to have a positive turnover for the previous year.

5.6 Potential for Additional Support

5.6.1 Introduction

Depending on the ownership of the footwear manufacturing companies their priorities may differ. In the case of foreign ownership, the investors received tax incentives at the time of relocating their production to Romania. The government understandably considers that the competitiveness of these enterprises should not be supported from Community contributions such as the Structural Funds, which are aimed to mitigate the differences between the less and more developed regions of the European Union. However, as national productivity and employment are strongly impacted by the efficiency of foreign owned companies, their contribution to the economic figures could be further supported by other financial measures.

For Romanian owned companies, access to financing for infrastructure and human resource development is crucial in order to match the production efficiency levels required in the international market and to gain the necessary skills and expertise.

Small and medium-sized companies interviewed identified a number of areas where additional support would be welcomed, including:

- support to improve infrastructure; and
- increased support for competitiveness and networking.

5.6.2 Support to Upgrade Equipment

Several of the companies interviewed indicated that they were not considered eligible to tender for regional development fund programmes, due to their foreign ownership, and therefore had no access to funds aimed at developing their infrastructure.

The enterprises interviewed all reported growth for the past two years and wish to invest in developing their capacity. Often these companies are working at full capacity, having to delay or refuse orders, because their out of date machinery means that their production capacity remains below that of their competitors. Investing in new machinery could also have a beneficial impact on employment and general working conditions, as companies are considering buying bigger and larger factory sites.

Increased financial support for investment by Romanian SMEs, ensuring that foreign-owned companies have access to structural funds, could provide a considerable incentive for expansion of the footwear industry in the region.

5.6.3 Competitiveness and Networking

While there have been examples of industry collaborations with stakeholders in neighbouring countries, as geographical proximity to Serbia and Hungary provide the potential for regional cooperation, the impact of these collaborations have not been widespread.

The Timisoara Chamber of Commerce (TCCIA) organises regular events for stakeholders from Serbia and Hungary, to increase collaboration, and also lobbies for more support for the industry at the ministerial level. However, interviewees indicated that participation in the events organised by Chamber is limited to member companies.

Support for a long-term development of a cluster in the region (not necessarily limited to Timis county), rather than individual companies, could provide further support to companies, most of which operate outside the new industrial parks to increase production capacity through networking with local stakeholders. A strategy guide for 2004-2040 developed by the Timisoara Chamber of Commerce together with the Managers and Economic Engineers Association from Romania (AMIER), entitled Competitive Romania Programme 2004-2040 (ROK 2040) pointed out that classic four year strategic plans cannot assure a rapid increase of competitiveness in the local industries. Therefore the programme aims to increase the competitiveness of networks of industrial and agricultural companies by running pilot projects on incorporating and utilising the Local Economic and Employment Development procedures developed by the OECD[75].

5.7 Summary

Timis is one of the most developed counties of Romania and was a once booming centre of footwear and textile manufacturing. By now only approximately 150 companies remain, mainly SMEs and most of them working with foreign capital.

Foreign direct investments are characteristic of the region and Italian companies are predominant in the ownership of footwear and component manufacturing companies in Timis County. Many of the companies in the sector work in the *lohn* system. This

75 Horia Liviu Popa *et al* (2004): **Competitiveness development of SME cluster in the Timisoara zone region 5 west in Romania**.

means that the Romanian company supplies the premises and the personnel but all management decision and strategies are handled by the Italian owners. Consequently, the Romanian enterprises and the management operating with this system do not develop their strategic and marketing competencies. Whilst providing a cheap and rapid means of entering the market, this system risks instability in the longer term, as the contracting companies can quickly move their production to other countries with cheaper labour, and does not necessarily support local development.

The key problems faced by the sector include a shortage of skilled workers, high social costs and limited financial support for investment in upgrading equipment. In comparison to these challenges, the main advantage of the Romanian footwear sector remains its cost competitiveness, even though nearby countries such as Moldova, Bulgaria and Albania are providing competition.

6. DIFFICULTIES FACED BY SMEs AND PROSPECTS TO OVERCOME THEM

6.1 Characteristics of Footwear SMEs

6.1.1 Number of Companies and Employment

Maintaining the competitiveness of small and medium-sized enterprises is a key factor of the overall performance of the European economy. The majority of companies in Europe are categorised as micro or small and medium-sized enterprises. According to Eurostat[76], in 2008 there were approximately 20 million active enterprises within the EU-27 business economy (excluding the financial sector); 99.8 % of these were SMEs and 91.8% of them were micro enterprises.

Similar percentages are reflected in the footwear manufacturing sector. However, there are discrepancies in the data available from different sources. Eurostat estimates that there were 22,501 footwear enterprises in 2008, of which over 90 percent (22,368) were SMEs; unfortunately Eurostat has no more recent EU-wide data on SMEs for the sector in the EU27. By contrast, the CBI study[77] indicated that the footwear sector in the EU comprised only 13,500 SMEs in 2008.

Employment in the footwear manufacturing industry is concentrated in smaller enterprises, which employed approximately 198,000 people in 2008; large companies account for less than 15%[78] of the workforce. The majority of staff are employed in micro enterprises, with fewer than 10 staff.

The three regions covered by the case studies all have an important role within their national footwear industry. According to the Asociación de Industriales del Calzado de Elche, 40% of Spanish footwear companies are to be found in the cluster of Elche (within Valencia). The footwear industry in the region of Emilia-Romagna is smaller, but includes several clusters between Forli and Cesena. Prior to 1989, Timis was a centre for the footwear and textile industries in Romania. It still accounts for a high proportion of footwear manufacturing firms in the country, but has now become the hub for Italian and German firms that have outsourced their manufacturing processes. The majority of footwear firms within the three regions are SMEs:

- 94% of the 250 enterprises in the San Mauro Pascoli cluster of Emilia-Romagna are small or micro enterprises and the 85 enterprises remaining in the Bagnacavallo-Fusignano cluster employ fewer than 10 staff on average;
- over 99% of the 1,130 footwear companies operating in Valencia are SMEs and a high proportion of these are family firms; and
- around 95% of the 150 footwear manufacturing companies in Timis are SMEs.

