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

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Task 4: Restructuring and Modernisation

Final Report

prepared for

DG Enterprise & Industry

RPA

April 2012

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DG Enterprise & Industry, European Commission

by

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EXECUTIVE SUMMARY

Introduction

The European footwear industry has been subject to an elongated period of transition since the early 1990s. During these years EU manufacturers have maintained their competitiveness by offshoring the most costly production processes and introducing cost cutting measures, which have included a reduction in employment within the sector.

In response to the challenges the footwear industry is facing, the European Commission has contracted Risk & Policy Analysts Ltd (RPA) to undertake an assessment of the situation of the footwear sector in the EU and prospects for its future development. The aim of Task 4 of the study is to assess past or ongoing restructuring and modernisation processes in footwear enterprises in five regions of the EU (described in Box 1) and to anticipate future modernisation and restructuring. The assessment also aims to identify best practices in anticipating and managing the challenges of restructuring and modernisation that could be transferred to other countries and regions.

Box 1.1: The Case Study Regions

*The **Norte** region, focused around the city of Porto, is Portugal's main footwear-producing area. It contains 96% of all Portuguese footwear companies and employs 98% of people working in the industry.*

***Veneto:** the region is one of the most important footwear manufacturing centres in Europe. There are several footwear clusters within the region, each specialising in different types of footwear.*

***Southern Poland,** encompassing the Malopolska and Silesia regions: the area hosts around 49% of all footwear manufacturing companies in Poland and accounts for 70% to 80% of all employment in the industry.*

***Rheinland-Pfalz** in Germany is located on the borders of France, Luxembourg and Belgium. Shoe production in the region has a long tradition but has declined significantly over the last 20 years.*

*The **Rhône-Alpes** region of south-west France is a traditional footwear production area, focusing on the luxury segment. The sector has seen a decline in production; it now has only seven manufacturing companies with around 400 employees.*

Restructuring and Modernisation in the EU Footwear Industry

Restructuring can involve a range of activities, as companies seek to adapt to changes in market conditions. Although companies will often undertake several different activities, it can be helpful to classify the different types of restructuring. This report therefore differentiates between:

- *operational restructuring (new process technologies; organisation and IT-based process management);*
- *product restructuring (innovation in products, entering new market segments, development of takeover of brands);*

- *reorganisation of sales channels (opening new market channels, investment in downstream or upstream integration);*
- *locational restructuring (offshoring/outsourcing of production, within the EU of third countries);*
- *closure; and*
- *merger with or acquisition of other companies.*

Over the last 10 to 15 years, restructuring of the EU footwear industry has led to steady reductions in production, the number of companies in operation and employment. These job losses are partly attributable to investment in modernisation but also to the transfer of production sites to non-EU countries with lower labour costs and the closure of companies that could not compete in current market conditions. The economic crisis exacerbated the problems already being faced by the footwear sector. There are indications from some countries, though, that although turnover declined sharply in 2009, there was some recovery in 2010

The Process of Restructuring

The process of restructuring has differed between the case study regions, depending on their particular circumstances and the state of development of the footwear industry. One key feature has been that various countries and regions have been through different stages of restructuring:

- *The development of the footwear industry in* ***Norte*** *from a small-scale, domestically focused sector began in the 1980s when it became an outsourcing location for major brands, because of its low labour costs. When these companies subsequently moved their production to even cheaper locations, the industry went through a second phase of restructuring. This focused on innovation, increased development and promotion of own brands based on fashion and quality rather than subcontracting, and the use of technology to improve flexibility.*

- *The footwear industry in* ***Italy*** *has a long history of offshoring production. Within the Veneto region, different clusters have adopted different approaches to restructuring. Companies in Brenta, mainly SMEs, have restructured by subcontracting for major fashion label companies that entered the luxury footwear market in the mid-1990s. Montebelluna is dominant in technologies for the production of ski boots and other sports footwear. Companies in the cluster have focused on developing and promoting their own brands, offshoring production to lower labour cost locations.*

- ***Southern Poland*** *has followed a similar trajectory to Norte in moving from mass production (in state owned firms) to a more flexible approach with smaller private companies. However, unlike Norte, this process is not yet complete. These smaller companies combine some subcontracting for major European brands with development of their own brands. As the domestic market is still growing, companies are also focusing on this market.*

- *Companies in **Rheinland-Pfalz** addressed competitive pressures through retaining their technical competence whilst offshoring the high-cost aspects of production to eastern Europe and China (although there appears to be a trend of moving production back from China to lower cost locations in the EU, including Hungary). The main strength of the sector appears to be technical competence and product design, with companies focusing on design, branding and ensuring access to sales channels.*

- *In **Rhône Alpes**, the footwear industry appears to have been squeezed out of the market due to high costs and unsuccessful responses by companies. The few remaining firms have mainly focused on design and pattern production, with some finishing for the luxury end of the market and niche areas. The market focus is on exports, including exports to China.*

In terms of the types of restructuring undertaken:

- *in **operational restructuring** the current focus on niche markets and more fashionable footwear relies on smaller batches and faster response times. This requires innovation in equipment to enable greater flexibility as well as organisation of factories and more effective production management;*

- *for companies that continue to manufacture in the EU, primarily SMEs, the focus in **product restructuring** has been on markets where price is less of a consideration. Innovative design is a key factor, including rapid response to fashion trends and a greater range of styles and colours. EU manufacturers are also targeting niche markets, such as safety footwear with design and fashion elements, specialist work footwear for hospital staff and shoes for people with foot problems. Quality and design are also important factors for larger companies. Brands are vital to the sector;*

- *the key elements in **reorganising sales channels** are developing new sales channels and new markets. Some companies, both large and small, have decided to open their own stores as a way of ensuring access to sales channels, either mono-brand stores or in cooperation with other manufacturers. At the same time as some manufacturers are moving into retailing, some traders are moving into footwear production. Another important focus of reorganising sales channels is on exporting, particularly for manufacturers in countries where the home market is dominated by cheap imports. Although some companies in all the case study countries are embracing internet retailing, others are more reluctant. One reason for this is concern about competing with retail customers. Another concern is the practicality of internet retailing for footwear, given differences in sizing and the attitudes of consumers;*

- ***locational restructuring** has been a feature of all of the case study countries. One interesting trend is the initiative by some companies to move at least some of their production back from China in particular to the lower cost areas of Europe such as Bulgaria, Romania and Hungary. The main reasons for this are the rising costs in China and the awareness that relocation to other (low-cost) countries in*

Asia, such as Indonesia, means high learning costs at the beginning. At the same time, proximity to the market is increasingly required due to the need for product quality, flexibility, and speed to market and due to changing retail structures;

- ***closure** of footwear companies has been a feature of all of the case study countries, and the number of footwear companies within the EU has contracted significantly during this century; and*

- ***mergers and acquisitions** have also been important in several case study countries. These include mergers of footwear companies within a region, acquisition of bankrupt firms with important brands, including by purchasers from outside the EU, and acquisition of retail chains by footwear manufacturers.*

Drivers for Restructuring

*The key driver for restructuring in every cases-study country was **increased competition**, particularly from low-cost producers in Asia (with China being the largest threat). Although few companies mentioned trade policy specifically as a major driver, this clearly underlies the increase in competitive pressure that they are facing.*

*None of the companies and other organisations we interviewed, in any of the case study countries, considered the **availability of funding** to be a driver of restructuring. However, the availability of EU, national and regional funding has facilitated the restructuring process for some companies. This has been more successful in some case study areas than others.*

*The extent of **assistance** available from regional (and national) industry associations varied considerably amongst the case study regions. In Norte, the association has taken a leading role in driving restructuring and innovation. It has developed a Strategic Plan for the sector, which was agreed by all members. Regional and national associations have not played a similarly proactive role in the other case study areas.*

*The overall view from the companies and organisations that we interviewed was that restructuring has enabled the footwear sector to remain relatively resilient through the **economic crisis** so far. Although most companies we interviewed had lost sales initially, they were poised to take advantage of market upturns and in many countries sales had increased in 2010 and 2011. The increased focus on exports had enabled companies to take advantage of better market conditions in some countries. In addition, the luxury market was less affected by the recession than other segments, so the general trend of moving to higher price brackets had helped insulate many companies. However, the footwear industry in Europe remains heavily dependent on the EU market, however, and the state of the EU economy remains a major concern for the companies we interviewed.*

Key Success Factors

Despite the turmoil of recent years in the footwear sector, and the difficult economic outlook, the overall view of most companies and organisations that we interviewed was quite positive. A number of different factors had contributed to this success.

A key reason for the success of the Portuguese footwear industry in restructuring has been the ***close partnerships*** *that exist within the industry and with the Government. A similar situation is found in Italy, with the cluster system still operating despite the effects of restructuring. This level of cooperation does not appear to exist in the other case study regions. In Rheinland-Pfalz companies have only recently begun to cooperate rather than complete. However, there are strong relationships with the local research and training institute. In Poland, too, cooperation appears to be emerging between larger companies, but SMEs continue to be suspicious of their competitors. In Rhone-Alpes, the small number of manufacturers remaining in the area makes cooperation between them difficult, but the industry does retain close ties with the research institute in the area.*

The level of support to the sector from the ***National and Regional*** *Governments also appears to be a factor. The Portuguese Government has been very supportive of the footwear industry and has helped it to access EU funds. The sector has a good reputation with the Government because of its record in exports. By contrast, a company in Germany noted that the shoe industry has always been a small part of the German economy, so is not influential at federal Government level.*

Another key factor in successful restructuring has been ***flexibility*** *in the face of changing market conditions. The manufacturing companies that have remained in business and been successful are those that were best able to adapt to the new requirements. For SMEs, this meant changing the focus of their operations from just production to design and quality and developing skills in marketing and distribution. For larger companies, the ability to remain competitive has been linked to the flexibility provided by offshoring/outsourcing production. This has led to a very adaptable system, where production can be closely geared to market requirements. This flexibility is one reason why footwear companies appear to have been relatively resilient through the recession.*

The ability to ***differentiate their products*** *has been an important factor in allowing EU footwear manufacturers to remain in business. Focusing on factors such as fashion, comfort and safety has enabled them to avoid direct competition with low-cost competitors. The basis for differentiation varies between the case study regions, although fashion is an important aspect for most markets. Ensuring access to* ***sales channels****, through developing marketing skills, acquisition of retail chains or opening their own stores has also been a key factor in ensuring the success of companies.*

Barriers to Effective Restructuring and Transferability of Best Practices

The companies and organizations that we interviewed identified a number of barriers to effective restructuring.

*One remaining barrier identified by companies focusing on exports is the **lack of openness of non-EU markets** to EU footwear exports. Most exports by EU footwear companies are still to other EU countries, and exports outside the EU are limited. Given the likely growth in markets in China in particular in future, lack of access to these markets could constrain future growth.*

*Another barrier, identified by many of the companies we interviewed, was increasing **difficulty in recruiting younger people** to replace ageing workforces. This was identified as an issue in Norte,, Veneto, Rhône-Alpes and Rheinland-Pfalz. There are two aspects to this problem. Firstly, there is a lack of people with specific skills, such as lasters and finishers, particularly at the luxury end of the market. Secondly, it is difficult to recruit young people to production roles in the industry because of its poor reputation; young people do not consider that footwear manufacturing has a future.*

We identified best practices in this area which could readily be transferred to other regions. In particular, the 'Step up Shoes' campaign in Rheinland-Pfalz appears to have been successful both in increasing the general interest of young people in the sector and in increasing the number of applications for training positions.

***Access to credit** is a concern for some footwear firms in some regions, particularly smaller companies in the countries most affected by the recession, such as Norte. As a consequence, most restructuring activities have been financed by companies' internal resources. Nevertheless, cash flow remains a critical issue for the sector, especially for smaller firms and, as with SMEs in other sectors, there is a risk that even companies with full order books could fail because of a lack of short-term credit. None of the regions had found a successful way to address this barrier.*

*Several companies and organisations also raised concerns about the difficulties of **protecting designs**. Many of the companies we spoke to had not taken action to protect designs, because they considered that the current process for protection is not really effective. Companies considered that patenting innovations is costly and takes too long.*

Other barriers identified during the case studies included:

- *the continuing decline of traditional specialist shoe shops, which could have a significant impact on companies that rely on such shops as sales channels;*
- *increases in the prices of raw materials, particularly leather. It will be difficult to pass these costs on to consumers, this could lead to pressure on profit margins; and*
- *the future of family firms. These still tend to seek new managers within the company, which requires the younger generation to be engaged and not want to sell up. While this is the case in some regions, such as Norte, in others such as Veneto younger generations appear less interested, putting the future of the firms in doubt. The reasons for these differences are not clear.*

The extent to which best practices in restructuring can be transferred between regions is variable. Some of the best practices relied on close cooperation between industry associations, companies, research and training institutes and governments. This worked effectively in Norte and Veneto; elsewhere, the level of cooperation was much lower, so that transfer of best practices would be more difficult. However, the experience of Rheinland-Pfalz, where stakeholders had recently begun to cooperate closely, shows that change is possible. In Rheinland-Pfalz, companies had come together with other stakeholders in the campaign to attract young people to the industry. This is a problem in many regions, so could potentially act as a catalyst for future progress.

Other best practices are very much individual-company driven, such as improvements to the design of products, greater fashion input and development of new sales channels. Transfer of these best practices does not rely on a framework for cooperation. However, individual companies may equally be less willing to share experiences in these areas, because they may aid the companies' competitors. Nevertheless, there does seem to be scope for footwear companies in many regions of the EU to invest in better design, greater flexibility in production and improved service.

Future Trends in Restructuring

In general, the companies and organisations that we interviewed expected that restructuring in the industry would continue in future, but at a slower pace than in recent years:

- *the footwear industry in **Norte** anticipates that that there will be further improvements in efficiency, especially in the use of materials, increasing focus on quality and service and moves into additional export markets;*

- *companies in both clusters in **Veneto** plan to continue with their current strategies in future. Work for major brands will continue to be the main strategy for companies in the Brenta region. Companies in Montebelluna plan to continue with the promotion of their brands and the development of international markets;*

- *the companies we interviewed in **Southern Poland** identified continuing competitive pressure as a key future challenge. They planned to respond to the challenge by further investment in equipment to increase efficiency, by improved product design and quality, and by effective marketing;*

- *although the majority of restructuring of the footwear sector in **Rheinland-Pfalz** has is complete, the industry is now one of continual change. Most companies envisage only minor changes in the location of production in future. However, changes to sales channels are likely to continue; and*

- *companies in **Rhône-Alpes** anticipate an emphasis on further reductions in time to market and development of products, including customised ranges and new, more eco-friendly materials and production methods. This factor has encouraged some*

companies to consider switching production back from China to locations nearer to France.

Conclusions and Recommendations

The process of restructuring in the EU footwear industry has taken place over a number of years and has resulted in a major contraction of the industry. Competition has been the key driver of restructuring; despite technology advances, footwear manufacture remains highly labour intensive so is vulnerable to competition from low-wage economies. The major stages of restructuring appear to be largely complete; the level of output, the number of firms and employment appear to be stabilising. Most companies we interviewed see the focus of the next few years as consolidating their position in the market. Nevertheless, companies recognise that they need to continually adapt to market changes to stay in business.

The EU footwear industry faces a number of challenges in the coming years. One major issue is a growing problem of skill shortages, due to an ageing workforce and difficulties in attracting young people into the industry. Innovative approaches will be needed to overcome the perception by young people that footwear is an industry with no future. If this is not successful, it could result in a further round of production relocation and the closure of small firms that are not able to undertake this step.

In northern Europe (including Italy), the model of outsourced production, with high-added-value activities such as design and marketing within the EU, appears set to continue (although this could change if China develops its own capability in fashion and design). Small-scale production is likely to remain in Europe, focusing on niche markets such as luxury fashion, quality safety footwear and footwear designed for people with health problems. Eco-friendly footwear may provide another niche in future.

In Norte, although good progress has been made in moving to the higher quality fashion end of the market, this process is still ongoing. There is also potential for further improvements in productivity and upgrading of technology. In eastern Europe, the picture is more mixed. Progress is restructuring is more variable and some countries remain vulnerable to changes in outsourcing policies by northern European companies, as they have not yet developed the skills in marketing and design to become more independent of their customers.

Based on the findings of the task, we recommend that the following actions are considered by ***the Commission****:*

- *policy assistance should focus on assisting manufacturers in southern and eastern Europe to upgrade in terms of improved products and sales channels;*

- *trade policy should focus on ensuring that EU companies have open access to other markets;*

- *access to EU incentives should be simplified and industry should be more involved in design and decision-making on these;*

- *examine the potential to develop a more effective platform for producers and potential sub-contractors to get into contact with each other, as existing platforms do not seem to be working well; and*

- *there could be a role in encouraging exchange of experience in training and recruitment activities between countries.*

National and regional authorities *could consider:*

- *upgrading training programmes, liaising closely with industry to ensure training is relevant and promotion of the industry to young people;*

- *providing training in marketing and sales for companies; and*

- *assisting companies to access EU resources.*

For ***industry associations****, the priorities should be:*

- *encouraging companies to work together;*

- *assisting with awareness of and access to incentives at national and EU level;*

- *participating in the development of training; and*

- *identifying innovative approaches to showcase the industry's products and qualities.*

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AEDT	European Association of Fashion Retailers
ANCI	Associazione Nazionale Calzaturifici Italiani (Association of Italian Footwear Manufacturers)
APICCAPS	Associação Portuguesa dos Industriais de Calçado, Componentes, Artigos de Pele (Portuguese Footwear, Components & Leather Goods Manufacturers' Association)
ATC	Agreement on Textiles and Clothing
BA	Bundesagentur für Arbeit (Federal Employment Agency, Germany)
BRICS	Brazil, Russia, India and China
CBI	Centre for the Promotion of Imports from Developing Countries, Ministry of Foreign Affairs, the Netherlands
CAD	Computer assisted design
CAM	Computer assisted manufacturing
CEO	Chief Executive Officer
CRM	Customer relations management
CTC	Centre Technique du Cuir, Chaussure, and Maroquinerie (Technical Centre for the Leather Industry, France)
CTCP	Centro Tecnologico do Calçado (Technical Centre for the Leather Industry, Portugal)
DGE	Direçcão-Geral da Empresa (Enterprise Directorate-General, Ministry of Economy, Portugal)
ECC	European Clearing Centre
ERP	Enterprise resource planning
EU	European Union
GDS	international shoe fair, Düsseldorf
HDS	Bundesverband der Schuh und Lederwarenindustrie (Federation of the German Footwear Industry)
IAPMEI	Instituto de Apoio às Pequenas e Médias Empresas (Institute for the Support of Small and Medium-sized Enterprises, Portugal)
IBIS	International Business Information Service
ILI	Instytut Przemslu Skorzanego **(**Institute of the Leather Industry, Poland)
INSEE	Institut National de la Statistique et des Études Économiques (French statistical office)
ISC	International Shoe Competence Centre (Pirmasens, Germany)
ISO	International Organisation for Standardisation
IT	Information technology
Mercosur	Mercado Comun del Cono Sur (Southern common market)
MFA	Multi-Fibre Arrangement
NP	Normas Português (national standards, Portugal)
OSEM	Osservatorio Socio Economico Montelliano, (Socio-Economic Observatory Montelliano, Italy)
PFI	Prüf- und Forschungsinstitut für die Schuhherstellung e.V. (Test and Research Institute for Footwear Production Pirmasens, Germany)
PRIME	Programa de Incentivos à Modernização Empresarial (Incentive Programme for the Modernisation of Industry, Portugal)

REACH	EU Regulation on the Registration, Evaluation, Authorisation and Restriction of Chemicals, EC 1907/2006
R&D	Research and development
RPA	Risk & Policy Analysts Ltd
RFID	Radio frequency identification
SATRA	UK footwear technology centre
SME	Small and medium enterprise
ZIM	Zentrales Innovationsprogramm Mittelstand (program for the promotion of market-oriented technology SMEs, Germany)

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 offshoring the most costly production processes to Asia or to Eastern European countries (such as Romania, Hungary and Slovakia) 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 and European manufacturers have been forced to introduce cost cutting measures, which have included a reduction in employment within the sector.

In response to the challenges the footwear industry is facing, the European Commission has contracted Risk & Policy Analysts Ltd (RPA) to undertake an assessment of the situation of 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 consists of seven tasks:

- Task 1: EU survey;
- Task 2: Research and Innovation Centres;
- Task 3: Small and Medium 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 4.

1.2 Objectives

The aim of Task 4 of the study, as set out in the specifications, is to assess past or ongoing restructuring and modernisation processes in footwear enterprises in five regions of the EU and to anticipate future modernisation and restructuring. The assessment focuses on the key areas influencing the effective management of restructuring and modernisation:

- the ways in which restructuring and modernisation have been carried out, including a typology of the business models that have emerged from restructuring;
- the main drivers of restructuring and modernisation, including both push and pull factors;
- the results of restructuring and modernisation in terms of business benefits and the impacts on employment; and
- the impact of the 2008/2009 economic crisis on restructuring and modernisation.

The assessment also aims to identify best practices in anticipating and managing the challenges of restructuring and modernisation that could be transferred to other countries and regions.

1.3 Approach to Task 4

In agreement with the Commission, five regions were selected as case studies under Task 4. These are:

1. Portugal: Norte;
2. Italy: Veneto;
3. Poland: Southern Poland (Malopolska and Silesia);
4. Germany: Rheinland-Pfalz; and
5. France: Rhône-Alpes.

Brief descriptions of the five regions are given in Box 1.1 (over page). In each region, we carried out interviews with enterprises that had undergone different types of restructuring and modernisation. Table 1.1 sets out the number of organisations we interviewed in each region. The differences in numbers reflect the willingness of local companies and other organisations to participate in the study and the geographical constraints on the number of interviews that could be completed per day. In addition to the case study interviews, we also interviewed two UK footwear companies that had relocated the majority of their production outside the EU, to understand the reasons behind such decisions, and an association representing independent retailers of footwear and fashion, to understand the retailer's perspective.

Table 1.1: Number of Stakeholders Interviewed in the Case Study Regions

Region	**Number of Stakeholders Interviewed**	
	Companies	Other Organisations
Norte	6	2
Veneto	5	2
Southern Poland	4	2
Rheinland-Pfalz	5	4
Rhône-Alpes	3	1
Others	2	1
Total	**24**	**12**

The interviews were conducted using a semi-structured format and focussed on gathering details on the types of restructuring undertaken, drivers, best practices and barriers, as well as how different partners had worked together.

Box 1.1: The Case Study Regions

The **Norte** region, focused around the city of Porto, is Portugal's main footwear-producing area. It contains 96% of all Portuguese footwear companies and employs 98% of people working in the industry. Footwear companies are located in three areas: the "old" industrial district around Sao Joao da Madeira where most of very small companies and the Centro Tecnologico do Calçado (CTCP) are located; the fringes of the city of Porto which hosts the larger factories of foreign companies and the Felgueiras and Guimaraes area, where more medium sized Portuguese companies are located.

Veneto: the region is highly industrialised and is one of the most important footwear manufacturing centres in Europe. There are several footwear clusters within the region, each specialising in different types of footwear. The Brenta Valley is one of the most prestigious centres for footwear manufacturing, with 600 firms specialising in the production of luxury shoes. It also houses the Politecnico Calzaturiero which was founded in 2001. Montebelluna is a footwear cluster specialising in the production of sports footwear, particularly ski boots.

Southern Poland, comprising the regions of Malopolska and Silesia, hosts around 49% of all footwear manufacturing companies in Poland and accounts for 70% to 80% of all employment in the industry. The high density of footwear companies in the area is partly linked to the fact that, during communist times, the major state owned shoe manufacturers were located in this region. The Krakow branch of the Institute of Leather Industry (ILI), formerly the Central Laboratory of the Footwear Industry, is a research and development organisation, which has been active in the field of development and innovation in Polish shoe and leather industry for 40 years.

Rheinland-Pfalz is one of 16 states in Germany; it is located on the borders of France, Luxembourg and Belgium. The West Pfalz sub-region is characterised by medium-sized businesses and industries, including shoe-making. Pirmasens is known as the capital of Germany's footwear industry. Shoe production has a long tradition in Pirmasens but production has declined significantly over the last 20 years. The International Shoe Competence Centre Pirmasens GmbH (ISC), which is a training and research centre for the leather and footwear industry and trade, opened in the region in 2008.

The **Rhône-Alpes** region of south-west France is a traditional footwear production area, focusing on the luxury segment. The sector has seen a decline in production volume as well as value and some long established businesses in the region were forced out of business. It now has only seven manufacturing companies with around 400 employees. The region also hosts the Centre Technique du Cuir, Chaussure, and Maroquinerie (CTC)

As part of Task 4 we have also undertaken a detailed review of relevant literature, statistics and studies, which provide a useful context for the case study information.

1.4 Structure of this Report

The remainder of this Report has been organised as follows:

- Section 2 provides an introduction to the concept of restructuring and modernisation in the footwear sector;
- Sections 3-7 contain the findings of the case studies undertaken in the five selected regions;
- Section 8 provides an evaluation of the key factors affecting the success of restructuring and modernisation; and
- Section 9 provides the conclusions and recommendations of the Task.

2. INTRODUCTION TO THE CONCEPT OF RESTRUCTURING AND MODERNISATION

2.1 Introduction

2.1.1 Background

During the 2000s, the EU footwear industry has changed from a near equilibrium in international footwear trade to a trade deficit in 2010 of €5.5 billion[1]. A key reason for this change is the full integration of China into world trade. During the period 2001 to 2010, imports from China into the EU more than tripled from 420 million pairs to almost 1.9 billion. Now six out of ten shoes in the world are produced in China[2]. A major reason for such high import penetration is the low price of Chinese footwear, an average of €4 per pair (wholesale); this is less than a quarter of the price of intra-EU imports and considerably lower than imports from other Asian countries.

In response to these market pressures, the EU footwear industry has undergone a period of dramatic change, in terms of production, numbers of companies and employment. This process appears to be largely complete. The industry is now in a mature market and the rate of reduction in production volumes has started to slow down, as the restructuring process has enabled the industry to adapt more effectively to the new global trading environment.

2.1.2 What is Meant by Restructuring

Restructuring has developed in many social sciences as a catch-word for all types of purposive actions in reorganising incumbent economic structures. These actions may take place at various scales:

- from a micro-economic perspective at the firm level;
- from a meso-economic perspective to systems of firms (clusters, networks, sectors); and
- from a macro-economic perspective to nations and world regions.

A sectoral analysis, such as this one on the footwear industry in Europe, primarily focuses on the meso-level but needs a closer understanding of the micro-level.

At the sectoral, regional and national scale the term restructuring was largely used during the 1970s and 1980s when industrialized economies faced hitherto unrealized crises and competitive squeeze from newcomers[3]. It primarily had a defensive connotation, more concerning reaction to emerging threads than pro-active shaping of the future. When looking at a number of outcomes, however, it is not easy to decide

1 APICCAPS (2011a)

2 CBI (2010a)

3 See, for example, the introductory text in Ruigrok and van Tulder (1995)

whether they are the result of re-action or pro-action. Focusing on the firm, Porter[4] suggested three types of strategy which result in restructuring of the company: cost leadership, differentiation and specialisation. In reality, however, there are different mixtures of these strategies.

2.1.3 Restructuring in the Footwear Sector

Literature on the footwear sector in Europe and the USA has a common understanding that the sector is an old industry characterised by low technology, high labour intensity in production, subject both to mass production (in large units) and flexible production (in small units) but mainly driven from cost-leadership strategies[5].

During the 1970s and 1980s, such industries were subject to what was called the New International Division of Labour (NIAT[6]). Labour-intensive industries, mostly in the consumer industry sectors, learnt to separate production processes into capital-intensive and labour-intensive parts, the latter susceptible to relocation to low wage countries. This gave rise to 'offshoring' of parts production (such as upper stitching) by large companies, while final assembly of the shoe largely remained in West European industrial countries. Some socialist countries, such as Poland, Hungary or the GDR, were integrated into this capitalist spatial division of labour during the 1980s. However, there was no similar division of labour in the footwear sector in the communist block, as socialist goals rather than costs determined location.

The effect of such changes was detrimental to employment levels, both at the traditional production site of companies and in the traditional production regions and nations. Employment in production has declined while employment in all kind of services has increased within most companies. However, it is extremely rare that companies in a region/cluster which has lost most of its footwear production to other regions are able to completely replace the lost employment through non-production activities such as design, production planning and supervision, supply chain management and sales organization. Effects on the quality of employment are rather ambiguous at the traditional locations of production, as a low skilled (largely female) labour force and home workers were the main losers, while highly qualified (male) employees were winners in restructuring.

The 1990s and 2000s saw a new phase in the changing global division of labour, due to the appearance of China at the world markets, major reforms in South Africa, India, Indonesia and the opening of Eastern Europe[7]. Particularly new phenomena included the rise of contract manufacturing, in the emerging "buyer driven" global value chains[8], and the increasing participation of SMEs in offshoring and outsourcing of production. A multiplicity of factors combined to enable remote production and long-distance trade in consumer goods, such as the increasing competence of newcomers in

4 Porter (1990)

5 See, for example, Scott (2006)

6 See Fröbel *et al* (1980)

7 McCann and Acs (2011)

8 Gereffi et *al* (2005)

manufacturing full products, new forms of cross-border regulation (including regulation of contracts), reduced international transportation costs and reduced information costs through innovation in IT.

It has now become clear that the common perspective on the global division of labour is too much oriented towards production in its true sense and tends to neglect the societal embeddedness of production (as discussed in the cluster concept) and, in particular, the increasing importance of having a local presence in the market[9]. One of the reasons is that footwear has largely changed its character from 'Ford-type' mass production to flexible customized production.

As a consequence, different approaches to restructuring at the company level can have different drivers. While some authors[10] suggested a simple dichotomous typology of some footwear companies sticking to well-known technology and products but relocating to low cost locations and others (mostly suppliers) changing products and technology but sticking to the region, the actual strategies of footwear companies are much more diverse. This is particularly the case if analysing companies in different European countries, producing in different societal environments, which determined the particular regional or national development paths of footwear clusters and companies. Corresponding to the current debate in evolutionary economics, heterogeneity in strategies is to be expected among footwear companies, not similarity[11].

2.2 Restructuring Models

2.2.1 Typology of Restructuring

The European Restructuring Monitor, based at the European Foundation for the Improvement of Living and Working Conditions (Eurofound) records restructuring announcements in establishments, based on media reporting. Eurofound has developed a typology of restructuring, which is shown in Box 2.1 (over page).

9 Gertler (1995)

10 such as Schamp (2005)

11 This is common understanding in evolutionary economics since the seminal work of Nelson and Winter (1982)

Box 2.1: Typology of Restructuring Used by Eurofound

Relocation: When the activity stays within the same company, but is relocated to another location within the same country

Outsourcing: When the activity is subcontracted to another company within the same country

Offshoring/delocalisation: when the activity is relocated or outsourced outside of the country's borders

Bankruptcy/closure: when an industrial site is closed or a company goes bankrupt for economic reasons not directly connected to relocation or outsourcing

Merger/acquisition: when two companies merge or during acquisition, which then involves an internal restructuring programme aimed at rationalising an organisation by cutting personnel

Internal restructuring: when a company undertakes a job-cutting plan, which is not linked to another type of restructuring defined above

Business expansion: where a company extends its business activities, hiring new employees

Source: European Commission (2012)

The typology is focused on the impacts of restructuring on employment within particular EU locations. In practice, the restructuring activities of footwear companies do not always fit neatly within this structure:

- *relocation and outsourcing* within the same company are relatively rare in the footwear sector;

- *offshoring/delocalisation* can take a number of different forms. These can include 'near shoring', with relocation to nearby countries (which can include countries outside the EU, such as Tunisia) or 'far shoring' to distant countries such as China and India. Offshoring can also be combined with outsourcing, through subcontracting of labour-intensive activities (such as upper stitching) either 'near shore' (early outsourcing to European low-cost countries such as Portugal in the 1980s, Eastern Europe and even North Africa since the 1990s) or 'far shore' (to non-EU and non-neighbouring countries such as China);

- *internal restructuring* in the footwear sector generally involves modernization through measures to improve its productivity, such as innovation in process technologies or improved management practices. This may or may not involve job-cutting;

- *bankruptcy/closure*: most company closures in the sector are a consequence of bankruptcy; and

- *acquisition/merger*: this may be linked to business expansion or, commonly in the footwear sector, takeover of a company by another following its bankruptcy.

In this study we therefore suggest modifying the Eurofound typology set out in Box 2.1 by focusing more on the internal restructuring of the footwear companies and the destination of offshore/delocalization strategies in more detail. Internal restructuring is intended to increase the company's chances of survival, to improve its productivity

and, therefore, its competitiveness.

Where offshoring and outsourcing investments are directed is important, as 'near-shoring' supports the sector's sustainability within Europe while 'far-shoring' still most often results in reduced footwear production in Europe. However, 'far-shoring' is also a strategy for getting access to foreign markets, particularly in the sports shoe sector. It seems that some of the larger men's and women's shoe companies are currently try to follow a similar 'global market' strategy. By far the majority of European producers are oriented, however, towards the (regional) European markets[12].

Table 2.1 compares the classification used by Eurofound[13] with the list of restructuring activities set out in the specification and the detailed types of restructuring activities identified in the case studies (described in Sections 3-7 of this report).

Table 2.1: Types of Restructuring Activities

Eurofound (EU Restructuring Monitor)	**Project specification**	**Typology Used in this Study**
Internal restructuring	[n/a]	**Operational restructuring**: New process technologies New process organisation New IT based process management
	Moved into higher segment of market Developed own brands	**Product restructuring**: Innovation in products Entering into new market segments Establishment of brand Takeover of brand
	Changed distribution policy, e.g. combining manufacture with own distribution Become distributors of footwear produced elsewhere	**Reorganisation of sales channels**: Opening new sales channels Investment in downstream integration or in upstream integration
Relocation Outsourcing, Offshoring/ delocalisation	Moved parts of manufacturing within EU or proximity countries (maybe with lead company retaining responsibility for design and raw material purchase but outsourcing one or more phases of production) Delocalised production to Asia	**Locational restructuring**: Near-shoring: offshoring (via outsourcing or in own factories) to nearby countries within the EU and at the borders of the EU Far-shoring: offshoring/outsourcing to distant countries, mostly in Asia
Bankruptcy/ Closure	Disappearance	**Closure**
Merger/ Acquisition	[n/a]	**Merger and acquisition** of other companies

12 APPICAPS (2011b)

13 European Commission (2012)

Although there are differences in the terminology used, the three classifications are broadly consistent. We therefore propose to use the higher-level classification in the third column in the remainder of this report, differentiating between:

- operational restructuring;
- product restructuring;
- reorganisation of sales channels;
- locational restructuring;
- closure; and
- merger or acquisition.