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76 Eurostat: *Statistics in Focus, Industry, Trade and Services 31/2008*

77 CBI Market Survey (2010): **The Footwear Market in the EU**.

78 Commission of the European Communities (2009): **European Industry in a Changing World Updated Sectoral Overview**

6.1.2 Types of Products

In all three regions, SMEs undertake a wide range of footwear-related activities, from raw material supply (including tanneries), component supply, design, footwear manufacture and support services such as IT. The number of suppliers is significantly larger than the number of footwear manufacturing companies; for example, AVECAL's member companies in Valencia have around 3,500 employees within the footwear sector and 9,000 in total, including suppliers (unfortunately, no similar data are available for the other regions).

In Emilia Romagna, the cluster of San Mauro Pascoli is focused on the manufacture of women's shoes for the luxury/premium segment of the market. By contrast, in the Bagnacavallo-Fusignano cluster the majority (approximately 80%) of products manufactured still target the low priced segment.

Footwear SMEs in Valencia operate in a variety of product segments, including children's shoes, slippers and comfort shoes and women's fashion shoes. It is notable that none of the SMEs currently manufactures products for the lower price footwear segment, particularly men's shoes, as they were unable to remain competitive.

Timis has now become a hub for Italian manufacturers outsourcing all or part of the manufacturing process.

6.1.3 Main Markets

Footwear SMEs in Emilia Romagna are strongly focused on export markets. Two thirds of the outputs of the San Mauro Pascoli cluster are destined for export, mostly to the higher end markets in the European Union, Russia and the Far East. However, exports reduced significantly between 2009 and 2010. The Bagnacavallo-Fusignano cluster was also strongly focused on low-cost exports in the past, particularly to central and eastern European and the United States. However, competition from lower-cost countries has meant the loss of many of these markets.

Many of the SMEs in Valencia previously focussed solely on supplying to the Spanish market. However, the on-going economic problems of the country meant that demand has reduced significantly. Therefore, companies are seeking to compensate for the loss of their home market by increasing exports. One of the most important, emerging markets for SMEs in Valencia, after the EU, is Asia (primarily China and Japan).

The majority of footwear products manufactured in Timis are for export. For companies that undertake outsourcing for manufacturers from Germany or Italy, the main immediate markets are other EU Member States. However, some of the products are then exported by the mother companies outside the EU, to the USA and Russia. Only one of the companies we interviewed operates independently; its main market is domestic.

6.1.4 Business Models

SMEs within the three regions have adopted different business models; however, sub-contracting and outsourcing of various types play a key role in each region.

Italy has traditionally merged footwear businesses into industrial clusters. The organisational structure of these industrial clusters is mainly based on vertically disintegrated supply chains. Leather is sourced from a variety of locations around the world; however, other raw materials are generally purchased locally. While subcontracting of operations such as stitching has been decreasing, established inter-firm relationships are a widespread feature. The more informal nature of inter-firm relationships, especially within the cluster, is another important factor supporting the development and flexibility of SMEs.

Many of the SMEs in Valencia undertake at least some outsourcing of production; in many cases, the outsourcing is to other SMEs within the region. This can range from contracting out individual production operations to outsourcing the entire process, from design to finishing.

In contrast to the other two regions, the footwear industry in Timis is dominated by outsourcing from manufacturers in other countries, particularly Italy. From the 1990s, outsourcing to Timis was dominated by the *lohn* system, in which the contractor provides designs, material and equipment and the local company provides only the labour and the workplace. Whilst providing a cheap and rapid means of entering the market, this system risks instability in the longer term, as the contracting companies can quickly move their production to other countries with cheaper labour, and does not necessarily support local development.

6.2 Key Problems Faced by SMEs

6.2.1 Introduction

SMEs located in the three regions faced a number of significant challenges in maintaining and expanding their operations. These included:

- reduction in demand and increased competition;
- access to finance;
- availability of skilled labour;
- access to technology, particularly IT; and
- increasing costs of raw materials.

The impacts of the problems varied by region and to some extent by company type.

6.2.2 Reduction in Demand and Increased Competition

Reduction in demand is an issue across the European footwear industry. The drops in output were steepest in 2008-2009, but according to the 2011 Plimsoll financial analysis, which looked at the performance of the top 350 companies in the industry, over half of the companies analysed recorded a drop in sales during 2010, of up to 16%. An average company in the footwear manufacturing sector is currently experiencing a sales reduction of 3.7% per year, while one in three companies can expect to see an average increase of 10% in their sales[79].

The footwear industry in Italy experienced a sharp decline in production value and quantity, amounting to a 12% reduction (198 million pairs, €6.5 billion) in 2009[80]. In 2010 the losses continued, although on a smaller scale as the number of shoe manufacturing companies has reduced by 3.7% (224 factories closed); the number of employees was also reduced, with an average 3.3% (2,754 jobs lost) compared to 2009. Short-term economic indicators from the Italian Footwear Association, though, indicate that the value of production increased by approximately 4% in 2010 compared to the previous year[81]. The Bagnacavallo-Fusignano cluster in Emilia Romagna was home to more than 200 companies employing 3,000 workers in the early 1980s; by 2005 there were only 85 companies remaining, employing 800 people[82].

One of the key issues faced by footwear SMEs in Valencia is the reduction in domestic demand for their products, due to both the impacts of the economic crisis on consumer spending and the impacts of competition, particularly at the lower end of the price scale. The number of companies in Valencia has reduced by 37% since 2005. One of the most significant reductions in the number of enterprises took place between 2006 and 2007, when approximately 10% of the companies went out of business; since then the rate of reduction has been slowing down. According to the regional footwear association, more than 25% of companies were forced out of business during the last five years, with approximately 30% of the remaining enterprises facing serious difficulties. All of the companies we interviewed had experienced a reduction in domestic demand, though the impacts on their overall business varied.

In Timis, there has also been a significant drop in the number of footwear SMEs. The region is highly dependent on demand from companies that have outsourced their manufacturing operations. This places the companies at risk, should the mother company decide to change its activities or to move production to even cheaper locations, as they have no direct access to the markets for their products.