We discuss each of these types of restructuring in the footwear industry in more detail below.

This typology of restructuring at the company level can be qualified in two respects. Firstly, company restructuring in the European footwear manufacturing sector is specific insofar as it mostly concerns small and medium sized enterprises in the women's and men's footwear subsectors. Large footwear producers are found mostly in the sports footwear sector, which is dominated by global brands such as Adidas or Puma, and in the footwear retail sector, where large retailers such as Deichmann or Wortmann of Germany also have moved into footwear production outside the EU.

Secondly, types of restructuring can be combined in different ways. In theory, the literature in social sciences has differentiated between a 'low-road' approach to restructuring based on a strategy of cost leadership, offshoring production to low wage countries and/or outsourcing, both near and far, and a 'high-road' trajectory of restructuring. The latter is based on strategies of diversification and innovation through internal restructuring, business extension and offshoring/outsourcing. High road trajectories of restructuring are also based on regional and national institutions fostering, for example, collaboration in education and training and R&D with non-profit institutions

However, these are ideal-type strategies. In practice, restructuring involves a host of hybrids. We consider that part of the hybrid restructuring in the European footwear sector can be explained by the still very different national development paths of the industry. Or, in other words, company restructuring in Europe is highly heterogenous.

At the meso-level, restructuring of the sector is related to the trajectory of an old industry, where exits (either through bankruptcy and closure or complete relocation to low cost countries) prevail, although a few firms based on new concepts in product and process technology may enter the sector. Furthermore, takeovers may consolidate the sector and enhance companies' access to the final consumer through adding more brands and/or new sales channels to the company's portfolio. The meso-level perspective adds more actors to the restructuring concept, for instance informal and formal networks in a cluster, third parties such as educational and training institutions or research institutions, and policy agents from very different scales of government.

2.2.2 Operational Restructuring

Operational restructuring tends to take place to support and enhance other restructuring activities. The CBI survey[14] identified the use of computer aided design to develop new types of footwear such as waterproof footwear and software systems to enable a degree of customisation for the consumer as key trends in innovation.

The Task 1 survey indicated that improved product quality and customisation were amongst the most widely adopted measures taken by companies to address the challenges they face. Operational restructuring can be a key aspect of this; for example, changes in the organisation of production to allow for smaller production runs and greater variety, to meet the demand for customisation. The costs of production were identified as the most important future challenge by survey respondents. Operational restructuring can assist in enhancing the efficiency of production and helping to manage costs. Production equipment was also one of the main areas of investment made by companies responding to the survey.

The case studies for the Task 2 report also confirmed the importance of technological innovation in the production process to improve efficiency and effectiveness. Customisation and environmental issues were key factors to be addressed in technological development, as well as the incorporation of ICT into manufacturing, sales and design.

The case studies in Task 3 found that modernisation of IT in production planning and order processing and process flexibility were important for SMEs wishing to move into higher price segments and increase exporting. For other market segments, improved functional capability, increasing productivity through modern machinery, could play a key role in meeting the current challenges.

2.2.3 Product Restructuring

Product restructuring focuses on developing products for new market segments and developing and promoting brands. In general, companies which produce higher-quality products, which have identified niche markets and which are able to compete in export markets are better able to maintain their turnover and profitability.

The Task 1 survey indicated that responding companies had made significant investments in product design and viewed product innovation as a key area of innovation. Information from the Task 3 case studies indicated that the SMEs most affected by reduced demand are those focusing on domestic markets, which have been hit by the recession, and those producing lower-priced footwear, which is most vulnerable to foreign competition.

Changing Market Segments

In recent years, the general trend in Europe has been for manufacturers to focus on

[14] CBI (2010a)

reducing volume but improving quality and innovation.

The CBI report[15] indicates that European footwear manufacturers have also focused on targeting niche markets and upgrading to higher value footwear. Examples of key directions of innovation include:

- ***Comfort:*** for the growing group of older people, casual footwear has become increasingly popular, for example softer leathers, improved fit, warmth, inner soles with linings made from a single piece of leather, fabrics protecting against moisture, membranes, breathable footwear or rubber soles. There is also a trend towards more comfort in evening footwear by using different forms of high heels, allowing easier walking;

- ***Design:*** the increased role of fashion and design is making footwear production more and more complex; effective links between conception, production, distribution, marketing and sales channels are crucial;

- ***Technology:*** developments such as mixing different materials to obtain different properties in soles and uppers;

- ***Niches:*** focus on high-quality market niches like luxury, safety or orthopaedic footwear, which are more diversified and offer greater added value. This may also include bespoke 'made to measure' footwear, recycled footwear, ethical footwear and urban footwear and in outsized or specialised shoes; and

- Respondents to the Task 1 survey indicated that their strategies were very much focused on improving the production and selling of existing products through improved product design/quality, improved image/communication/service and product customisation. Positioning their products in the higher market segments and ceasing production of cheaper brands are ways in which SMEs in both Emilia Romagna and Valencia SMEs have adapted to increased competition (see Task 3 report).

Developing Own Brands

- The EU has become home to some of the world's largest and most prestigious footwear brands. Manufacturers are increasingly seeking to differentiate their products to gain competitive advantage over cheaper imports from developing countries. While many domestic markets are dominated by low cost imports, EU producers are discovering that they can find markets for branded luxury footwear in emerging economies such as Russia, China, Brazil, India and the Middle East.

Footwear industry associations responding to the Task 1 survey noted that maintaining the reputation, image and presence of EU footwear manufacturers, as well as emphasizing the benefits of EU brands in their home markets, was an important area of activity.

[15] CBI (2010a)

The Task 3 report demonstrated that 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.

2.2.4 Reorganisation of Sales Channels

The CBI report[16] found that footwear is supplied in most EU countries through a specialised distribution route, which is from manufacturer to importer/wholesaler to retailer.

With an increase in the quantity of imports entering the EU market, large distributors and retailers 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. However, smaller specialist retailers are also under pressure, from under-cutting by e-commerce and suppliers opening 'own-brand' stores adjacent to, and in competition with, the retailers they supply[17].

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 multi-brand stores or wholesale buyers. Finding customers was seen as a main challenge by respondents to the survey, but very few had changed their methods of distribution in response.

Nearly all of the companies responding to the Task 1 survey sell products not only in their own country, but also to countries inside and outside the EU; very few respondents sell all their products in one market. The SMEs interviewed for Task 3 have adopted similar strategies. 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. Export strategies and access to new markets are predominant in Emilia Romagna as well.

2.2.5 Locational Restructuring

The EU has traditionally been an important supplier of high quality footwear to the world market. However, production of high volume items has increasingly been offshored/outsourced.

Offshoring has been a trend for several years. Many of the leading footwear brands that originate in the EU have production facilities throughout the world, depending on the location of their main markets. For example, large athletic shoes companies like Nike and Adidas often utilise contractors in Asia and other developing countries to

16 CBI (2010a)

17 Interview with the European Association of Fashion Retailers, AEDT, September 2011

produce their athletic shoes[18]. Although many larger companies have sub-contracted production to China, India or elsewhere in Asia (far-shoring), others have maintained at least some of their manufacturing within the EU or neighboring countries (near-shoring).

However, even where production has been totally or partially outsourced to subcontractors, companies continue to carry out product design and marketing activities in house. These stages are closely related, since designing a successful sample collection requires constant monitoring of the market (taste, demand trend, fashion etc.) and keeping close relationships with the retailing system[19].

For example, near-shoring is a functional upgrading strategy for footwear firms in Brenta, Italy, which specialises in the high-end footwear market for major fashion houses[20]. The company has moved low value added activities and products to low wage countries such as Romania, generally through outsourcing, and focusing on production for the luxury market at home[21]. The impacts on Romania of such strategies are examined in the Timis case study in Task 3.

SMEs in Valencia had made significant use of outsourcing, primarily to other companies within the region (although some had offshored/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.

2.2.6 Closure

As a result of locational restructuring and increased competition, there was a continuous reduction in the number of footwear firms in the EU between 1999 and 2007. Eurostat data[22] indicates that the number of firms in the footwear industry fell by 10% between 2004 and 2007 alone. Figure 2.1 illustrates the reduction in the numbers of footwear firms in Europe from 1999 to 2007.

18 IBIS (2010).

19 Amighinia A & Rabellotti R (2006)

20 Amighinia A & Rabellotti R (2006)

21 Anon (undated)

22 Eurostat (2011):

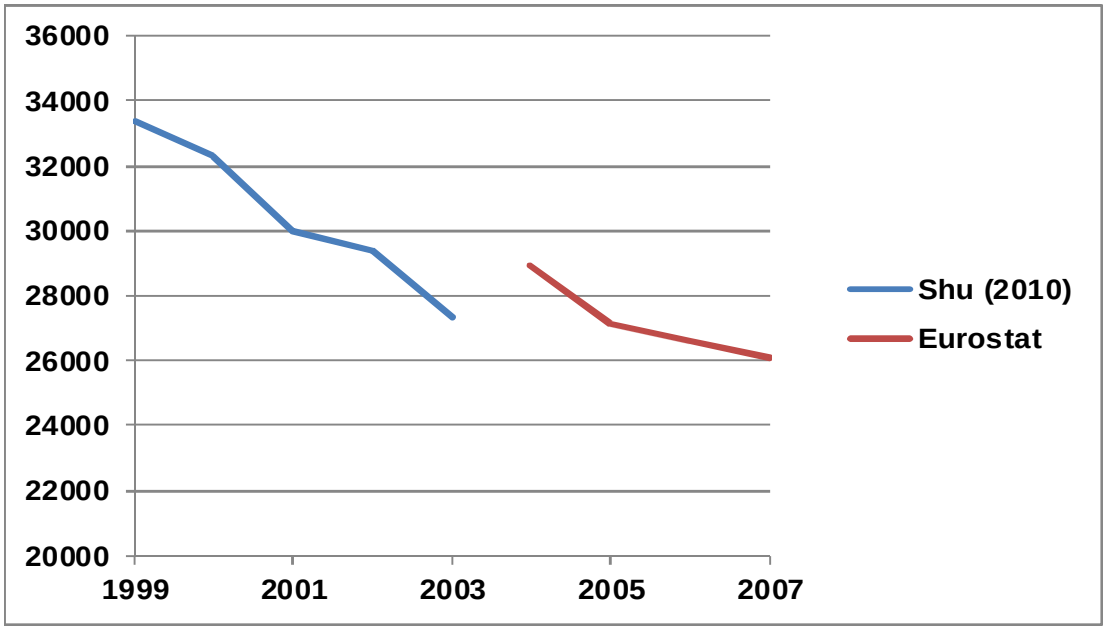

Figure 2.1: Number of Footwear Firms in Europe (based on Eurostat (2010) and, for pre-2004 data, Shu M (2010))

2.2.7 Mergers and Acquisitions

In response to the new competitive environment, Capasso and others[23] found that firms located within clusters have been forced to achieve greater efficiency by growing in size, through strategies of merger and acquisition and the creation of business groups, as well as by cutting costs. As a consequence, industrial districts that were once characterised by networks of SMEs, are now more often populated by large and medium size firms, and, in several cases, the local leaders have turned into "small multinationals" or business groups that govern global value chains.

There are few published data available on mergers and acquisitions in the footwear industry, as most deals are not sufficiently large to merit the attention of competition authorities. The mergers which have been publicised, such as Adidas acquiring Reebok and PPR acquiring Puma in 2005 (see Section 6.1) and VFC acquiring Timberland in 2011 involved companies where footwear is only one part of their activity. However, the case studies in Sections 3-7 of this report provide some examples of mergers and acquisitions by footwear-specific companies.

[23] Capasso M, Cusmano L and Morrison A (2010)

2.3 Drivers of Restructuring in the Footwear Sector

2.3.1 Introduction

The concept of drivers for restructuring, as described in the literature on globalization, is rather "fuzzy". For instance, technological change and innovation is exogenous in the view of the traditional neoclassical approach, while recent economic growth theory attempted to internalize technology and innovation. From the company's perspective, some exogenous drivers may be compulsory, such as new state regulations on environmental protection, changes in tax and tariff regulation or changing labour market regulation. Others may create new opportunities, such as through innovation in production technologies (automation), new materials (e.g., textiles in upper production), new IT based concepts (e.g., merchandise planning and control systems) and organization (new workflow management).

Globalization in manufacturing (through delocalisation, both in the form of offshoring and outsourcing) is often said to be driven by changes in transport technologies which have caused a decline in transportation costs, innovation in information technologies and cross-country regulation reducing transaction costs. Altogether, these factors create new opportunities for emerging multinational companies, resulting in increasing competition in markets. As a consequence, differentiation between endogenous and exogenous drivers or between push factors (in the sense of traditional migration theory: pushing the footwear sector out of Europe) and pull factors (attracting footwear companies to a location abroad) seems arbitrary. It may thus not be appropriate for understanding the reciprocal processes of challenge and action creating new challenges (for others, if the action is successful).

A general perception in much commentary is that the footwear sector is foot-lose and prone to easy delocalization, in particular as companies often seek greater cost efficiency[24]. From the perspective of the knowledge bases of sectors, only "tacit" knowledge may tie an industry to a region or nation. "Tacitness" could be related to an immobile skilled labour force, if skills are important for quality production; to spillovers from local knowledge sources in technological development (such as specialised universities), if products are innovative; and to proximity to (fashion) markets, if speed to market and customization are required. It seems clear that the non-production parts of a footwear company following a strategy of high quality high priced (fashion) products are less foot-lose than merely cost efficiency-seeking production.

2.3.2 Drivers for Changes to Company Strategies

Respondents to the Task 1 survey identified a number of challenges to the industry. The highest rated challenges were:

- costs of production;
- competition;

[24] see, for example, Hoffman U (2003)

- finding customers;
- access to new markets; and
- availability of skilled staff.

These were broadly consistent (although in a different order) with those identified in the general survey for the Eurobarometer 'Access to Finance' report[25] as:

- finding customers (29%);
- access to finance (16%);
- competition (13%);
- availability of skilled staff (8%) ; and
- costs of production or labour (8%).

For responding industry associations, the main challenges were seen as 'access to new markets', 'availability of skilled staff' and 'access to finance' which were not rated quite so highly by the responding companies. For the responding trade union 'competition' and 'access to new markets' were seen as 'very challenging'. Most of the six challenges identified as 'moderately challenging' were also in the top eight of those identified by companies. Furthermore, according to the union, these challenges had led (and would continue to lead) to job losses, pressure on pay and reduced training.

Based on its experience over many years with the footwear industry across the EU and world-wide, SATRA identified a number of key drivers:

- **technology**: the increasing availability of technology to either replace labour or to enhance what labour can achieve (such as new types of robots, software; new types of adhesives);

- **labour**: the lack of new labour entering the footwear manufacturing sectors results in an aging work force with less flexibility. These two drivers are interconnected; the lack of labour hastens the introduction of technology and the use of technology reduces the labour force;

- **markets**: the increasing average age of consumers in most Western countries and Japan, coupled with a move by the younger generation away from dress shoes to casual footwear, and the growing power of the brands to market their lifestyle products has changed the market. Offering quality/fashion/value for money has helped some Western manufacturers to retain their market share, but in the next five to eight years we will see growing competition from Asian (especially Chinese and Indian) brands exported to the West. There are also new requirements from retailers, such as requiring new IT based order systems; increasing flexibility in deliveries, such as increase in number of collections per year, fast fashion; changes in price and/or quality;

[25] Flash Eurobarometer (2009)

- **globalisation**: the drive to compete with lower prices of products made in south east. Asia and Brazil. Both distributors and the consumers have come to expect year on year reductions in the real price of footwear and therefore, to compete, the footwear industry has established supply chains that meet this demand. This has given the major sourcing companies the power to control large sections of manufacturing in low cost countries. However, we see already these manufacturers flexing their muscles by expanding their domestic markets; and

- **environmental issues**: consumer concerns about environmental issues such as global warming, ecological characteristics of products (concerning leather, colours and adhesives) and recycling/end of life. There are also new regulatory requirements. These issues offer Western manufacturers a marketing edge, especially for claims about the carbon footprint and air miles travelled of products. This is still an underdeveloped driver but the signs are that it will be significant. There is no evidence yet to indicate if the growing domestic markets in China and India know or care about this, so as an export route it seems unproven.

2.3.3 Increased Competition

Rabelotti[26] identified different types of increasing competition faced by Italian footwear companies:

- competition from low priced imports from outside the EU; and
- competition within the EU from new forms of organization in the value chain.

Examples of both types of competition were identified in the case studies described in Sections 3-7 of this report.

International Competition and Trade Policies

The footwear sector has faced a series of challenges connected with the liberalisation of world trade. Increased offshoring has made the footwear industry highly globalised and has created strong competition between producers in the EU and in Asia. Chinese producers now undertake 60% of all global footwear production[27]. European policy makers have sought to protect the interest of EU manufacturers through a series of international agreements. These are summarised in Table 2.2.

[26] Rabelotti R (2004).

[27] IBIS (2010)

Table 2.2: Timeline for the Tariffs and Quotas	
Year	**Trade Agreement**
1974-1994	Multi-fibre Arrangement (MFA) - The MFA governed the world trade in textiles and garments from 1974 through to the end of 1994, imposing quotas on the amount developing countries could export to developed countries
1995-2004	Agreement on Textiles and Clothing (ATC) – the WTO Agreement on Textiles and Clothing, negotiated in the Uruguay Round, became operational on 1 January 1995
2006-2009	The EC placed anti-dumping duties in 2006 to protect the EU footwear manufacturers from import surges. The EC imposed duties of up to 16.5% on Chinese and 10% on Vietnamese leather footwear for two years in 2006
2010-2011	The anti-dumping duties were due to be lifted on 1 January 2010 but on 22 December 2009 the EC took the decision to extend the duties for a further 15 months until the end of March
2011	The anti-dumping duties were phased out on 1 April 2011

Table 2.3 shows that EU imports in 2008 were valued at almost €27 billion, or 3.1 billion pairs. The 4.0% average annual increase in value since 2004 compares with a more significant 6.3% average annual increase in volume. These two key figures illustrate the increasing role that imports are playing in the EU market.

Table 2.3: Imports of footwear into the EU 2004-2008, € million/millions of pairs

	2004		**2006**		**2008**		**Annual Avg. % change in value**
	Value	**Volume**	**Value**	**Volume**	**Value**	**Volume**	
Excluding developing countries	2 556	212	2 046	116	472	29	-34.5
Developing countries	8 289	1 521	11 101	2 022	11 443	2 232	8.4

Source: CBI (2010a).
Notes: 'Developing countries' include China

The role of developing countries (including China) in supplying footwear to the EU has become increasingly important. In 2004, 36% of all footwear imports by value (62% by volume) into the EU were from developing countries. By 2008, this had increased to 43% by value (71% by volume). China and Vietnam are the largest exporters of footwear into the EU market and in 2009; they accounted for 63% in value and 85% in volume of all imports into the EU.

While some European footwear manufacturers have called for further action against what they consider to be dumping of footwear products on the EU markets, other companies that have invested in cost-cutting production chains around the world opposed the anti dumping tariffs. Some such companies claim that tariffs were limiting economic growth and economic recovery as well as harming its EU companies and consumers through increased prices. A similar view was expressed by an association representing independent retailers, which considers that overseas production benefits customers by reducing prices and that most of the value-added in

fashion lies with the design and distribution, rather than manufacturing, so that locational restructuring benefits the EU economy.

Other EU manufacturers interviewed for the case studies instead called for the focus to be on ensuring equal access for EU manufacturers to export markets. Exports from the EU in 2010 consisted of 177 million pairs of shoes valued at € 4 776 million. Despite a sharp downturn in 2009, the overall figures (for both volume and value) show a slight increase over the period 2006-2010.

Competition within the EU

Rabelotti[28] identifies two main new sources of competition for the footwear sector within Europe:

- in the luxury segment, by high value fashion brands, which added shoes to their product range during the 1990s (such as Gucci and Louis Vuitton); and
- from vertically-integrated large fashion chains (such as Zara).

The luxury fashion system has gone through important changes in the late 1990s and early 200s, turning it into an oligopoly dominated by a few multi-product giants. The growth strategy of many companies has been characterised by a similar pattern: first of all successful firms established their brand names in specific product lines (for example LVMH, Gucci and Prada began producing and selling leather goods), then they capitalised on their brand names and diversified to other segments (in the cases named above, they entered into clothing, footwear, glasses, perfumes, wines) and finally, they have also grown through the acquisitions of other well known existing brands. The economic logic behind these growth strategies is a search for economies of scale in activities other than manufacturing, such as branding, marketing, advertising and retailing.

The entry of such brands into the footwear market introduced a new form of competition for shoe manufacturers focusing on the luxury end of the market. However, it also brought opportunities, as in the case of Brenta, Italy (see section 4). In this case, the fashion labels outsourced manufacturing of footwear to companies in Brenta, which enabled them to remain in business and even expand, as the luxury market has been an area of growth, even through the economic crisis. However, as the fashion labels provide the designs and undertake sales and marketing, this could be seen as a form of functional downgrading for the firms in Brenta.

The second area of competition within the EU is also buyer-driven, but is more focused on the lower and medium-range segment of the market. In response to the reduction in footwear prices over the last 10 years, as cheaper imports have become increasingly available, the retail chains in the EU have become more powerful. They are introducing new requirements, such as the use new IT based order systems, increased flexibility in deliveries, including as increase in number of collections per year and fast fashion, and keener prices combined with quality.

[28] Rabelotti R (2004)

A further development of this area of competition is the trend for retailers to develop their own footwear designs and outsource production directly to manufacturers in lower cost countries, either to 'far shore' destinations in Asia or to eastern European countries. For example, German retail chains have outsourced production of children's footwear to Poland (see Section 5) and ladies fashion shoes to China (see Section 6).

2.3.4 Increased Costs of Production

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.

Production costs in the footwear sector have traditionally been mainly ascribed to labour costs. Labour costs have substantially increased in most European countries in recent decades, both absolutely and relatively compared to Asian countries. Yet European footwear companies still survive, either by seeking lower waged production at home (for example through outsourcing to nearby home workers) or seeking compensation for high wages by focusing on high price market niches.

Because footwear production is so heterogenous, though, other costs can become even more important. These can include the costs of raw materials, particularly of leather (for example, prices have increased in Germany by 7.9% recently and even more for bio-leather), costs of technology (through investments in automation and replacement of labour) and costs of entry into new sales channels. As a result, focusing simply on the basis of absolute labour costs may not be sufficient to explain the persistence of footwear companies at a European location or delocalization abroad.

Companies responding to the Task 1 survey indicated that 'costs of production' had been the greatest challenge over the past five years and, furthermore, this was also considered to be the greatest challenge for the next five years. Most companies indicated that production costs had increased by 25-50% over the past five years; mostly associated with increases in raw material and labour costs.

SMEs interviewed for the Task 3 report noted that, 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.

2.3.5 Availability of Skilled Staff

From the footwear manufacturing perspective, training and development of footwear employees is essential for effective operation and innovation. From an employee perspective, the same factors are critical for skill development. The development of new products, and changes in sales channels, mean footwear businesses are faced with the need for new improved skills and techniques. A major contributory factor to the lack of trained employees is the historically low wages that are paid in the industry

and the resulting failure to attract workers from other industry sectors. Around 40% of the companies responding to the Task 1 survey indicated that they were experiencing skill shortages. All but one of the responding companies provided training and full-time training in-house and/or apprenticeships were provided by nearly half.

The Task 3 report found that, historically, it has been the larger employers who have led in training and development activities, as smaller companies have found it difficult to finance the training of employees. Small companies have relied on "trickling down" as trained employees move on, bringing their experience and training to the wider market. However, as the number of larger employers contracts and training budgets are cut in response to tough market conditions, smaller employers can no longer rely on the trickle-down effect and must look to develop skills within their own businesses

2.3.6 Changes in the Market

In order to compete on a global level and share some of their costs, smaller producers have been joining with colleagues, designers and trade associations to compete with Asian suppliers. The leading producer countries (such as Italy, Germany, France, Spain and Portugal) have all embarked on a campaign of origin marking to help their sales efforts in both domestic and overseas markets. However, there is some controversy over what origin marking signifies in practice, and about the extent of monitoring and enforcement of origin marking schemes[29].

Traditionally, the footwear market makes a distinction between two seasons: summer and winter. However, the influence of media and celebrities on footwear styles has meant that EU producers have had to adapt to a more rapid turnover in footwear styles, whereby lead times are greatly reduced. Some producers market more than two product lines per year; in some cases, the market requires four or even six collections per year, leading to extreme fragmentation of production batches. This development makes product life-cycles increasingly short, making it more difficult for producers as well as retailers to keep up with new developments and at the same time trying to get rid of their old stock.

One response has been to switch offshoring from locations such as China to nearby countries, or even keeping manufacturing processes within the country in order to supply smaller quantities and guarantee a time-to-market of two to three weeks. Suppliers are also affected by these changes; for example, many tanneries have become more flexible and can adapt to the rapid changes in demand

2.3.7 Impacts of Other Policies

Neither the literature nor the first three case studies identified other policies as a particular driver for restructuring, and this has been confirmed by the case studies described in Sections 3 to 7. Regulations such as REACH, the new chemicals

[29] Interview with the European Association of Fashion Retailers, AEDT, September 2011

regulation, will impact the sector by introducing downstream user obligations or safe management of chemicals. The use of large volumes of water by the leather industry in the tanning process is an increasingly important issue. Pollution of the water supply, as well as shortages of water in some countries such as Spain, is forcing changes to working practices.

However, the environmental concerns of consumers have been identified as an area of increasing importance, and opportunity, for the EU footwear industry. A number of companies are manufacturing eco-friendly footwear to gain a competitive advantage against Asian producers. Vegetable tanning[30] is now increasingly used, particularly for luxury goods, where clients are more environmentally aware.

2.4 Impacts of Restructuring

2.4.1 Introduction

Although the footwear sector developed along with industrialization and urbanization across Europe in the late 19th and early 20th centuries, regional trajectories are quite different. They are dependent upon:

- the status of countries as forerunners or latecomers in industrialization;
- early and late responses to societal changes such as the shift from Fordist to Postfordist industrial organization;
- low-road and high-road alternatives to industrial restructuring (see below); and
- different state policies.

The current literature indicates considerable heterogeneity in the state of restructuring in the footwear sector and its clusters which, can be distinguished between a "low road" trajectory (lack of social cohesion, lack of innovation, low wage production and subcontracting) and a "high road" trajectory (based on technology and innovation, local networks, pro-active restructuring strategies, changes in educational and training institutions). This was recently discussed using the example of Italian industrial districts[31] . There appears to be a continuum of footwear clusters, ranging from:

- those that have achieved a 'high-road' steady state of restructuring (such as in Germany, the Italian districts of Brenta[32] or Portugal);
- 'low-road' growth regions based on relocation via subcontracting from old footwear districts to districts in transition with low wages, such as in Romania[33] and to some extent Poland;
- the shrinking of 'low-road' districts (such as in Italy and, particularly, in Spain where the turn-around from an earlier informalisation strategy[34] to a new 'high-road' strategy is still unclear[35]; and, finally

30 Ellis L (undated)

31 Ramazotti P (2010)

32 Amighini A and Rabelotti R (2006)

33 Crestanello P andTattara G (2011)

- decline (some Italian districts) and demise of clusters, as in France[36,37].

As a consequence, recent research on the restructuring in the footwear sector and local clusters emphasizes, as discussed in Section 2.2, tremendous differences in the impact of firm restructuring, depending on the heterogeneity of firm strategies, local networking and policies. With the exception of the Montebelluna district[38], restructuring is generally tied to a reduction in employment and the number of companies. However, the decline of the local footwear industry could be halted in those regions which chose some form of 'high road' trajectory.

2.4.2 Evidence from Other Tasks

Overall, restructuring of the EU footwear industry over the last 10 to 15 years has led to steady reductions in production, the number of companies in operation and employment. There was a further decline following the financial and economic crisis of 2008 and 2009. However, amongst respondents to the Task 1 survey, some companies were increasing staff numbers (particularly administrative staff and skilled workers) while others were reducing (particularly unskilled workers) and some were staying the same (see Figure 2.2).

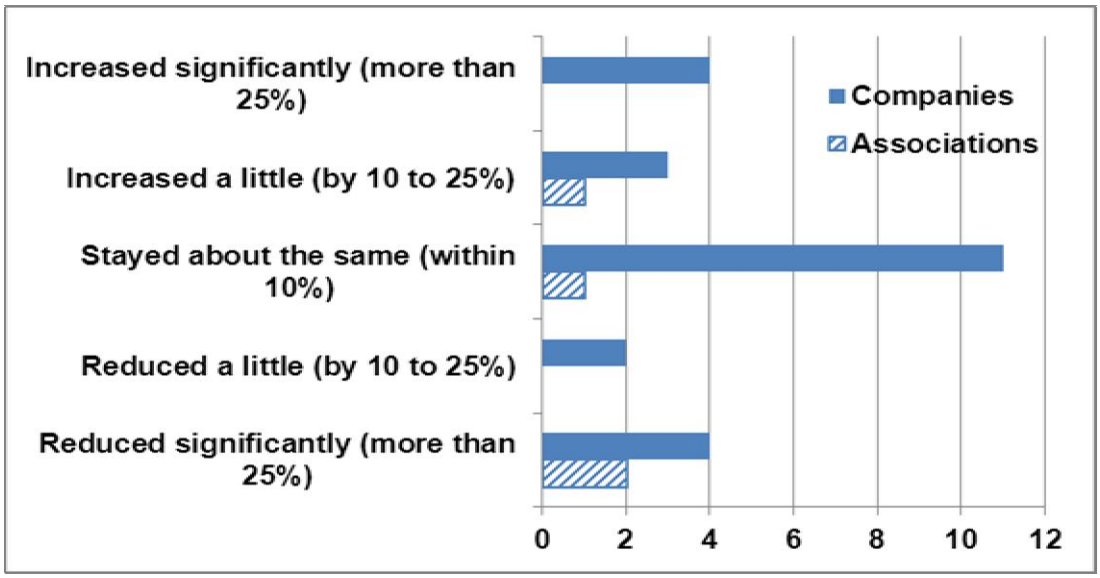

Figure 2.2: Responses from 24 Companies and four Industry Associations to*: Has the number of people you (your members) employ changed in the last 5 years?*

34 Ybarra J A (2000)

35 Herrero G P and Puche A M (2003)

36 Le Bot F and Perrin C (2009)

37 Courault M (2006)

38 Sammarra A and Belussi F (2006)

Respondents were also what action they had taken in response to the drivers for restructuring. Figure 2.3 shows that the emphasis was very much on 'high road' approaches, such as improving the production and selling of existing products through improved product design/quality, improved image/communication/service and product customisation.

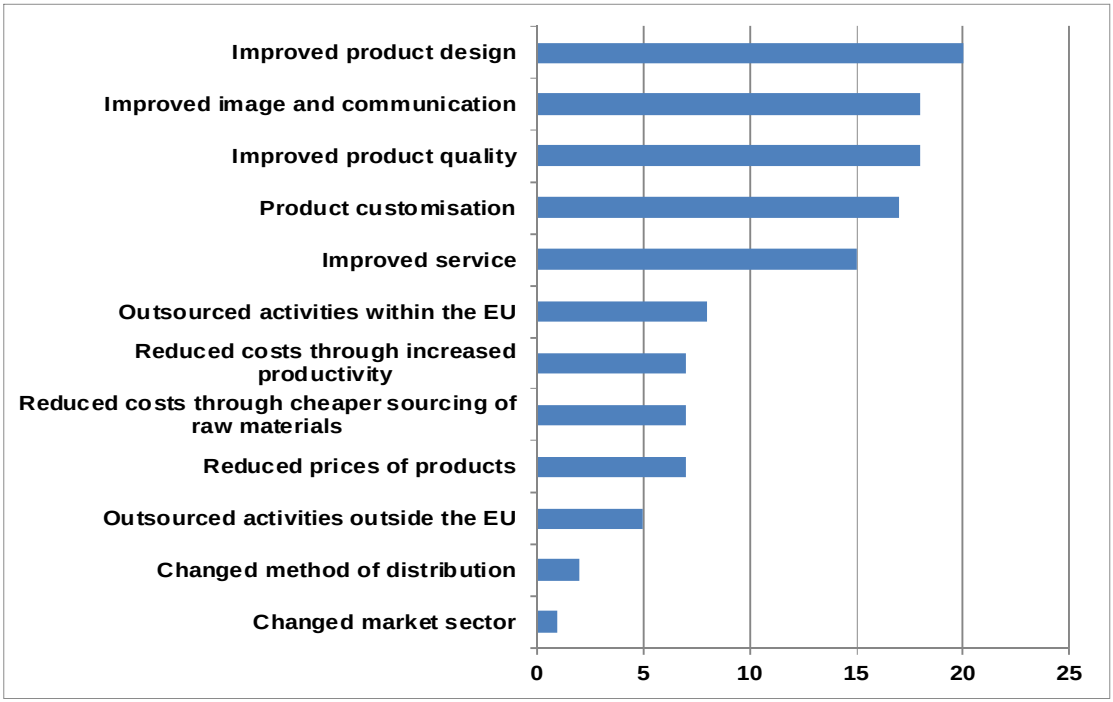

Figure 2.3: Responses from 24 Companies to: ***What actions have you taken in the past 5 years in response to the challenges facing the footwear industry in Europe?***

In all three regions covered by the Task 3 case studies, 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 (again, this represents a 'high road' approach).

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. This provides an example of how restructuring can eradicate inefficiencies.

2.5 Effects of the Economic Crisis

The economic crisis exacerbated the problems already being faced by the footwear sector. However, the picture of its impact is mixed. 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 experienced 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[39].

Although more recent comprehensive data are not available from Eurostat, there are indications from some countries that turnover declined sharply in 2009, but that there was some recovery in 2010, as shown in Table 2.4.

Table 2.4: Available Data from Eurostat on Turnover of Manufacture of Footwear since 2007

Country	Index of Production (2005 = 100)			
	2007	**2008**	**2009**	**2010**
Germany	105.52	103.14	72.44	84.98
Italy	112.02	113.90	97.52	111.07

Source: Eurostat (2011)

Data on sales and production from national associations also suggest that the industry has managed to stabilize output levels following the steep drops in 2008-2009. 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 to the previous year[40].