Information from the case studies confirms that the companies most affected by reduced demand are those focusing on domestic markets, which have been hit by the recession (particularly in Spain), and those producing lower-priced footwear, which is most vulnerable to foreign competition. Companies which produce higher-quality

79 Plimsoll Worldwide Business Intelligence (2011): **The Footwear Manufacturers European Industry, a comprehensive financial analysis of the top 350 companies in Europe**.

80 ANCI Servizi Srl: The Italian Footwear: Industry, Preliminary results 2010

81 ANCI Servizi Srl: The Italian Footwear Industry- Preliminary results 2010

82 Emilia-Romagna regional portal: downloaded from http://assemblealegislativa.regione.emilia-romagna.it

products, which have identified niche markets and which are able to compete in export markets, have been better able to maintain their turnover. This contrast is starkly demonstrated by the differences in impacts on the San Mauro Pascoli and Bagnacavallo-Fusignano clusters in Emilia Romagna.

This mirrors the findings of Rabelotti[83], that Italian footwear companies faced different types of increasing competition:

- competition from low priced imports from outside the EU;
- competition within the EU from new forms of organization in the value chain, for example:
    - from vertically-integrated large fashion companies such as H&M or Zara (the medium price segment), or large distributors such as Deichmann or Reno (low to medium-priced segment). In addition, a new low priced segment has emerged outside the specialist footwear retail sector, with low-price supermarkets such as Aldi or Lidl, which sell very low-price imported shoes; or
    - in the luxury segment by high value fashion brands, which added shoes to their product range in the 1990s.

In response to this increased competition, SMEs could target particular market niches where they might achieve a better price, because these are not the focus of large companies, such as:

- the niche between medium price and luxury footwear, combining quality, fashion and customisation,
- the comfort shoes segment; or
- the functional and health shoes segment.

In general, though, the level of competition will remain high. The fashion aspect of footwear has always been important, and is increasingly so. Nearly all categories of shoes are made in response the perceived demands of the customer and in the hope that they will be purchased. Some footwear SMEs are highly professional with good, strategic plans and they invest in the future. Many others are small, family owned and run, and are effectively living hand to mouth, depending on the major retailers or brands for future product orders and sometimes technical advice.

6.2.3 Access to Finance

Access to longer-term finance is crucial for small and medium-sized enterprises to set up or expand their operations, particularly within deteriorating market conditions. SMEs often find it more difficult to obtain finance than larger companies; they have fewer assets against which to secure finance and they may also have less awareness of potential finance sources. This can negatively impact their ability to innovate, train

[83] Rabelotti, R (2004). *How globalization affects Italian industrial districts: the case of Brenta*. In H. Schmitz (ed), **Local enterprises in the global economy - Issues of governance and upgrading**.

employees or simply restructure their operation. Therefore their potential to break out of a bad economic cycle is more limited.

Obtaining short-term financing is also important to bridge the gap between invoicing and supply chain payments. Footwear manufacturers (and SMEs in particular) have traditionally been squeezed financially by both ends of the supply chain. Distributors often make it a condition of trade that they will take longer to pay (their argument is that they take the risk by stocking the products for the longest time at the highest value, and do not receive payment from the customer until the shoes are sold). The footwear manufacturers have to pay their materials and component suppliers promptly, as they are individually a very small part of the customer base. In Valencia, for example, while companies are obliged to pay their raw material suppliers within 60 days, consumers/buyers are paying on 90 day terms and manufacturers are forced to bridge the invoice gap from their own resources.

In the case of both Emilia Romagna and Valencia, companies are struggling to find sources of finance, particularly as the economic crisis has led to the merger of the local banks that were previously their primary source of lending. In the current economic climate, financial institutes simply do not loan the same amounts of money as before; they can also renegotiate conditions on existing loans. As a result, even successful companies have cash-flow problems.

Both in Emilia Romagna and in Valencia, one of the concerns for enterprises was the lack of information on the available options for financing; companies were unaware what sources of finances would be most suitable for them to utilise. This is supported by the findings of Handke[84] that SMEs in Alicante lack knowledge of finance and do not appear to be aware of financial tools to improve liquidity, such as factoring or leasing. The SMEs we interviewed had not been able to identify innovative ways to overcome the problem of lack of access to finance. Although one company in Valencia commented that the national footwear association is helping to fund expansion of footwear manufacturing by trying to network customers with producers, in the main SMEs appeared to be simply putting expansion plans on hold until the financial climate improved.

Although SMEs in Timis mainly undertake outsourced manufacturing, and are therefore less directly affected by problems of access to finance (especially if the contracting company supplies their raw materials), there is an indirect impact. As contracting companies struggle with financing, they are less able to expand or even maintain their operations, potentially leading to the stagnation of the industry in Timis.

[84] Handke, M. (2009): *Flexible Finanzierung in Industriedistrikten Spaniens?* Das Beispiel Alicante. Zeitschrift für Wirtschaftsgeographie (The German Journal of Economic Geography) 53, pp1-13.

6.2.4 Availability of Skilled Labour

Finding skilled workers has been highlighted as a particular concern in Emilia Romagna and Timis, although it was not identified as a problem in Valencia (where there are few other employers). A lack of skilled staff limits the potential for expansion of SMEs in the footwear sector and makes it harder to maintain a high-quality output. Rapid turnover of staff, which is a particular problem in Timis, increases costs and also absorbs management time. The reasons identified by SMEs for their problems in finding and retaining skilled staff are different in Emilia Romagna and Timis, as summarised in Table 6.1.

Table 6.1: Reasons for Shortages of Skilled Staff

Emilia Romagna	Timis
Lack of succession planning by family businesses Unattractiveness of the industry for young people (due to lower wages) Lack of involvement of staff in developing strategies and objectives	Low wages compared to other sectors High overhead costs of labour Lack of interest from foreign owners to invest in human resource development

In Emilia Romagna some of the small, family owned businesses have been struggling to find and keep skilled staff. This is despite the fact that many firms have closed down in the area, leading to redundancies amongst footwear workers. It appears that skilled staff prefer to leave the industry and seek better-paying jobs elsewhere. The SMEs have attempted to address the problem by contacting local or regional education institutes and establishing partnerships. Alternatively, companies are hiring unskilled staff and providing them with in-house training. This does not, however, provide a solution to the shortage of staff with design skills. The resulting collaborations between universities and enterprises do, however, have a positive impact in supporting the education and training of students and whilst helping to develop skills and knowledge applicable to the local and regional needs.