From 2008 to 2009, the total number of company bankruptcies across all sectors increased in most European countries. One key factor was un-availability of finance; even companies with a high demand for their products have faced problems because of their customers being unable to find the credit to pay them[41]. It is notable that the majority of companies responding to the Task 1 report had used self-financing for investments. Although over half of the survey respondents still found access to finance 'quite easy', this varied by company size, with a larger number of small companies finding access to finance difficult.

Lack of credit was a particular problem for companies that began to restructure before the downturn, and had borrowed large amounts of money to do so, suddenly found their sales income falling and reluctance on the part of banks to extend more credit[42]. However, the majority of large-scale restructuring in the industry, particularly locational restructuring, took place in the first half of the 2000s and was therefore complete before the recession took hold.

39 Plimsoll Worldwide Business Intelligence (2011)

40 ANCI (2011)

41 Eurofound (2010)

42 Eurofund (2010)

3. CASE STUDY: NORTE

3.1 Introduction

3.1.1 The Footwear Industry in Portugal

Detailed statistical data on the Portuguese footwear industry is published by the Portuguese Footwear, Components & Leather Goods Manufacturers' Association (APICCAPS). Information in this section is drawn from the Association's annual statistical publication[43].

The Norte region is Portugal's main footwear producing regions. It contains 96% of all Portuguese footwear companies and employs 98% of people working in the industry. **The Norte regional industry and the national industry are thus effectively the same thing**.

3.1.2 The Footwear Industry in Norte

Norte is one of five regions of mainland Portugal and is in the northern part of Portugal. The region has around four million inhabitants and is one of the poorest in Portugal; it has the second lowest labour force productivity in the country, and one of the highest unemployment rates.

Norte has three main footwear producing areas:

- the "old" industrial district south of Porto, around Sao Joao da Madeira, Santa Maria de Feira and Oliveira de Azemeis, where many small companies are located (together with the footwear research institute);
- the fringes of the city of Porto, where the larger factories of foreign companies were located and where some plants still remain; and
- the Felgueiras and Guimaraes area, where more medium sized Portuguese companies are located.

The municipality of Felgueiras alone employs one third of the people in the footwear industry, with a further 10% in Guimaraes. Together with Santa Maria de Feira and Oliveira de Azemeis, these four municipalities account for 70% of total footwear sector employment in Portugal. About 67% of the components industry workforce is also concentrated in these municipalities.

Industry Structure and Employment

Portugal has a significant presence in the footwear market. According to APICCAPS, in 2010 Portugal's shoe industry comprised approximately 1,350 firms. The industry is comprised of mainly of small and medium-sized companies. The average company

[43] APICCAPS (2011a)

employs just over 24 people, larger than the average in Spain or Italy. The average size has fallen significantly in recent years (in 1998 it was 34 people). This is mainly due to the closure of large, foreign owned companies in the last decade.

With around 33 000 employees, footwear is one of the nation's primary employers within the manufacturing sector. During 2010, the industry focused on maintaining levels of employment. In a period of reducing output, this resulted in a 9% reduction in labour productivity from over 2 000 pairs per worker per year to about 1 900. However, the reduction in value of output per worker was only 3.6%, to €42 000. This is a long-term trend in the industry; the quantity produced per worker peaked in around 2000 and has reduced since, due mainly to the closure of large factories which focused on high production runs. By contrast, value added per worker increased throughout the decade.

Table 3.1 summarises the changes in the numbers of footwear manufacturing companies and employment in Portugal 2004-2010.

Table 3.1: Footwear Industry Structure and Employment in Portugal, 2004-2010

Year	Number of Companies	Number of Employees	Average number of Employees per Company
1994	1 635	59 099	36
2004	1 432	40 255	28
2005	1 481	37 836	26
2006	1 448	36 221	25
2007	1 424	36 366	26
2008	1 407	35 398	25
2009	1 346	32 510	24
2010*	1 354	32 738	24

Source: APICCAPS (2011a)
**APICCAPS Forecast*

Although the number of companies has reduced by 281 (17%) since 1994, the number of employees has fallen by over 26 000 (44%) over the same period. According to APICCAPS[44], this is due mainly to relocation of the foreign-owned companies that once operated in the country. There are now only 10 to 15 foreign owned companies remaining. Such companies once represented approximately one quarter of employment in the sector in Portugal, but now account for less than 10%[45].

Production

The industry produced around 62 million pairs of shoes in 2010, with a value of around €1.4 billion. Production by the Portuguese industry has been reducing since the beginning of the century; during the 1990s, Portugal produced over 100 million pairs a year (see Table 3.2). The reduction in output was due to a series of

[44] APPICAPS (2011a)

[45] APPICAPS does not have exact figures on foreign-owned companies; these are best estimates

circumstances, including competition from China and other Asian countries for market share and foreign investment, following the removal of trade barriers. The enlargement of the EU to countries with lower labour costs, and greater proximity to the markets of central Europe, also increased competition for foreign investment.

Table 3.2: Production, Exports and Imports of Footwear in Portugal by Numbers of Pairs, 2004-2010

Year	Production (million pairs)	Exports (million pairs)[1]	Imports (million pairs) [1]
1994	108.8	89.4	15.0
2004	84.9	75.2	33.2
2005	72.3	64.3	39.2
2006	71.6	63.8	41.2
2007	75.1	71.8	55.6
2008	69.1	64.7	50.1
2009	67.0	63.3	54.4
2010*	61.5	68.1	67.6

Source: APICCAPS (2011a)
Notes:
1. Includes trade with other EU Member States
**APICCAPS Forecast*

Table 3.3 provides information on the production, export and import of footwear by value. The table shows that the value of production has reduced since 2004, but by a much lower percentage than the reduction in numbers of pairs (6% compared to 27%). The average value of footwear has increased by nearly 29%, from around €17 per pair in 2004 to €22 per pair in 2010[46].

Table 3.3: Production, Exports and Imports of Footwear in Portugal by Value, 2004-2010

Year	Production (€ million)	Exports (€ million) [1]	Imports (€ million) [1]
1994	1 620	1 284	97
2004	1 471	1 273	271
2005	1 307	1 138	285
2006	1 339	1 166	318
2007	1 337	1 268	397
2008	1 398	1 291	432
2009	1 418	1 232	401
2010*	1 376	1 296	430

Source: APICCAPS (2011a)
Notes:
1. Includes trade with other EU Member States
**APICCAPS Forecast*

[46] This compares with an average inflation rate for Portugal between 2002 and 2010 of 2.5%. (Information from http://www.tradingeconomics.com/portugal/inflation-cpi)

Table 3.4 provides a breakdown of production by type in 2010. Leather footwear dominated production, accounting for over 80% of all production volume and nearly 90% of production value. Around half of leather footwear production is of ladies shoes and around one third of men's shoes. The table also shows that the average (wholesale) price of leather footwear is considerably higher than that of most other types.

Table 3.4: Production of Footwear by Type in Portugal, 2010

Type of footwear	Volume (million pairs)	Value (€ million)	Average price (€)
Leather			
Ladies	23.5	615.5	26.2
Mens	18.6	465.6	25.0
Childrens	4.9	89.9	18.4
Unisex	0.9	18.6	20.9
Safety	0.8	22.1	28.2
Sports	0.3	7.7	28.7
Other leather footwear	0.9	21.4	24.8
Total leather footwear	49.7	1240.7	24.9
Other materials			
Textile uppers	6.2	24.6	3.9
Water resistant	2.4	15.3	6.4
Other plastic	2.1	14.9	7.2
Other materials	1.2	80.9	n/a*
Total	**61.5**	**1376.4**	**22.4**

Source: APICCAPS (2011a)
** due to various data problems, the average price for this category is not statistically valid*

Footwear Components

Table 3.5 provides information on the footwear components[47] industry in Portugal. The number of firms and employees has been declining steadily since the 1990s and Portugal has been a net importer of components throughout this century, with imports around 50% higher than exports.

Table 3.5: Production of Footwear Components in Portugal, 2004-2010

Year	Number of Companies	Number of Employees	Value of Exports (€ million)	Value of Imports (€ million)
1999	263	5 569	99.2	143.3
2004	303	5 431	72.8	118.9
2005	305	5 268	58.9	103.6
2006	297	4 707	51.4	95.8
2007	256	3 917	45.8	111.9
2008	276	4 090	49.1	97.9
2009	259	3 901	48.0	80.3
2010*	258	3 895	45.5	89.2

Source: APICCAPS (2011a)
**APICCAPS Forecast*

[47] Producers of parts of footwear, such as uppers, soles and heels

International Trade

Tables 3.2 and 3.3 also provide data on exports of Portuguese footwear and imports of footwear into the country (including trade with other EU Member States). The data in the table indicate that the value and volume of exports has remained fairly constant over the period 2004-2010, while the value and volume of imports has increased rapidly. However, this masks the fact that, according to APICCAPS, the development of overseas footwear trade in Portugal has gone through three distinct phases:

- during the 1990s, exports grew faster than imports and the trade surplus in footwear grew from €830 million in 1991 to €1,360 million by 2001. Foreign-owned companies played a key role in this, accounting for nearly 40% of exports in 2000;

- the period from 2000-2005 saw a restructuring of the industry, with the closure of the majority of large, foreign-owned firms and greater competition from China in the major markets. Portugal's exports fell by nearly 30% between 2001 and 2005 and imports rose, with the trade surplus in footwear falling to around €850 million; and

- since 2005, footwear exports have risen in value (though reduced in volume), with a dip due to the economic crisis in 2009. In 2010 exports recovered to nearly €1 300 million, over 5% up on the previous year. Despite a further increase in imports, the trade balance also improved, by 4%, to €866 million.

The Portuguese footwear industry is now strongly focused on exports, with 95% of production exported in 2010. However, this was accompanied by a slight fall in the average export price to €19, compared to €20 in 2008, although the long-term price trend is upward. The main exports are of ladies' and men's leather footwear.

Footwear exports are primarily aimed at Europe (96%), with the remaining 4% spread between America (1.6%), Asia (1.2%) and Africa (1.1%). Five markets alone (France, Germany, the Netherlands, Spain and the UK) account for over 80% of exports by volume and value. Figure 3.1 shows the main export destinations for Portuguese footwear exports.

In 2010, Portugal's imports of footwear were valued at around €434 million, or over 67 million pairs. Between 2005 and 2010, footwear imports grew by around 6%. A single country, Spain, accounts for 45% of total imports. Imports from Asian countries were 44% by volume or nearly 30 million pairs in 2010. China accounted for over 97% of all Asian imports by volume in 2010 (86% by value). Brazil, India, Indonesia and Vietnam were also important suppliers. Figure 3.2 shows the main sources of footwear imports into Portugal in 2010. From a quality point of view, the economical and medium footwear segments primarily consists of shoes made mainly in China and Brazil. High quality and fashionable shoes tend to come from Spain, Italy and the UK. Shoes in the moderate price and quality band also tend to be imported from Spain[48].

[48] CBI (2001e)

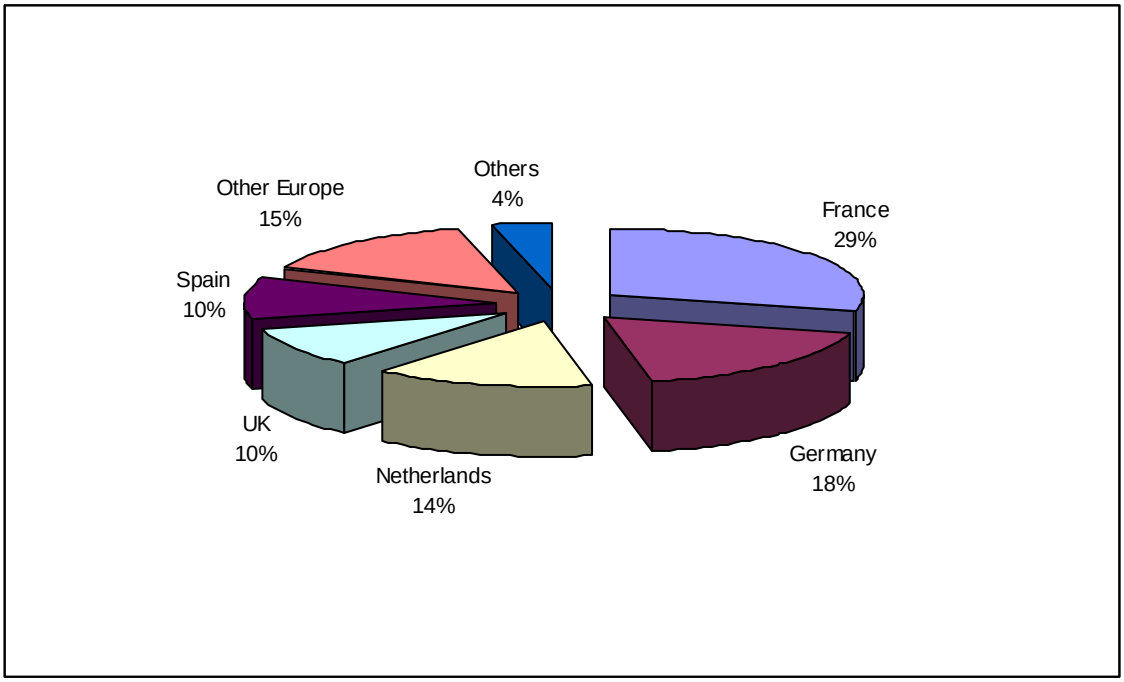

Figure 3.1: Destination of Portuguese Footwear Exports by Value, 2010 (Source: APPICAPS (2011a))

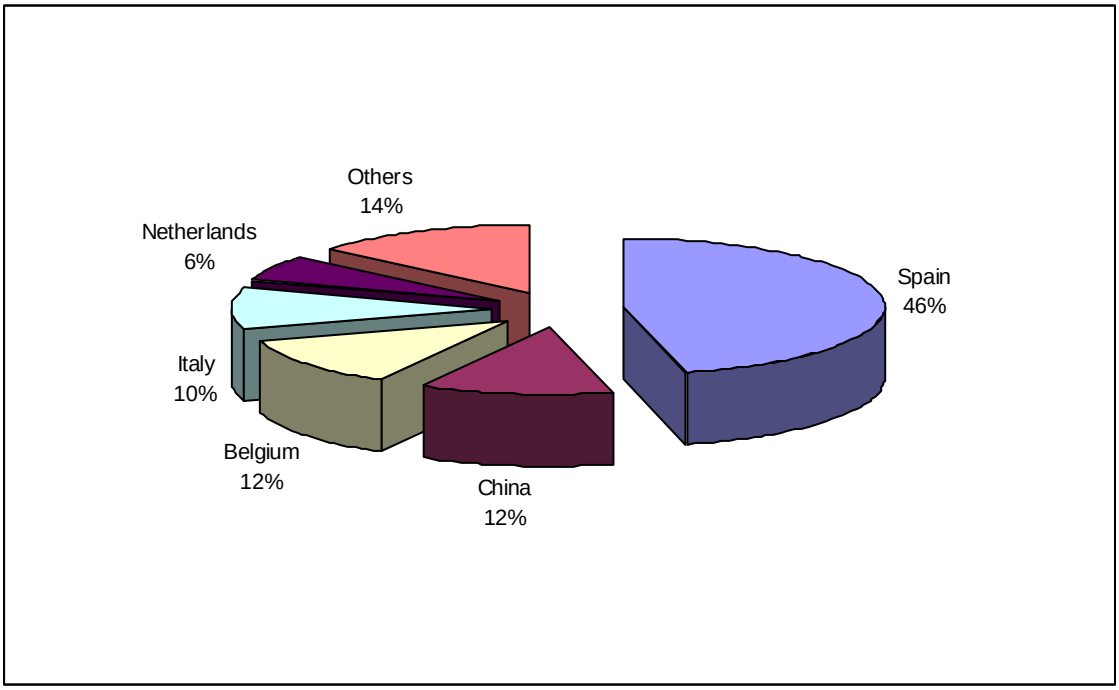

Figure 3.2: Source of Portuguese Footwear Imports by Value, 2010 (Source: APPICAPS (2011a))

Consumption

The first decade of the century has been one of near stagnation in the domestic market for footwear in Portugal, due to low growth rates in the economy as a whole, with a decline in average prices over the period. As Table 3.6 shows, the market was valued at € 543 million in terms of retail sales in 2010, 9% lower than in 2009. By volume, the Portuguese bought round 61 million pairs in 2010, around 5% fewer than in 2009. The decline in prices is partly due to increased consumption of all types of non-leather footwear (including sports footwear). Between 2005 and 2010, consumption of textile and plastic footwear increased by 47% and 77% respectively and consumption of water resistant footwear grew by 20%. By contrast, sales of men's and ladies leather footwear grew by only 7% and 6% by volume respectively over the same period. Sales of all other types of leather footwear fell.

Table 3.6: Footwear Consumption in Portugal, 2004 - 2009

Year	Quantity (Million Pairs)	Value (€ millions)
2004	42.9	469.1
2005	47.1	454.6
2006	49.0	490.7
2007	58.8	465.3
2008	55,4	538.3
2009	58.1	597.0
2010	61.0	543.0

Source: APICCAPS (2011a). Footwear, Components and Leather Goods Statistical Study 2011

Restructuring and Innovation

The footwear industry in Portugal has gone through different phases of restructuring over the last 20 years. Initially, this involved learning how to act as a subcontractor to foreign companies for the assembly of footwear. Secondly, after the retreat of foreign companies, it needed to adapt to new market conditions.