A particular issue for traditional family businesses is a lack of succession planning. Many family owned businesses are unable to continue production due to a lack of interest by second or third generation family members in maintaining the business. This is an issue not only for manufacturing companies but also for suppliers (and, indeed, for all types of family business, not just those in the footwear sector).

In Romania, the main reason for the lack of skilled staff is also the low level of wages compared to other sectors. The appearance of high-tech investors in the region has given rise to new skill demands that are better remunerated. Therefore, skilled workers have either retrained for the new industries or decided to leave the area. In addition, foreign investors have little incentive to invest in human resource development.

6.2.5 Access to Expertise and Technology

A key issue for Romania is that the business model followed after privatisation, focusing on low-cost production for foreign partners, provides limited incentives for skills and technology development. As the country had a long tradition of light industry, and had built close ties with other countries in the region, it was expected that some of the privatised companies bought by their employees would serve to re-establish the industry. Apart from a few examples, though, companies were bought by foreign investors and the country has become an outsourcing location. The companies that remained in Romanian ownership struggled to gain market access in Europe and many of them eventually closed down due to increased competition and lack of support. The *lohn* system was successful in guaranteeing employment and providing significant trade and investment opportunities. However, this advantage may quickly come to an end if there is no upgrading of companies (e.g. development in the fields of design, marketing, distribution etc., both to local and export markets).

Enterprises in Elche in Valencia were in a similar position to that of Romanian companies in the 1950s, when foreign investors from the United States decided to close their factories and move production to cheaper locations. Following nearly a decade of low-cost manufacturing for foreign owners, both a skilled Spanish workforce and technology were available. Initially, in the 1970s and 1980s, the Spanish footwear industry attempted to further reduce costs (often by shifting into clandestine production to avoid taxes, social security expenditures etc[85]). However, this strategy was not successful, given the rising wages in Spain and the rising currency against the dollar. Later on, using local incentives to facilitate entrepreneurship, previous employees founded their own companies, utilising their skills. The main positive factor was, however, market diversification (principally to the German, French and British markets) and improvement of market access through own distribution and own brand (1990s and beyond)[86].

However, the circumstances for Elche in the 1950s were rather different from those in Timis today, which limits the lessons that can be learnt from this experience:

- the spatial division of labour in labour intensive industries was not yet developed, so companies were not prepared to relocate parts of production (e.g., upper production) abroad;
- Spain was not integrated into a regional market and had its own currency, resulting in different trade policies and export promotion policies;
- the US market was open to imports of low cost shoes at that time, and this was organized by large retail companies, not the footwear producers; and

[85] Herrero, G.P. and Puche, A. M. 2003: Factores de impulso en la configuracion de un territorio innovador: La contribucion del entorno al sistema productivo del calzado alicantino. *Investigaciones Geograficas* 32, 39-63.

[86] Miranda-Encarnacion, J. A. (2001): En busta del tiempo perdido: la conquista del mercado exterior y el desarollo de la industria de calzado en Espana de la segunda mitad del siglo XX. *Revista de la Historia Industrial* no. 19-20, p. 165-203. (In search of lost time: the conquest of export markets and the development of the footwear industry in Spain during the second half of the 20th century).

- markets had not yet evolved to fashion, (international) brands were not yet important in most segments of the market.

As a consequence, Timis has relatively less to learn from early experience in Elche but more from strategies followed elsewhere, e.g. in Italy. For example:

- maintaining competitiveness by seeking cost reduction based on reducing wages, lower quality etc. is successful only for a very short period;
- invest as early as possible in improvement of quality and productivity, specialization of products and/or processes, in market access (own brand and own distribution) and market diversification;
- establish intermediary institutions assisting in this upgrading of the sector;
- accept insolvencies of weak companies and reduction of employment but promote young entrepreneurs;
- accept relocation of parts of production which deliver low value added (i.e., make active use of the global spatial division of labour).

6.2.6 Increasing Costs of Raw Materials

The rising and unpredictable price of raw materials was identified as an issue in both Valencia and Emilia-Romagna. This is a direct effect of increasing oil prices, which directly impact the contract prices of synthetic raw materials used to make polyethylene (such as purified terephthalic acid/dimethyl terephthalate (PTA/DMT) and monoethylene glycol (MEG) and polyester chips.

The problem is exacerbated because, while orders for shoes and contracts for production are often signed three months in advance, raw materials are paid for as production proceeds, and prices are set at the time of purchase. As enterprises do not have the leverage to change contractual terms for their products, they are forced to absorb the difference.

6.3 Strategies to Address the Problems

6.3.1 Introduction

While companies in Emilia Romagna and Valencia in have been adopting medium to long-term business strategies in increasing numbers, there is still scope for further development. According to the Valencia regional association, AVECAL, approximately 30% of its member companies make formal business plans and have effective business strategies. The remaining enterprises face difficulties adapting to changes and effectively identifying new market opportunities. This finding implies that 70% of SMEs do not have formal business plans. However, they may still have informal strategies to manage the future of their businesses. Nevertheless, the finding implies that a considerable proportion of footwear SMEs in Valencia may be operating on a day-to-day basis, without longer-term plans.

This is not an unusual position for SMEs. For example, research by a business insurance comparator of 400 British entrepreneurs indicated that 54 per cent of firms have no written business plan and more than two thirds of entrepreneurs make decisions on gut instinct alone (Simply Business, 2010).

Responses to our survey of business for Task 1 of the study questions gave slightly different results. Responding to the question: *Does your company have a strategy in place ...?* 16 out of the 23 companies (43%) claimed to have a 'medium term strategy' in place. Respondents were then asked to mention which actions had been taken in recent years. The emphasis of responses was focused on improving the production and selling of existing products through improved product design/quality, improved image/communication/service and product customisation.