APICCAPS has taken a leading role in driving restructuring and innovation in the footwear sector in this later phase. It developed a Strategic Plan[49] for the sector, covering the period 2007-2013, which was based on APPICAPS and its members' understanding of market conditions, together with analysis by a university[50]. Preparation of the plan was supported by PRIME (Programa de Incentivos à Modernização Empresarial), within a project to strengthen Associations coordinated by IAPMEI (the Portuguese Institute for the Support of Small and Medium-sized Enterprises) and the economics ministry.

The studies identified a number of options for the future of the Portuguese footwear sector; this included:

[49] APICCAPS (2007)

[50] Centre of Business Administration and Applied Economics of the Catholic University – Regional Centre of Porto

- a focus on production innovation to increase productivity (which is important for international competitiveness); and

- flexibility and closeness to the market to enable companies to meet the requirements of customers for rapid production of small product runs (which allows for frequent changes in fashion, which in turn drives consumption). The flexibility model only works in the medium to high price and quality range; it is not a viable approach for low-cost footwear.

The plan was agreed by all members and is being implemented by the companies. Progress with the plan is being followed up by APICCAPS and by the University to check whether amendments are needed. Such close cooperation with universities is not a common model in Portugal; the University involved does not have a specific footwear department but specialises in industrial strategy and economics.

The Portuguese footwear industry has been moving up the quality scale since the 1990s; this has been a trend for the Portuguese economy as a whole post EU entry. The aim is to increase added value and service and to create Portuguese brands, rather than simply producing low-cost footwear for overseas brands. This was necessary after foreign footwear companies largely pulled out of Portugal in the period 2000/2001, moving production to locations in Asia with lower labour costs.

Innovation has been a key aspect of restructuring. Data on the use of intellectual-property protection instruments, presented in Figure 3.1, demonstrates the growing importance that Portuguese companies place on innovation; model registration requests grew rapidly until 2008, although numbers have reduced over the past two years. One safety footwear manufacturer that we interviewed has focused on product innovation, establishing its own brands. Particular attention has been given to the consequences for footwear design of changing demographics, such as people becoming older, heavier and/or suffering from medical conditions affecting their feet (such as diabetes[51]). The company has the largest number of patents per company in Portugal outside the chemicals sector.

[51] Ensuring correctly fitting footwear is very important for people who suffer from diabetes because poor fitting shoes, whether too loose or too tight, can cause rubbing leading to ulcers and further complications if not treated. Many people with diabetes experience numbness and loss of sensation in their feet, thus it becomes even more critical that they wear correct fitting shoes to ensure that ulcers do not develop.

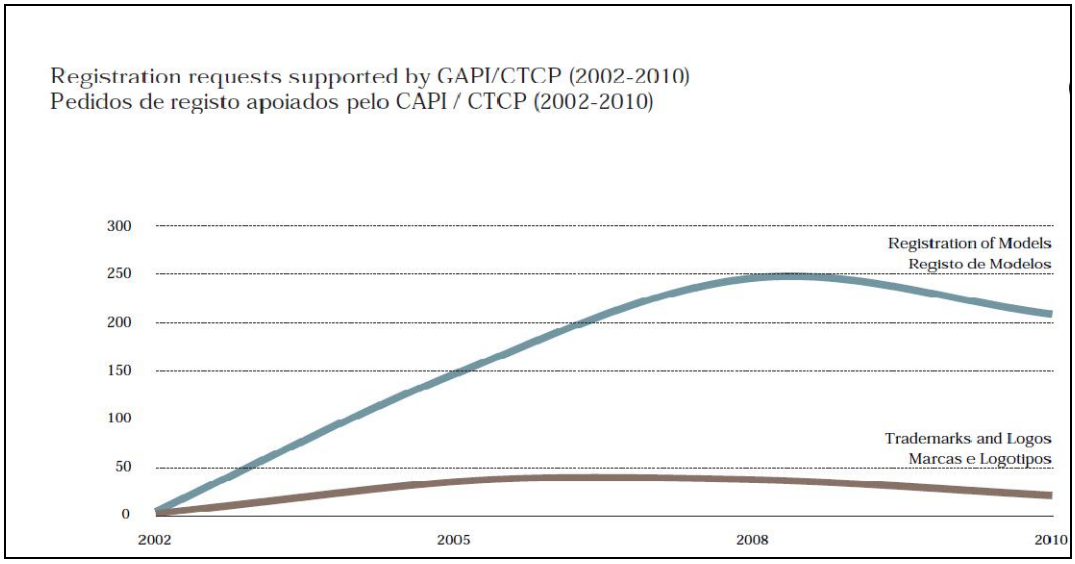

Figure 3.3: Registration Requests by Portuguese Footwear Manufacturers, 2002 – 2010 (Source: APPICAPS (2011a))

Despite this growth, however, there is some concern about the value of patents in protecting intellectual property. The footwear research institute (Centro Tecnologico do Calçado – CTCP) has taken out some national patents and has presented two or three international ones (but these are not yet complete). Taking out patents is an expensive process and, in addition, CTCP does not have the money to take action against infringements. It therefore considers that is better to present an idea in public, which means that the idea cannot be patented by anyone else. The safety footwear company described above takes out Portuguese rather than EU patents, because Portuguese patents take 1-2 months and Euro patents 3-4 years, as all Member States have to approve them. Euro patents are also more expensive to enforce.

3.1.3 Organisations Interviewed in Norte

Table 3.7 lists the organisations we interviewed in Norte.

Table 3.7: Organisations Interviewed in Norte		
Type of Organisation	**Main Activities**	**Size**
Industry Association	Representing and promoting the footwear, footwear components, leather goods and related equipment sectors	n/a
Research organisation	Research and development, consultancy, training and quality control for the footwear industry	n/a
Footwear manufacturing company	Manufacture of women's fashion shoes (€100 - €200 per pair in the shops after the retailers' margin of around 150%)	Medium
Footwear manufacturing company	Manufacture of women's fashion shoes (€100 - €150 per pair retail)	Medium
Footwear manufacturing company	Manufacture of safety shoes	Medium
Footwear manufacturing company	Manufacture of women's high-fashion shoes (€300 – several thousand € per pair retail)	Small
Footwear component manufacturing company	Manufactures of rubber and plastic soles for footwear	Medium
Process equipment manufacturing company	Manufacture of process and testing equipment for the footwear (and other) manufacturing sectors	Medium

3.2 Footwear Restructuring in Norte

3.2.1 Types of Restructuring

Companies in Norte have undertaken a range of different types of restructuring, often with companies adopting a number of different approaches at the same time:

- the most important focus of restructuring has been on reorganisation of sales channels, focusing on promotion of the image and reputation of the industry as a whole and of individual brands. Other types of restructuring have included;

- operational restructuring: the use of innovative technologies (including technologies developed by companies in the region, with the assistance of APPICAPS and the CTCP) and the reorganisation of processes to allow for production of smaller batches of footwear;

- product restructuring: an increased focus on design and new materials, together with a move into market niches such as safety footwear, professional footwear, health products and comfort shoes aimed at the ageing population; and

- only limited locational restructuring has taken place; this was mainly by foreign-owned companies, which had outsourced production to Norte, then off-shored to cheaper production locations, primarily in China. This led to the closure of a number of businesses in Norte.

Further information on each type of restructuring that has taken place is provided below.

The companies we interviewed were mainly privately-owned SMEs, with several being family firms. They included producers of ladies fashion footwear, safety footwear, synthetic soles and occupational footwear and footwear production machinery. Much of the investment for restructuring has been funded by company owners from their own resources. For example, investment by a high-fashion footwear manufacturer has mainly been self-funded and investment is continuing, with a new cutting machine on order.

EU funding has also been important for technology innovation and marketing promotion activities (see Section 3.3.3).

3.2.2 Operational Restructuring

Operational restructuring has taken place in line with the move towards higher value-added markets. As the industry began to produce more fashionable and own-brand shoes, there was a need for smaller batches and faster response times. This required innovation in equipment (to enable greater flexibility) as well as re-organisation of factories and more effective production management. For example, order sizes for one rubber sole manufacturer ranged from 500,000 down to 2,000 items. The company aims to provide consistent quality, technology and materials to all customers, but sometimes juggling the different orders can be challenging.

APICCAPS began to work with CTCP, Portuguese footwear and equipment manufacturers and universities in the 1990s. Its aim was to deliver innovative technologies and machinery for the industry. As the industry has gone through different stages of restructuring, from large-volume subcontracting of footwear assembly for foreign companies in the 1990s to adopting more flexible production after the foreign companies had withdrawn, the type of assistance provided by CTCP has also changed, with less focus on large-scale equipment and more on the use of IT.

In the early stages, CTCP focused in particular on new cutting technologies (water jet, laser), as these allowed for greater flexibility in production. Some new footwear equipment manufacturers were formed as a result of the cooperation (see Box 3.1).

Box 3.1: Formation of New Companies to Deliver Innovative Technologies

In the mid-1990s, CTCP issued a challenge to organisations to develop machinery specifically for the footwear sector, as its needs seemed different from other sectors. In particular, equipment was needed to help the industry meet the demand for smaller orders (for the limited own brand market) and customisation.

One solution identified was for automatic cutting equipment. The three shareholders in the company knew the sector and so started up the business to respond to the challenge. One of the founders was an academic working on CAD/CAM software; his partners were working in companies manufacturing equipment for other sectors. CTCP brought the partners together and also helped customers to obtain public funding to minimise their risk in working with the new company (the company itself received no public funding).

Source: Interview with footwear equipment supplier, October 2011

More recently, IT advances such as CAD systems, exchanging files with customers to make samples and 3D CAD have been critical in delivering the increased emphasis on

design and more frequent changes in collections which are a key part of the sector strategy.

The sector has adopted a cascade process for introducing innovative technologies. CTCP tends to work initially with the most progressive footwear manufacturers to develop new products or processes. Once these companies are able to demonstrate that the innovations are successful, they are taken up by others, including smaller companies (who may be sub-contractors to the advanced companies). For example, one particular CAD system was developed in 1997 with two companies; within two years, it was being used by 200 firms. In this way, the CTCP plays an important role in supporting the equipment sector in Portugal, which has a limited internal market due to the reduction in size of the sector.

Cross-fertilisation with other sectors has helped the internal restructuring of the footwear sector. For example, around 30% of the time of CTCP's R&D staff is spent going to exhibitions, learning from other sectors. Its links with universities are not with specific footwear departments but with departments having expertise in particular areas, such as informatics. This also helps CTCP to draw on the experience of other sectors. Such cross-fertilisation has also been assisted by equipment suppliers (see Box 3.28 in Section 3.6.2).

As well as new technology, meeting the requirements for increased flexibility required reorganisation of processes. CTCP was also able to assist with this process (see Box 3.2).

Box 3.2: Assistance with Process Reorganisation

In the 1990s, as the footwear industry in Norte began to move towards fashion shoes, with smaller batches and faster response times needed, CTCP began offering consultancy and technical assistance to help the industry with this transformation. The assistance focused on upgrading to more modern equipment, optimising the layout of factories and management of manufacturing. CTCP still provides such services for smaller companies and those with limited internal technical capability.

Source: Interview with CTCP, October 2011

In some cases, such process reorganisation meant that previous technology investments were no longer required, as Box 3.3 describes.

Box 3.3: Impacts of Process Reorganisation on Technology Requirements

During the 1990s, a company manufacturing casual footwear focused on restructuring of its technology base. This allowed it to increase production through greater automation and to approach new foreign customers as a sub-contractor. It invested heavily (€0.5 million per year) in new technologies. The company was one of the first in Portugal to use water jet cutting, CAD/CAM and automated cutting knives.

When the company downsized in the 2000s, after foreign customers relocated production outside the EU, much of this automated technology was no longer needed. The company switched to producing for its own ladies fashion brand, which required smaller series and larger numbers of styles (around 100 styles per collection, with 700 different combinations of styles and colours). The automatic conveyers were removed from the factory and production is now much more manual.

Source: Interview with footwear manufacturing company, October 2011

A second manufacturing company had taken a similar approach; all the company's footwear is hand-made (see Box 3.4).

Box 3.4: Process Changes to Meet the Need for Greater Flexibility

All the company's footwear is now hand-made for the luxury ladies fashion market. Larger volume models are hand cut using metals knives whilst laser and water-jet cutting are used for smaller volumes. The company has the ability to carry out all aspects of footwear production itself, to reduce its dependence on suppliers. It even has a small in-house leather tanning and dyeing facility (leather is bought in unfinished from all over the world – mainly South America and Asia - and treated in-house). It produces footwear in small batches, with the emphasis on rapid response to customers.

Source: Interview with Footwear Manufacturing Company, October 2011

Similarly, a high-fashion ladies footwear manufacturer had made minor technological changes but part of the brand's profile is doing things 'the old way', which is increasingly valued by customers. The company's past activities meant that it had manufacturing know-how. However, to maintain the quality required for the high end of the market in which the firm operates, most work is done by hand.

Restructuring can also pose unexpected problems of organisation. For example, a sole manufacturer that began producing its own brand of injection moulded footwear found that this change led to unexpected problems with on-site storage capacity, for the simple reason that a boxed pair of shoes takes up a lot more storage volume when compared with a pair of soles.

3.2.3 Product Restructuring

Product innovation has been one of the key aspects of restructuring in the Portuguese footwear industry. The main aspect of product restructuring in recent years has been a move away from large-scale subcontract manufacturing for major brands (as they off-shored production to China and other Asian countries) to development of own brands, together with contract production for private labels. The process went through a number of phases, as Box 3.5 shows.

Box 3.5: Stages in Product Restructuring

The company is a family business founded in 1976 (the grandfather of the current CEO began making shoes over 60 years ago). During the 1970s, it focused on the domestic market, making own brand sports shoes. In the 1980s it began exporting, working under contract for foreign firms on a range of large volume lines. In the 2000s, foreign companies moved their production to lower labour-cost areas. The company downsized significantly (in production and employment - the workforce has reduced from around 450 in 2000 to around 160 now) and began making women's fashion footwear under its own brand.

The brand, which is now one of Portugal's top 10 brands, accounts for 60% of the company's sales, with production of 250 000 pairs annually. The emphasis now is on growing its brand and improving marketing. The rest of its production is for private labels (retailers' own brands).

Source: Interview with footwear manufacturer, October 2011

In developing their own brands, footwear manufacturers in the region have sought to identify particular product niches. For example, a manufacturer specialising in safety footwear has focused on introducing design and even fashion into safety footwear. It has a specialist ladies range, using a separate last rather than a modified men's last, which retains the safety features but offers variety in colour, material and style. It is also launching a men's range of safety footwear which looks like football boots or sports shoes. It has a bobbled sole designed for shock absorption and uses a Kevlar insole for protection. These innovations make the footwear lighter and more flexible. The company regularly attends fashion shoe fairs for inspiration. The company is also very focused on technical development in safety footwear (see Box 3.6).

Box 3.6: Technical Developments in Safety Footwear

The company is very focused on technical developments in safety footwear and has developed a number of innovative features. It has an in-house podiatry and biomechanics research laboratory, to ensure that the lasts it uses provide the correct mix of comfort and protection. It also has a research department and an innovation laboratory, which has recently been certified under NP 4457:2007 - Research, Development and Innovation Management System Certification (this is a national standard but, apparently, there are similar standards in Spain and Italy).

The company's key areas of technical innovation include:

- the Clima Cork System, which has been patented for 15 years. A layer of cork (formed from a by-product of the production of bottle corks, milled and glued) is inserted between the insole and the outer sole. It protects from heat and moulds to the shape of the foot to increase comfort;
- responsive shock absorption: this is a shape of the heel and sole (with gaps) which provides protection six times greater than is required by the standard. It helps to protect the backs of people regularly jumping from trucks, such as refuse collectors;
- toebox: the company's protective footwear uses a composite toebox, completely enclosing the toe area, instead of a steel toecap. It offers better protection to the foot;
- 3D vario: different insoles can be inserted into shoes to change the volume of the shoe. It takes account of variations in the 'height' of the foot between different people with the same length and width fitting, and can also be altered if a person's feet expand or contract during the day (e.g. from standing for long periods).

Source: Interview with footwear manufacturer, October 2011

We also interviewed a company that had developed from making soles for footwear manufactured by others to developing its own footwear products (see Box 3.7).

Box 3.7: Progressing from Component to Footwear Manufacture

The company specialises in the production of soles, but in the last 10 years it has also begun to make light-weight injection-moulded men's and ladies' footwear for specific professional markets, such as hospitals. The company was able to compete with imports in this market because the focus is on materials and technology, rather than price (the shoes retail for around €30 - €50).

The aim was to enter a new market using the company's existing systems, expertise in injection moulding and staff. There was a lot to learn to make this step, including adapting the technology (requiring new moulds etc) as well as learning to understand the professional footwear market and how to sell. However, as most of the company's competitors are brands such as Crocs, rather than manufacturers, they have greater scope to innovate. This is still a small project at the moment, with only two products, but these are already sold in 20 countries.

Source: Interview with manufacturing company, October 2011

The sole manufacturer described in Box 3.7 considers that innovation is also a key advantage for its main business of sole manufacturing. Most soles it produces are specific to particular customers to meet their needs for fashion, comfort and safety. The company monitors footwear fashion developments and then suggests sole designs to its clients; it is not a commodity manufacturer producing only to customer designs. It was therefore not a major jump to designing footwear.