A lack of forecasting and business planning can inhibit efficiency improvements as well as a lack of understanding of consumer demands and slow response to them. In Timis, the focus on outsourcing means companies do not have direct access to markets but are dependent on their mother companies. There is little scope for the companies to become involved in business planning and strategy development.

Extending the involvement of employees in setting strategies and long-term planning has been found to be a particular asset in keeping personnel. Companies in Emilia Romagna have been faced with the problem of finding and keeping skilled labour; one of the reasons given was that people felt unmotivated working in the industry as, even though they contribute to the success of the companies, they are not involved in the decision making processes. Involving employees in the development of objectives and strategies can assist with staff recruitment and retention, potentially allowing SMEs to develop and grow.

In response to the problems they face, SMEs in the three regions have adopted a number of different strategies. These include:

- seeking new markets;
- strengthening brand identity;
- rationalisation and outsourcing; and
- new marketing approaches.

6.3.2 Seeking New Markets

Positioning their products in the higher market segments and ceasing production of cheaper brands are ways in which both Emilia Romagna and Valencia SMEs have adapted to increased competition.

Additionally, almost all Valencia companies were seeking to access new export markets or to increase their presence in current ones. Most companies had been severely impacted by the contraction of the national market; in fact, in the region of Valencia, close to 25% of the companies had been forced out of business in recent years. The changing market environment and the loss of the national market requires

Valencia companies to attach a higher value on research and innovation as well as developing consumer services.

Export strategies and access to new markets are predominant in Emilia Romagna as well. For Timis, the fact that most footwear manufacturing is outsourced from Italian or German companies, and there is no direct access to markets, means that the scope to seek new markets is limited.

Exploring and understanding new markets can enable companies to successfully implement export strategies. The example of an SME in Valencia, which had re-entered the US market following a previously unsuccessful attempt, shows that assessing risks and distribution channels can significantly increase the potential for succeeding in new markets. The company decided that changes in the way its products would be sold in the US, with greater use of e-commerce by its distributors, offered a greater chance of success.

There are various ways in which footwear enterprises can gather information on foreign markets, for example through industry associations or various private consultancies aimed at helping footwear manufacturers to access third countries. However, SMEs often require more support to develop effective export strategies, including understanding market conditions and supply chain developments as well as calculating short and medium-term financial risks of entering new markets. They are also less likely to be able to afford the fees of consultancies to assist in this process.

Industry events, at both local and an international scale, are of crucial importance for SMEs in the footwear sector. Trade fairs, conferences and exhibitions can serve as a platform for conducting business but, most importantly, they are a source of market information. Not only do they provide an opportunity for promotion and marketing, they also allow manufacturers to review their current supply chain and extend it if necessary.

6.3.3 Strengthening Brand Identity

Strengthening brand identity provides a way for SMEs to expand their markets, for both high-end and lower price range brands. SMEs in both Valencia and Emilia Romagna have adopted this approach successfully. In Valencia, companies have survived difficult economic conditions by focusing their efforts on higher-quality brands and ceasing production of lower-priced, under-performing brands. A similar strategy was adopted by one of the few independent companies in Timis. However, this is not an option for the majority of companies in Timis, which only undertake outsourced manufacturing.

Brand awareness has also been the basis for campaigns for consumers, such as the *I Love Italian Shoes* campaign, organised by the Italian Footwear Association, and the *Made in Spain* label. SMEs consider that such campaigns can have significant impact on the demand for European products.

6.3.4 Rationalisation and Outsourcing

Rationalisation and outsourcing have been an important strategy for cost cutting in all three of the regions. Box 6.1 lists the cost cutting approaches adopted by SMEs in the two regions.

Box: 6.1: Cost Cutting Measures Adopted in Valencia and Emilia Romagna
• Ceasing production of lower price ranged products • Eliminating excess costs in marketing and administration • Use of management and business administration software tools • More efficient use of space in the factory • Outsourcing production to cheaper partners • Changing suppliers • Sourcing cheaper raw materials and components • Reducing profit margins

In all three regions, SMEs have stopped manufacturing brands or product lines that can no longer remain profitable in the face of increasing competition from outside the EU. These are generally the lower-price range products. Whilst this can mean a significant reduction in output for the SMEs concerned, with a consequent reduction in employment, it does allow the companies to remain in business. This means that they can focus on more profitable niche markets which will hopefully provide the opportunity for growth in future. This option is not open to the majority of companies in Timis, as their role as outsourcing centres for Italian and German companies means that they compete mainly on price.

In both Emilia Romagna and Valencia, SMEs have made increasing use of IT to reduce administrative and marketing costs. The most extreme example was an SME in Valencia, which replaced 58 management and logistics staff by making greater use of IT.

SMEs in Valencia had made significant use of outsourcing, primarily to other companies within the region (although some had outsourced to Romania or North Africa). The strong relationships developed through clusters made this possible. One company had outsourced all activities other than design of footwear and raw material purchasing. By contrast, SMEs in Timis mainly undertake outsourcing and need to keep their costs as low as possible to retain this business.

Although managing costs is essential for all footwear SMEs, manufacturers in Emilia Romagna and Valencia have realised that the low-cost, low-price business model is not one that can be maintained in the long run, as there will always be locations outside Europe where manufacturing can be undertaken more cheaply. This is a significant challenge for Timis in the longer run.

6.3.5 New Marketing Approaches

Another approach adopted by SMEs to address the challenges they face is the adoption of new marketing approaches. Companies in Valencia plan to rely increasingly on online sales. SMEs in Emilia Romagna did not yet appear to have adopted this approach, although one company upgraded its website, following our visit, to make it more consumer friendly.

Another approach being adopted by SMEs is offering greater customisation of products by buyers. This approach has been adopted by an SME interviewed in Italy (in the luxury segment) and is being attempted by one in Spain (in the medium-priced segment. As most companies in Timis undertake outsourcing, they do not have the opportunity to develop new marketing approaches.

6.4 Development of Clusters

Footwear enterprises in both Valencia and Emilia Romagna work in traditional industrial clusters, composed of manufacturers, suppliers and other participants in the supply chain. The footwear industry in Romania is more fragmented; even though the area of Timis hosts a large number of enterprises, these are mostly involved in the *lohn* system of production, thereby limiting their scope for developing local partnerships.

Industrial clusters can play a key role in preserving skills and knowledge within a geographical area as well as assisting regional and local companies in establishing industrial relationships. While horizontal clusters contain businesses with similar functions, vertical clusters house different types of companies belonging to the same supply chain. Where a cluster of footwear manufacturers can negotiate with a supplier, this may also result in better payment terms and potentially lower prices.

Italy has traditionally merged companies into industrial clusters; this is the case in Emilia Romagna. The organisational structure of these clusters is mainly based on vertically disintegrated supply chains. Leather is sourced from a variety of locations around the world; however, other raw materials are generally purchased locally. Italian enterprises have a strong reliance on collaboration within and between clusters. In Emilia Romagna, clusters are supported by a number of government measures. There have been national incentives to increase the competitiveness of the industry in general, such as Industria 2015, as well as localised programmes run through industry associations.

Valencia companies are also focussed on increasing collaboration within clusters; however, there are no central incentives such as those in Italy. SMEs in Valencia are open to innovation, as they also seek collaboration with educational and research centres within the cluster. The state of technological development is below that of Italy, but the need to compete for new markets (as their primary internal market has shrunk) is providing strong incentives.

6.5 Use of Supporting Services

6.5.1 Availability of Supporting Services

A range of supporting services is available to SMEs within the three region. These include:

- access to technology and educational centres;
- export assistance services; and
- promotional campaigns.

6.5.2 Technology and Educational Centres

Industrial collaborations horizontally, between manufacturers, and vertically along the supply chain are both extremely important for SMEs to gain up-to-date knowledge of technologies, trends and design. However, these can be enhanced though collaboration with technology centres.

In Valencia, the SMEs we interviewed had worked closely with the regional footwear technology centre on research and innovation projects. These projects included both product development (e.g. new soles) and software (design and software). SMEs in Emilia Romagna did not appear to have undertaken such collaborative projects, but a number had worked with regional education institutes to develop ways to address the lack of skilled staff.

Most manufacturers in Timis are subcontractors, and rely on their mother companies for innovation and technology development. There is therefore little scope to work with technology centres. Many of the vocational schools in Timis have now closed; the lack of educational institutes limits the potential for collaboration to address the issue of shortage of skilled staff.

6.5.3 Export Assistance

In Spain, opportunities are provided for companies to seek financial support for representation industry fairs. Both the Spanish Institute for Foreign Trade (ICEX) and the Valencia Institute of Export (IVEX) provide a 50% contribution to the cost incurred in relation to transport, accommodation and representation fees. These funds are not limited to micro sized companies or SMEs. Although the funds are seen as a valuable means of support, companies that are struggling financially are unlikely to benefit as they will not be able to finance the remaining 50% of the attendance and exhibition fees.

Such support is not available in Italy, probably because some of the most important fairs and exhibitions take place in the country, providing easier access for SMEs.

The fact that most Timis companies operate as subcontractors means that they do not export on their own account; therefore access to export assistance is not an issue. The

Timisoara Chamber of Commerce (TCCIA) does organise regular events for stakeholders from Serbia and Hungary to increase cross-border collaboration, and has lobbied for more support for such activities from the national government. However, this support is only available to member companies and only a small number of footwear SMEs are members, because of the Chamber's membership conditions.

6.5.4 Promotional Campaigns

Both Spain and Italy have instigated marketing campaigns to promote locally-manufactured products. The SMEs in Valencia and Emilia Romagna both indicated that these campaigns were valuable in retaining existing markets and accessing new ones.

SMEs in Emilia Romagna considered that the *Made in Italy* label does provide additional assistance to enterprises, as does the industry's representation via the associations at various policy levels. Italian market presence is strongly linked to the dynamism of SMEs, who were able to identify new markets and products and thereby identify niches.

Valencia SMEs rated the strength of the *Made in Spain* label as below of Italy and above that of Portugal. The label is growing in significance but is lacking the drive of big name designers and appears to remain little-noticed in large department stores.

The footwear industry of Romania is largely unknown to consumers in Europe, as manufacturing is undertaken mainly on behalf of companies from other Member States. It retains only a small presence in the national market.

7. CONCLUSIONS AND RECOMMENDATIONS

7.1 Conclusions

The footwear industry in the EU has faced significant challenges in recent years, from increased competition from low-cost manufacturers outside the EU and the impacts of the financial crisis. The latter has led to reduced domestic demand and difficulties in accessing finance. The challenges are likely to increase in future, with the growing importance of issues such as the environmental aspects of production, new supply chain organisation, the growth of 'fast fashion' and a demand for customisation, new developments in materials, IT and robotics.

SMEs comprise the majority of footwear companies within the EU, both in terms of numbers of companies and employment. Because of their more limited resources, SMEs are likely to be most impacted by changes in market conditions. In all three regions covered by the case study, the number of footwear SMEs has contracted significantly in recent years due to reduced demand and increased competition. They are also faced by rising costs for raw materials, which SMEs are required to absorb because their sales are often on fairly long-term fixed contracts, whilst their raw materials are purchased on a spot basis.

Access to finance has been identified by enterprises as a particular problem for SMEs, due to the limited availability of internal resources. They need access to loans not only for expansion and innovation, but to cover cash flow problems caused by different payment terms for suppliers and customers. This has become increasingly problematic following the financial crisis; the rationalisation of the finance sector has led to the closure of smaller local banks which provided small loans to footwear SMEs (with companies often taking out a number of small loans from different banks). Now companies are forced to seek larger loans from the larger banks which have replaced the smaller ones; these are not only more difficult to obtain; they also come with more demanding conditions and higher costs.

Industry representatives have listed access to skilled labour as another major problem in two of the regions, although it did not seem to be a problem in Valencia, where contraction of the industry has limited employment opportunities for the many skilled workers in the region. The problem in Emilia Romagna and Timis is due to a combination of factors, including the relatively low wages in the sector and the attraction of better-paying, high-tech industries. In Emilia-Romagna the problem is exacerbated by the high number of family firms where future generations are not interested in joining the business. In Timis, the high incidence of outsourced manufacturing, with foreign owners having little interest in personnel development causes further problems.