Restructuring of the footwear industry in Portugal has been accompanied by restructuring of the supply chain. One example of this is the formation of a new company to supply innovative process equipment to the industry, as described in Box 3.1. This particular company then underwent further restructuring, expanding beyond the footwear sector (Box 3.8).

Box 3.8: Product Restructuring by Equipment Manufacturers

A company that was founded to provide innovative equipment for the footwear industry (see Box 3.1). transferred its knowledge of water jet cutting to other material, e.g. cutting stone, ceramics, frozen and fresh food, plastics, metals and composites. The company also expanded its markets beyond Portugal, exporting to other EU countries, the Middle East, Australia and Canada. In total, around 95% of the company's output is exported.

It also transferred its knowledge of leather handling to other sectors using leather, particularly the automotive sector. Working with the automotive industry, the company gained expertise in laser cutting. This process was later introduced into the footwear sector, first for cutting but also for roughing, engraving and particularly for welding. This latter move in technology has allowed to the company to develop very flexible integrated production systems for the footwear sector based on robots. The systems require steering software, and thus competences in software development are critical. These are delivered by a sister company (based in Lisbon).

Multi-sector and multinational markets make sense for the company, because a downturn in one sector can be balanced by increased sales in another (and the problem of lack of credit is less acute for non-EU customers). The Portuguese market alone would be too small for the company to prosper. From its foundation with three partners in 1995, the company now has 60 employees in Portugal. It subcontracts as much of the manufacturing process as possible, focusing on engineering design, final assembly and software. Metal manufacturing is subcontracted mainly in Portugal, but with some elsewhere in the EU.

Source: Interviews with equipment manufacturer and CTCP, October 2011

3.2.4 Reorganisation of Sales Channels

Since the 1980s, the footwear sector in Norte has focused increasingly on the export market, primarily within the EU. Many of the companies interviewed export 95% or more of their production, Table 3.8 provides some examples of this. One company noted that, having produced solely for export, is also now planning to re-enter the Portuguese market, though only on a small scale, as it believes the market for footwear in its price range (€100 to €150 per pair retail) is limited in Portugal.

Table 3.8: Export Performance of Companies Interviewed

Size of Company	Product Sector	% of Production Exported	Main Markets
Medium	Women's fashion shoes (€100 - €200 per pair in the shops after the retailers' margin of around 150%)	95%	EU (Belgium, Scandinavia, France, Germany)
Medium	Women's fashion shoes (€100 - €150 per pair retail)	100%	EU (France, Italy and Spain) plus 10% outside EU (Japan, Canada, USA, Australia, New Zealand)
Medium	Safety shoes	90%	Europe (EU and Switzerland), Middle East, Australia
Small	Women's high-fashion shoes (€300 – several thousand € per pair retail)	93%	EU, Africa, Russia
Medium	Rubber and plastic soles	50%	EU (Spain, France, Germany, Netherlands, UK)
Medium	Footwear (and other) manufacturing and testing equipment	95%	Global (EU, China, other Asian countries, Brazil plus Middle East, Australia, Canada for non-footwear equipment)

The move from subcontracting for major clients to focus on own-brand production has meant a major change in marketing strategies for footwear manufacturing companies, as illustrated in Box 3.9. For the component manufacturer, for example, introducing its own footwear brand required the company to learn about markets and selling direct to customers, rather than to shoe manufacturers.

Box 3.9: Change in Marketing Strategies

From having a small number of major brands as clients, a ladies fashion footwear company now has around 3 000 customers in the EU – mostly in France, Italy and Spain. It aims to have its footwear available in the best multi-brand footwear stores. It has a team of agents selling its products in each country; they travel from shop to shop with samples; this gives very good market feed-back.

As the company produces in small batches, it offers customers the ability to re-stock within three weeks. This enables customers to buy in small batches and has been very successful; they end up ordering more than they would have done in a single larger order.

The company also sells 10% of its output outside the EU, to Japan, Canada, the US, Australia and New Zealand. It made contact with customers in these markets through exhibiting at trade fairs.

Source: Interview with footwear company, October 2011

Companies have also focused on new marketing concepts. For example, the safety footwear manufacturer is developing a new marketing concept 'innovation at your feet', which provides eight typologies by occupation for customers to identify with and offers appropriate footwear for each. Over the last 15 years, its customers have changed from heavy industry companies buying large quantities of footwear for their workers to small companies and individuals buying footwear for themselves. It now has 600 customers (having begun with two). This has affected the company's sales channels (see Box 3.10)

Box 3.10: Changes in Sales Channels

To respond to changes in the market, the safety footwear company began selling its products through outdoors shops, to encourage purchase by individuals. Its largest market in outdoor shops is in Ireland.

It has a close relationship with its distributor customers, who are often SMEs (as larger distributors go directly to cheap producers in China to get footwear made under their own labels and sell these directly to large-scale customers). Representatives of the company visit its distributors regularly to introduce new products and discuss how sales are going. SME distributors recognise the benefit of taking the company's representatives with them when they visit major clients, as the company's staff can offer expertise in footwear problems and biomechanics, which enhances the distributor's status. This helps to differentiate the brands from cheaper imports, through enhanced service and expertise.

Source: Interview with safety footwear manufacturer, October 2011

Companies consider that entering new markets and increasing the number of customers is a way to manage risks and avoid the adverse impacts that can be caused by loss of a customer that accounts for a high proportion of sales. For example, the sole manufacturer aims to divide its risk by ensuring that no client accounts for more than 10% of its turnover. In the past, it used agents, but now it tends to deal directly with major clients.

At sector level, innovation in sales channels has focused on promotion of the image and reputation of the industry (overcoming a past poor image linked to the previous emphasis on low-cost production, which led customers to expect reducing prices). APICCAPS has an annual marketing and promotion plan to address this problem. With EU assistance, €10 million per year is invested in promotion. APICCAPS exhibits at major trade fairs across the EU, USA and worldwide and assistance is provided to companies to attend such fairs. The focus was initially on promotion to wholesalers and retailers, with advertising in professional journals. Now the campaign is moving on to direct targeting of consumers.

3.2.5 Locational Restructuring

There are a numbers of outsourcing models followed by footwear manufacturers in Norte. In most cases, outsourcing is to other companies within the region:

- most common is for manufacturers to outsource less complex procedures to smaller subcontractors, whilst retaining the more complex processes in-house. For example, a component manufacturer carries out injection moulding of soles in-house but contracts out some of the simpler assembly work;

- a less-common alternative is for all sewing to be outsourced, with assembly in-house; this allows quality control of the final product; and

- others outsource the manufacture of entire brands or segments, but this is not common except to deal with capacity problems. For example, a safety footwear company that we interviewed outsources some production, at times of high demand, to local craft companies that can assemble whole shoes. However, it has not outsourced beyond the region.

This approach provides flexibility for the larger companies, which is a key aspect of competitiveness. One company noted, though, that the cost of using subcontractors within the region is increasing. When the major foreign-owned manufacturers pulled out of Portugal, there were many subcontractors desperate for work so prices were low. However, this is no longer the case.

There has been relatively little relocation of production by Portuguese footwear companies. Some component manufacture has been subcontracted to companies in North Africa (e.g. a safety footwear company subcontracted some production to Morocco) and some, more recently, to India. One company we interviewed had been invited by its customers to offshore its production for the customer, but considered this step to risky (see Box 3.11).

Box 3.11: Risks Associated with Offshoring

One of the sole manufacturer's customers asked the company to join it when it moved its production to Morocco and India, but the company considered this too risky. The company visited its customer's location in Morocco and decided it would gain no benefit from the move and that there would be few cost differences (it would have had to build a new factory and manage it from a distance, and there was no local expertise in its field). Now the customer has left Morocco, so the company could have been left with a factory in Morocco and no market.

Similarly, another customer, which invited the sole manufacturer to set up a plant near the customer's plant in India, is now considering moving on. The customer is also now increasing its production in Portugal. The sole manufacturer has continued to supply the customers that off-shored their production; although it lost some business, it has found new customers.

Source: Interview with component manufacturer, October 2011

One ladies fashion footwear company we interviewed, though, had taken the unusual step of outsourcing design (see Box 3.12).

Box 3.12: Outsourcing Design

The ladies fashion footwear company's operations are all based in Felgueiras, apart from its design operation, which is in Alicante. This consists of an independent designer retained on a contract basis (who also works for another company manufacturing men's shoes) together with a company employee as a coordinator, who advises the designer whether his designs can be manufactured. The Commercial Director of the company is in regular contact with the designer, providing feedback from customers; the designer also joins the company representatives at trade fairs. The company selected Alicante as the area has designers with good fashion knowledge and the company considers that the area also makes the best-fitting lasts in Europe.

The designer sends the design and last to the factory, which then makes a prototype. Once the design is agreed, a full set of lasts in different sizes is ordered from Alicante.

Source: Interview with footwear manufacturer, October 2011

The sole manufacturing company had temporarily delocalised production of the sophisticated moulds it needed to move into a making its own professional footwear to Italy, as these moulds could not be produced by Portuguese companies. It is now trying to localise production, as this would be more cost-effective.

APICCAPS considers that locational restructuring by Portuguese firms has been limited, because there is still scope for further productivity improvement in Norte (as some inefficiencies remain).

3.2.6 Closure

As indicated in Table 3.1 (in section 3.1.1), the number of footwear companies in Norte has reduced from 1 635 in 1994 to 1 354 in 2010. This reduction is primarily due to the closure of companies, but the rate of closure is much lower than for some other EU countries. Closures have primarily been of foreign-owned companies, which initially outsourced their production to Norte on cost grounds (generally to plants that they owned). When the foreign-owned companies later moved production outside the EU to cheaper locations, primarily in China, the Portuguese companies closed. We interviewed one UK-owned company that had been through this process (see Box 3.13). There have also been some closures of Portuguese companies that had adopted a low-cost/high volume business model and were unable to adapt to increased competition from low-cost producers.

Few of the foreign-owned factories were taken over by Portuguese companies when the foreign-owned firms moved out. Most of the factories were dedicated to production for one customer – the foreign owned company – so it made little sense for Portuguese firms to take them over. In some cases, Portuguese firms bought some of the equipment but, in most cases, the foreign firm transferred the equipment to other factories it owned, in eastern European countries (or sometimes even to the Far East)[52].

Box 3.13: Locational Restructuring by Foreign-Owned Companies

The UK-owned casual, fashion and children's footwear company first outsourced production from the UK to Portugal in the late 1980s. It bought one existing factory and, when production was up and running the early 1990s, built a new plant on a green field site in a remote country area. The company relocated production to Portugal because labour was cheap and the company could easily transport leather from UK. The factories were owned by the UK company, rather than based on subcontracting. Initially, only stitching was carried out in Portugal. The shoes were then sent back to the UK for finishing, so that they could be marketed as 'Made in the UK'. The UK company provided the necessary expertise. In the late 1990s, the Portuguese plants also began finishing shoes. The reason for this was lower costs compared to the UK.

By the late 1990s, it became clear that production in Portugal was more expensive than in China and India. Productivity in Portugal was also lower than in the UK. The company started buying uppers from India to make in Portugal, to reduce costs. The company eventually closed its Portuguese factories in the early 2000s, over period of two to three years, and moved its production completely to India and China, based on sub-contracting rather than setting up its own factories.

Source: Correspondence with UK owned company, November 2011

[52] APPICAPS does not keep detailed data on such changes; this information is based on personal recollections

3.2.7 Best Practices in Restructuring

APICCAPS considers that the ability of manufacturers, the CTCP, Universities and suppliers to work together has been a critical factor in making restructuring successful in Norte. It has also played in key role in ensuring that the necessary skills are available in the region (see Box 3.14).

Box 3.14: Role of Clusters in Training
As well as the Government-funded training institute for footwear sector employees in Norte, the CTCP also provides short courses for supervisors/managers responsible for innovation (e.g. on CAD/CAM, informatics, planning). This training is carried out by CTCP staff and outside consultants; the focus is on learning from experience elsewhere and encouraging participants to think about how the problems their firms experience can be solved. CTCP can also bring equipment suppliers and companied together for specific training on new equipment.
Source: Interview with CTCP, October 2011

Several of the footwear companies we interviewed also indicated that being part of a cluster had brought considerable benefits. For example, one ladies fashion shoes manufacturer noted that:

> *"We continued to work with local suppliers after restructuring because their proximity made working together easier and because the company has greater bargaining power with local suppliers than with those elsewhere"*.

The safety footwear manufacturer had been able to work with local suppliers to reduce costs (e.g. through the move to composite toe boxes manufactured locally) and to address capacity constraints (through outsourcing of stitching and assembly of whole shoes).

3.3 Drivers for Restructuring

3.3.1 Main Reasons for Restructuring

The key driver of restructuring of the footwear industry in the region was China's entry into the WTO, which enabled it to compete directly on the EU market. This led price-driven British and German companies to relocate production from their plants in Portugal to China, where costs were lower. Some Portuguese footwear manufacturers with the same large volume, low cost business model also began to subcontract to Chinese manufacturers or became uncompetitive and closed.

Other Portuguese companies, either locally or foreign-owned, started to change their business model to move away from competition with low cost countries. Instead, they moved towards higher value-added markets, particularly in fashion footwear. As a result, they needed to develop flexibility in production, to produce smaller batches of footwear more rapidly. As these companies cannot compete on price alone, the

focus is on innovative products, style and service which cannot be matched so easily by competitors outside the EU. An example of such drivers is given in Box 3.15.

Box 3.15: Restructuring Driven by Relocation of Customers and Increased Competition
A sole manufacturer diversified its customer base for soles in response to particular manufacturing customer moving out of Europe. The sole manufacturer focuses on quality and design as it is not a commodity producer competing mainly on price. Its move into manufacturing a range of professional footwear was prompted by the view that it could offer a competitive product, because the market focuses more on quality and technology than on price.
Source: Interview with component manufacturer, October 2011

3.3.2 International Competition

APPICAPS consider that the accession of China to the WTO agreement on textiles and clothing and the ending of anti-dumping duties on footwear imports were a key factor in driving restructuring. These made it easier for foreign firms to move their manufacturing operations out of Portugal to lower labour-cost areas outside the EU. This opinion was supported by the companies we interviewed. The sector recognises that it is not politically feasible to re-introduce anti-dumping duties and this would not be in line with WTO rules, even though APICCAPS considers that footwear is still being sold on the EU market at below the true cost price.

Instead, as an exporting sector, APICCAPS believes the focus should be on ensuring that non-EU footwear markets are as open to EU producers as the EU footwear market is to imports. Recent agreements with South Korea and Canada, to reduce duties on footwear imports from the EU, are expected to have a positive effect; similar agreements with Mercosur would be welcomed. China also represents a market opportunity which could be enhanced if trade barriers were removed; these include both duties and factors such as the very different organisation of retailing in China. Duties on EU footwear in these (and other) markets should be reduced from current levels of up to 35% to EU levels (of 7% or 4.5%) and finally to zero.
There are also potential benefits for the EU from trading in footwear produced cheaply outside the EU. For example, traders in Belgium and the Netherlands import cheap footwear then re-export it with a higher margin. They have responsibility for financing, design, branding, sales and promotion and distribution. Indeed, Belgium has a higher positive export balance in footwear than Portugal, despite having no production. Germany, Italy and Spain are also starting to follow this route.

3.3.3 Competition within the EU

Companies we interviewed had few comments on restructuring of their competitors. However, the CEO of one footwear manufacturer commented that some competitors in Italy and Spain had been less affected by the recession because they had begun building their brands earlier. The component manufacturer's competitors are mainly in Italy and Spain, with a few in Germany and France. They have faced similar challenges.

3.3.4 Availability of Funding and Other Assistance

The Portuguese footwear industry has taken advantage of a range of EU funding. This has included very useful funding for training (from the European Social Fund) and from the European Regional Development Fund for trade promotion[53]. Footwear has made more use of trade promotion funding than other sectors of the economy and has reported back on the results (and all of the companies we interviewed had been helped in this way). Such funding has been helpful in assisting restructuring but was not a driver in itself. For example, one footwear manufacturer commented that:

> *"Without the funding [to attend trade fairs], the company would not be able to attend so many fairs, which would make marketing more difficult. However, availability of such funding was not a major driver for restructuring."*

EU Framework Programme funding has also been received for technology development, by the research institute, CTCP, and by equipment manufacturers. For example, funding has been received for projects on:

- traceability (creating logos with deliberate defects to ensure a guarantee of source);
- multifunctional materials (where the company worked on quality control equipment linked to research on materials with minimised permeability); and
- the CEC-made shoe project: work on a prototype laser roughing system that allows the sole and uppers of a shoe to be in a single piece, which gives much greater design flexibility.

However, both the research centre and the equipment supplier did express some concerns about the nature of EU funding for R&D (see Box 3.16).

Box 3.16: Concerns about EU Funding for R&D

EU incentives have encouraged and supported the development of innovative technologies and their implementation in the Portuguese footwear industry. However, EU Framework Programme-funded projects tend to be further away from the practical needs of companies. The process of selecting projects for funding seems to involve academics, who are less in touch with the industry, rather than sector experts. This means that academic proposals, which universities are good at writing, tend to be supported.

The projects have thus focused on new knowledge, rather than practicability; significant additional work is needed to make a commercial product. This is less of a problem for the more advanced companies, which are able to take initial ideas forwards, but more problematic for SMEs, which require finished products.