Despite these problems, however, the remaining SMEs in Valencia and Emilia Romagna have found ways in which to remain competitive and successful. SMEs have potentially significant market advantages, in terms of flexibility and closeness to customers, which firms have been able to exploit. In both Valencia and Emilia Romagna, one of the key characteristics of successful companies is a focus on export markets and a move to the higher quality end of the market. SMEs in parts of Emilia Romagna have had a focus on export markets for some time, and this has helped them to offset the reduction in local markets. In Valencia, the prime focus of SMEs was on the local market, which has contracted significantly. Successful SMEs have overcome this problem though an increasing focus on exports, identifying and exploiting new markets.

SMEs in both Emilia Romagna and Valencia are increasingly focusing on higher-price market segments, although there are examples where SMEs have successfully maintained lower-price brands, though careful targeting and better quality products than competitors. Success in higher price brackets requires high quality in both materials and production, together with a high design input and awareness of fashion trends. Some SMEs have also used innovative marketing approaches, such as online sales and product customisation, to increase their sales. However, many SMEs have still to exploit the potential of e-commerce.

The option of focusing on higher price range products and seeking new markets is not an option for many SMEs in Timis, as they function as outsourcing centres for companies based elsewhere. This means that SMEs in Timis have to compete on price, which is increasingly difficult with the rise of Asian production.

Even in the higher quality price ranges, it is still important for SMEs to manage their costs effectively. Companies in all three regions have achieved this through a combination of measures, including ceasing production of non-profitable brands, outsourcing production and use of management software. This has resulted in reductions in employment in the sector, but has ensured that SMEs can remain in business, with the potential for future growth.

In both Emilia Romagna and Valencia, the presence of industry clusters has been a significant advantage for SMEs. It provides a closely integrated local supply chain, often with informal relationships developed over the years. For example, most outsourcing by companies in Valencia is to other companies within the cluster. Clusters also receive financial support from national and local government, which SMEs can access. Clusters also provide a driver for innovation, as companies are able to exchange information and ideas, including information on fashion and market trends. The lack of a cluster in Timis, and the predominance of foreign ownership and subcontracting in the area, means that SMEs have been unable to have access to such advantages.

SMEs in Valencia and Emilia Romagna benefit from a number of support services. In Valencia, the ones most appreciated by SMEs are support for attendance at trade fairs (related to the focus on increasing exports) and the potential for collaboration with the regional footwear technology institute. In Emilia Romagna, SMEs have valued the presence of educational institutes and work with them to address the problem of skill shortages. Neither of these resources is available in Timis.

SMEs in Valencia and Emilia Romagna also value the promotional campaigns for locally-produced footwear operated by industry associations and government bodies.

These encourage consumers to buy local, as opposed to non-EU, products. There is no such campaign in Romania and the footwear industry remains largely unknown to EU consumers.

Together, the three case studies show that, while SMEs in the footwear industry do face significant challenges, there are strategies that can help to overcome these. Choosing the right market niche, operating flexibly and working closely with the supply chain can help companies to remain profitable. Companies in Valencia and Emilia Romagna have concluded that competing on cost alone is not a viable option long-term. Unfortunately for Timis, the business model adopted by most SMEs means this is their only option, which may bring further problems for the region in future.

The regions covered by the case study are rather different in economic terms. Emilia-Romagna and Timis are among the most advanced regions in their country (with a relatively low unemployment rate, high or rising incomes) while Valencia is not. A number of lessons for the rest of the EU footwear industry may be learnt from these differences, including the following:

- reorganisation of districts is possible, by focusing production on high value brands and exports (San Mauro, Elche) and by outsourcing of production (from San Mauro to Timis); and

- districts are only successful for a certain period if they do not adapt to market changes (as in the case of Bagnacavallo and Timis). Timis experienced initial success from the inflow of foreign, particularly Italian, capital taking advantage of the *lohn* system. However, this period may quickly come to an end if there is no upgrading of companies (i.e. in the fields of design, marketing, distribution, etc., both to local and export markets).

As a consequence of the pressures they face, development of SMEs in all regions is likely to be necessary, but the form may differ according to the characteristics of the region (and/or the type of business model):

- in the more advanced regions, this could focus on strategies for the development of “top” brands, high price segments and exports:

    - for many producers in this type of region this means improving their capabilities to participate in value chains organised by partners outside the sector, such as large retailers, luxury brand companies, sports brand companies and fast fashion labels. This is likely to require modernisation of IT in production planning and order processing, process flexibility, training of skilled labour force, learning the operating approaches of large customers; and
    - other companies that wish to strengthen their capabilities in exporting, need better information about potential new markets such as Asia and Russia, and ways in which to access these markets;

- in other regions, upgrading may take the form of development of functional capability, increasing productivity through modern machinery and training of the workforce; and
- in order to reduce or change their dependent situation in the value chains, SMEs may need to recover their home market. However, this would needs new capabilities in flexible response to customer demands through developing skills in marketing, logistics and distribution.

7.2 Recommendations

7.2.1 SME Suggestions for Further Support

SMEs in each of the regions made suggestions of how their efforts could be further supported. These are summarised in Table 7.1.

Table 7.1: SME Suggestions for Further Support

Suggestion	Comments
Further assistance with export promotion	SMEs in Valencia welcomed the existence of 50% funding for attendance at trade fairs. However, some smaller companies found it difficult to afford the remaining 50%. The companies believe that further assistance, targeted at SMEs, would be cost effective as manufacturers attending such events have experienced increases in orders of up to 20%. Such assistance could be valuable for the few independent footwear SMEs in Timis, but is not relevant to those undertaking subcontracting
Support funding (from the EU and other sources) specifically targeted at footwear SMEs	SMEs in Valencia and Emilia Romagna were aware of various types of financial assistance available from the EU, including assistance for innovation. However, many SMEs felt unable to compete for such funds as they are not targeted specifically at footwear, they would be competing with other sectors. They would welcome more targeted support, for example to transfer technologies from other sectors to footwear. SMEs also considered the administrative requirements and paperwork needed to obtain support to be a barrier, and would welcome simpler systems.
Protection against counterfeiting and cheap imports	SMEs in Emilia Romagna and Valencia called for greater protection from counterfeiting and cheap imports. Some stakeholders called for the introduction of origin marking for all imported products. This would be accompanied by a requirement for all footwear to be quality tested (proved by a quality assurance label) either within the EU or by EU quality control institutes selected by the Commission (similarly to the notified bodies concept). The aim of this would be to further strengthen awareness of the higher quality of EU-manufactured footwear. However, this concept would require additional financial support for EU manufacturing companies, which now would be faced with additional costs to meet the testing requirements.

7.2.2 Study Recommendations

Table 7.2 (at the end of this section) sets out the recommendations of the study based on the problems faced by SMEs and the potential solutions. It also sets out the partners who can assist with the delivery of the recommended actions; our interviews indicate that, for assistance to SMEs to be effective, it should be delivered at as local a level as possible.

The key recommendations drawn from the case study visits and the literature review are as follows:

- industry associations, national and regional governments and educational institutes should work together to assist SMEs to develop new export markets by measures such as:
  - providing readily accessible information on export markets (such as applicable tariffs, consumer requirements and distributors),
  - providing export credit guarantees, offering financial support to attend trade fairs (including covering part of the costs and providing loans for the remainder for the smallest firms),
  - providing tailored training in export management, and
  - encouraging SMEs to develop partnerships with existing footwear exporters to take advantage of their networks;

- industry associations and research institutes should work with SMEs to develop their capability in e-commerce and provide support in predicting future customer requirements (e.g. fashion trends) and developing supply chain networks;

- industry associations, national and regional governments should provide support for the development and enhancement of footwear industry clusters, including 'virtual' clusters for SMEs located separately from the main industry locations. This will encourage information exchange and provide a network for outsourcing and local supply to enhance efficiency;

- the European Commission, national and regional governments and industry associations should work together to provide better information for SMEs on available finance sources, including access to training and consultancy services. Existing schemes offering financial support to the footwear industry and/or SMEs, such as those providing finance for innovation, should be encouraged to examine the potential for reducing administrative requirements for smaller funding requests and to provide categories of funding specifically targeted at footwear SMEs;

- similarly, existing funding mechanisms for training should be evaluated by their deliverers to make sure the training support is properly targeted at the training needs of SMEs. Educational institutes, industry associations and trade unions should work together to encourage partnerships with SMEs to deliver customised training. This could also focus on greater involvement of staff in SME company decision-making;

- succession planning for family firms could be assisted by the development of information platforms designed to bring together firms with potential investors and buyers. In some regions (but not those covered by our study), this is carried out by industry associations. Regional governments could also supply risk capital to help with the funding of management buy-outs of such firms, while educational institutes could also provide management training to footwear students and encourage them to set up their own businesses; and

- research institutes and industry associations should continue to work to develop partnerships with SMEs to provide improved access to newer, more productive technologies and new materials. This may be best achieved through clusters, due to the limited resources of SMEs. Together with national and regional government, they should also provide information on the availability of new equipment, e.g. through leasing. SMEs could also be encouraged to negotiate with suppliers through clusters, to obtain better payment terms and cheaper prices.

In general, funding for improvements to business activities are useful, but are often available only for specific aspects, such as IT improvement, management training, etc. Whilst SMEs in the footwear industry do need all of these, their major problems are related to matching their ability to determine what products the distributors will require, in the way of styles, quantities and sizes, in time to tool up, purchase materials and make these before the fashion changes. Ideally, a much closer, symbiotic relationship between the various parties in the supply chain is needed. Funding and expertise for a tool to help with this process to be developed, tested and disseminated could be really useful.

Table 7.2: Study Recommendations for Additional Support to Footwear SMEs

Problem	Solution	Recommendation	Delivery Partner
Reduced domestic demand	Develop new export markets	Provide readily accessible information on export markets (including tariffs, customer requirements, distribution structure)	Industry associations, national and regional governments
		Provide export credit guarantees	National and regional governments
		Offer financial support to attend trade fairs	National and regional governments
		Provide training in export management	Industry associations, education institutes
		Encourage SMEs to work with existing exporters to take advantage of their networks	Industry associations, regional governments
	New marketing approaches	Provide assistance in developing e-commerce capability	Industry associations, education institutes

Table 7.2: Study Recommendations for Additional Support to Footwear SMEs			
Problem	**Solution**	**Recommendation**	**Delivery Partner**
Increased competition from low-cost imports	Move to higher-value markets	Offer support in identifying future market needs	Industry associations, research associations
	Strengthen brand identity	(Further) develop national and EU-wide promotional campaigns to encourage purchase of local products	European Commission, national governments, industry associations
	Improved productivity	Provide support for the development of clusters, including virtual clusters, to help develop partnerships for outsourcing and information exchange	Industry associations, national and regional governments
		Provide financial support for access to consultancy	National and regional governments
Access to finance	Better information on available finance sources	Provide training and consultancy services for SMEs to better understand the various finance sources	Industry associations, national and regional governments
		Reduce bureaucracy and better target existing financial support mechanisms (e.g. for innovation)	European Commission, national governments
Recruitment and retention of skilled staff	Staff training	Provide targeted financial support for training	European Commission, national governments
		Encourage partnerships with educational institutes to customize training to local SME needs	Industry associations, education institutes, trade unions
	Greater involvement of staff in decision-making	Provide management training to enable SME owners and staff to develop joint approaches	Industry associations, education institutes, trade unions
Lack of succession planning in family firms	Effective succession planning	Develop information platforms to bring together family firms with succession problems and potential buyers/partners	Regional governments, industry associations
		Provide regional risk capital to support management buy-outs, start-ups	National and regional governments
		Encourage students to start their own footwear businesses	Education institutes
Outdated/ low productivity technology	Improved access to technology	Encourage partnerships with research institutes	Industry associations, research institutes
		Provide information on availability of new equipment (e.g. through leasing)	National and regional governments, industry associations
Increased costs of raw materials	Access to cheaper materials	Provide access to information on alternative materials	Industry associations, research institutes
		Encourage negotiation with suppliers via clusters to obtain better payment terms	Industry associations

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