Source: Interview with Research Institute, October 2011

The Portuguese Government has been very supportive of the industry and has helped the industry to access the EU Social and Regional Development funds. The sector has a good reputation with the Government because of its record in exports and has received assistance in the form of export credit guarantees, which have been very

[53] This assistance is provided under the Quadro Estratégico de Referencia Nacional

important, as well as small grants for SMEs to work with consultants/advisors and assistance to APICCAPS in developing the strategy for the sector. The equipment company made an initial prototype of its first product, a water jet cutting machine, as part of a CTCP project with national funding. It also considers that the national government support that its initial customers received (via CTCP) was critical to the development of the company.

The high-fashion footwear company received some assistance from the Government, when the private insurer started cutting the availability of insurance, withdrawing it from established, reliable clients for no good reason. The company also receives some support for press publicity in Germany, the Netherlands, Portugal and Spain, but it takes two years to receive the funding and a considerable administrative effort.

Currently, there is a 'de minimis' level of €200 000 over three years below which Government assistance to individual footwear companies with development is not subject to EU state aid rules. APICCAPS notes that, although this can be of considerable assistance to very small companies, the level is too low to have a significant impact on larger companies

The national industry association, APICCAPS, is based in the region and has provided a range of assistance for footwear companies with restructuring, in conjunction with its research institute, CTCP, and with various universities. There is also a training centre for the footwear industry in the region, which is operated by the Portuguese Government.

3.4 Impacts of Restructuring

3.4.1 Negative Impacts

The most negative impact of restructuring has been the **significant reduction in the size of the footwear industry** in Norte (see Section 3.1). Since 2004 there have been reductions in the number of companies, the number of employees and the number of pairs produced (although the value of output has not changed significantly).

Almost all of the reduction in the numbers of footwear companies was due to the closure of subsidiaries of foreign companies; few Portuguese-owned firms went out of business. However, the remaining Norte companies have reduced in size (turnover and number of employees) as a result of restructuring away from subcontracting for multinational firms to developing their own brands. One company, which was previously a subcontractor to foreign-owned firms, identified the main drawbacks as the reduction in size of the company and the fact that payment terms are less favourable with its current small customers, increasing potential cash flow problems.

Restructuring of the footwear industry in the region has had a significant impact on employment, as shown in Table 3.9. This table provides data for the Portuguese footwear industry as a whole, but as 96% of all Portuguese footwear companies and 98% of people working in the industry are located in Norte, the regional industry and

the national industry are effectively the same thing.

Table 3.9: Changes in Employment in the Portuguese Footwear Industry		
Year	**No. Employees**	**% change compared with previous year**
1994	59 099	n/a
2004	40 255	[- 31.9 over 10 years]
2005	37 836	- 6.0
2006	36 221	- 4.3
2007	36 366	+ 0.4
2008	35 398	- 2.7
2009	32 510	- 8.2
2010*	32 738	+ 0.7
		[-13.5% over 5 years]
Source: APICCAPS (2011a) **APICCAPS Forecast*		

Most companies that we interviewed had reduced their workforce during restructuring, but had tried to retain their most skilled workers. Examples of such reductions by the companies we interviewed are shown in Table 3.8.

Table 3.10: Impacts of Restructuring on Output and Employment			
Size of Company	**Product Sector**	**Change in Output**	**Change in Employment**
Medium	Women's fashion shoes	Reduced from over 1 million to 400 000	Reduced from 450 to 160 (-65%)
Medium	Women's fashion shoes	Reduced from 3 000 – 4 000 pairs per day (around 750 000 to 1 million pairs per year) to 300 000 pairs per year	Reduced from 240 to 195 (-19%)

The companies we interviewed also indicated that they had made a number of mistakes in the early stages of restructuring, from which they had learnt (see Box 3.17).

Box 3.17: Mistakes in Restructuring
The women's fashion footwear company made a number of mistakes in the early stages of restructuring, including not consolidating each restructuring step before making the next one and the owners taking too much money out of the business. This limited the cash available for paying suppliers quickly, so the company had to ask for cash discounts or longer payment times.
Source: Interview with fashion footwear manufacturer, October 2011

3.4.2 Positive Impacts

Many of the companies we interviewed considered that the most successful aspect of restructuring was that it had **enabled firms to remain in business** when they might otherwise have had to cease trading. One ladies fashion footwear producer noted that:

> *"The 1990s investment in automation allowed the company to increase production. However, it did not reduce costs sufficiently to remain competitive with countries outside the EU, where labour costs are significantly lower, and*

thus to retain contracts with major brands. Developing its own brand has enabled the company to remain in business and profitable".

Similarly, the sole manufacturer indicated that focusing on quality and product innovation in soles has enabled it to maintain its markets in the face of significant changes to the footwear industry.

Individual companies identified a range of benefits, summarised in Box 3.18.

Box 3.18: Benefits of Restructuring for Footwear Companies

A key benefit is that the company is much more in control of its own destiny, rather than relying on a small number of major customers. The size of its customer base, and its spread across the EU, provides some stability in its market. The drawbacks include the reduction in size of the company and the fact that payment terms are less favourable with small customers, increasing potential cash flow problems. (*Ladies fashion shoe manufacturer*)

The overall benefit is that the company stayed in business and is competitive; the drawback was the reduction in size and employment that was necessitated by the switch from subcontracting (*ladies fashion shoe manufacturer*)

Continuing investment and innovation has helped the company to remain viable and profitable in difficult market conditions. (*Sole manufacturer)*

Source: Interviews with footwear companies, October 2011

The companies we interviewed had all changed business model as part of their restructuring. The main form of the change was a move from sub-contracting for large foreign-owned companies to developing their own brands and moving to more added-value products. This required in increasing emphasis on design, as illustrated by Box 3.19.

Box 3.19: Benefits of Innovative Design

A women's fashion shoe manufacturer prides itself on its product innovation and competitiveness following restructuring. For example, snakeskin boots are currently fashionable, but the material is very expensive. The company therefore developed a form of leather printing and engraving which produces a mock-snakeskin effect. The company carries out this process itself and the resulting boots can be sold for half the price of real snakeskin boots.

Source: Interview with footwear manufacturer, October 2011

Similarly, the safety footwear manufacturer's production now focuses on its own brands and it offers a much wider product range, with greater emphasis on style. However, it does not change collections as fast as fashion shoe companies, with the average product having a two year life.

The transition to own-brand manufacturing and higher value-added has had a positive effect on the **profitability** of companies. For example, the safety footwear manufacturer noted that its own-brand products command higher margins because of their improved features and better design, as shown in Box 3.20.

Box 3.20: Improved Profitability from Own-Brand Production
The move to a greater focus on style, technical innovation and building its own brand has helped the company to remain competitive in the face of cheap imports. It has also made production more flexible. For example, the company used to buy in steel toecaps from large companies and was very dependent on them. Its own-design composite toe boxes are manufactured by smaller local suppliers; they are easier and cheaper to make (the company designs the moulds itself)
Source: Interview with safety footwear manufacturer, October 2011

There have also been some positive employment impacts for the remaining companies, as restructuring has required the **development of new competencies**. For example, the safety footwear company has encouraged its existing staff to develop competencies in design and marketing, as it prefers to promote internally. It has also hired additional staff in design and marketing as well as five to seven engineers over the past 10 years. Similarly, the sole manufacturer needed to hire some new people to help with design and marketing when it began selling its brand of professional footwear. However, the company undertook most of the work itself, studying the competition and then innovating.

Increased flexibility in production has been a key feature of restructuring. The focus has been on smaller batches with a quicker turn-around time and working closely with customers on scheduling etc.

One company noted that ladies fashion shoe orders can be as low as 10 pairs. Every 15 days the company groups orders, produces the shoes and dispatches them to customers via a commercial delivery service. It guarantees to re-stock customers within three weeks. Another example of the change in flexibility is given in Box 3.21.

Box 3.21: Positive Impacts of Restructuring on Flexibility
The company now produces around 100 styles (of women's fashion shoes) per collection, with 700 combinations of styles and colours. These are produced in much smaller batches than when the company acted as a sub-contractor to major brands. Around 80% - 90% of each collection is new; some have the same design in new materials, or with new soles and heels. Not all new styles require new lasts, there may be 4-6 styles per last and heel.
Source: Interview with footwear manufacturer, October 2011

Another company noted that an efficient logistics system is important to meet the requirement for increased flexibility from customers. The company still uses some large delivery trucks but increasingly uses commercial companies such as DHL, UPS etc which can deliver within 48 hours.

3.4.3 Changes in Business Partnerships and the Supply Chain

There has been increasingly close collaboration between companies, the CTCP and machinery producers through implementation of the APICCAPS Strategic Plan. For example, the safety footwear manufacturer and the equipment supplier have both

worked closely with the CTCP and local universities in the development of innovative products.

Manufacturing companies have also needed to work closely with both customers and suppliers throughout restructuring, to maintain their competitiveness (see Box 3.22).

Box 3.22: Partnerships with Suppliers and Customers to Maintain Competitiveness

The sole manufacturing company works closely with the chemical industry, which supplies its materials, and is able to test new materials for its partners. It also maintains close links with its customers, aiming to bring innovative ideas to the customers rather than just manufacturing what is ordered.

Source: Interview with component manufacturer, October 2011

The move from subcontracting for major clients to focus on own-brand production has meant a significant change in sales and marketing strategies for footwear manufacturing companies, as illustrated in Box 3.23. In particular, companies now tend to have much larger numbers of customers. For example, the safety footwear company has moved from having two sub-contract customers which it worked with directly to having 600 customers and selling via a network of independent agents across the EU.

Box 3.23: Impacts of Restructuring on Marketing and Sales

The loss of major clients and the focus on own-brand production has meant a major change in marketing for a ladies fashion footwear company. Where 10 years ago the company had 10 – 20 customers, it now has over 1 000. Most of these are independent retailers and small chains across the EU. As a result, the minimum order size has been reduced. The company uses local agents, but its staff also travel more extensively to meet clients and it exhibits at trade fairs.

This has required a complete change to the company's logistics operations. It has increased the size of the commercial back offices to deal with the much increased volume of invoices generated. The warehouse has also been reorganised and the company uses an RFID system, linked to enterprise resource planning (ERP) and customer relations management (CRM), which allows invoicing as soon as a shipment leaves the warehouse.

Source: Interview with footwear manufacturing company, October 2011

The high-fashion ladies shoe manufacturer has focused on making its distribution system exclusive. It targets the most up-market retailer in each country, on the basis that others will follow. It tries to sell its products in only to one retail store in each city. The brand has strong sales in locations with wealthy consumers, such as Monaco/Cannes/St Tropez but also in locations such as Luanda in Angola and Lagos in Nigeria. Each location may have only a small number of customers that can afford the prices of the range; for example in Lagos, there are only six to seven regular customers.

Marketing smaller orders to a larger customer base has required footwear manufacturers to become more efficient in ordering and invoicing. For example, the safety footwear manufacturer has a very efficient ordering and invoicing system. An article number (barcode) is assigned to each product and customer. The barcode is

swiped as each order is packed and this links to the automatic invoicing system. Prices differ from market to market but are the same for each customer within a market, and for all order sizes. However, discounts can be given for cash payment. Similarly, the high-fashion ladies footwear company that now sells directly to small retailers noted that all its customers have credit insurance and it carries out careful credit checks on all new customers. Because it is no longer competing for large sub-contract orders, it is able to require payment in advance from its customers.

The sole manufacturer and safety footwear manufacturer have begun to use e-commerce, with internet sales direct to consumers. However, most of the fashion shoe companies do not plan to sell direct to consumers, as this would mean competing directly with their retailer customers. Instead, some companies' websites lists their retailers, so consumers can find stockists.

The interviews indicated that there have been relatively few changes to suppliers, as Box 3.24 shows.

Box 3.24: Impacts of Restructuring on Supply Chain

One ladies footwear manufacturer did not change suppliers a great deal when it downsized from its previous business model of large-scale subcontracting for foreign companies, but asked them to do better. Most of its suppliers are local; they were retained because of the benefits of proximity and because the company has greater bargaining power with local suppliers. There was also a small amount of sentiment involved, wishing to help local companies.

Source: Interview with footwear manufacturer, October 2011

3.5 Effects of the Economic Crisis

Restructuring throughout the 2000s, prior to the crisis, has enabled the sector to remain relatively resilient through the recession, although most companies we interviewed had lost sales initially, and to take advantage of market upturns. Over 2011 as a whole, APICCAPS anticipates an 8% to 9% increase[54].

The economic crisis has not really affected the customers of the high-fashion company, which are up-market retail stores selling to very wealthy clients. From January to August 2011 exports increased 19% compared to the previous year. Similarly, the crisis has not had a major effect on component manufacturer's plans; it still intends to make major investments in new technology for manufacturing soles, larger premises and to hire more people.

The footwear industry in the region remains heavily dependent on the EU market, however, and the state of the EU economy remains a major concern for the companies we interviewed. The safety footwear company noted that the economic crisis led to significant reductions in sales to certain markets (sales to Ireland fell by 50%), although some markets are now recovering. Customers are also more risk averse; a

54 APICCAPS (2011c)

UK distributor immediately reduced stocks and now purchases more frequently in smaller batches, which requires an efficient logistics system.

A lack of availability of loan finance was identified as a significant impact of the financial crisis by a number of companies. For example, the process equipment supplier noted that loan availability is tightening – the opposite of what is needed in the current situation. Because of this, footwear companies cannot buy the supplier's equipment; the company has two machines blocked on its premises by companies trying to withdraw from contracts because they cannot obtain loans. The company reduced its turnover in 2008, to reduce the risks to the business. Footwear manufacturers are also facing problems with the availability of short-term loans (see Box 3.25).

Another ladies fashion footwear company noted that the main impact of the economic crisis for the company has been on the availability of credit insurance. A high percentage of its customers cannot now obtain such insurance, even though their situation has not changed. In these cases, the company has to ask for payment in advance; however, it has not seen a downturn in sales as a result of this policy.

Box 3.25: Problems with Short-Term Finance

One specific problem concerns cash flow. A ladies fashion footwear manufacturer noted that the company has to pay for raw materials, such as leather, 12 months before it receives payment for its products. Lack of short-term loan finance from the banks means the company's revenues are taken up by covering this gap and it therefore cannot invest properly in the business. Whereas major foreign clients in the past paid invoices in 10 days, the company now has payment terms ranging from 60 to 180 days. This is a widespread problem in Portugal and the CEO fears that even companies with full order books may fails because of the lack of a relatively small amount of short-term finance.

The company would like to expand into new products, for example bags and clothing, and into its own retail activities, but this is not possible in the current situation.

Source: Interview with footwear manufacturer, October 2011

Raw material price increases are a major issue for the component manufacturer due to movements in international oil prices (its main supplier is the chemical industry). Some prices have increased by 50% to 100% and this cannot all be passed on to customers.

3.6 Future Trends in Restructuring

3.6.1 Expectations of the Industry

APICCAPS anticipates that the current trends in restructuring will continue in Norte, with further improvements in efficiency, especially in the use of materials, increasing focus on quality and service and moves into additional export markets. The association expects the current close links between the industry, the research institute, universities and equipment suppliers to continue. For manufacturers, maintaining and strengthening close links with customers will also be important.

Most of the footwear companies that we interviewed plan to continue with their current strategies of building and expanding their own brands of footwear. The next few years are seen as a period of consolidation after major changes and the shock of the economic crisis. Companies do not envisage any dramatic changes over the next few years and plan to continue with their existing business relationships. Most companies do not plan to expand their production significantly, but instead aim to move further upmarket (through better design) to gain enhanced margins on their products. However, the sole manufacturer plans further expansion of the company, maintaining markets for soles through continued innovation and growing its own professional footwear brand.

Some of the companies are also seeking to broaden their sales base beyond the EU. For example, the safety footwear company is aiming to increase exports to new markets and has agents in over 30 countries, including Qatar, Dubai and Saudi Arabia, Egypt (though its sales in North Africa have been adversely affected by the political upheavals in the region), Singapore, Australia and New Zealand.

The process equipment supplier considers that there will be continuing emphasis on flexibility and customisation in the footwear sector, with increased emphasis on material savings, eco-friendly production and environmental efficiency in machinery (e.g. reduced energy and water use).

3.6.2 Remaining Barriers and Action to Address Them

APICCAPS considers there is still more work to be done in enhancing the reputation of the Portuguese footwear industry; it is still perceived by some customers as a low-cost, low quality industry. There is also scope for further improvement in productivity and expansion into other markets, as the industry remains heavily dependent on the EU market.

Companies we interviewed gave various reasons for this dependence on the EU market. One ladies fashion shoe manufacturer no longer targets markets outside the EU, mainly because of the problems that can be caused by currency fluctuations. Its brand was initially aimed at the US market, but it made no sales there in 2010. Other companies, which are in the process of building their own brands, have targeted the EU markets first because it is easier to find customers and develop sales and marketing systems within the EU. For example, a ladies fashion shoe company will

continue to focus on the EU market, because the close proximity and cultural links make this simpler. It hopes that other markets can follow, on once the EU customer base is strong. The manufacturer of soles has focused on the EU market for the past 10 years because of the need to be close to the customer to meet the requirement for rapid delivery (this includes delivery direct to customers plants in neighbouring countries, such as German plants in Slovakia).

APICCAPS considered that one remaining barrier is the lack of openness of non-EU markets to EU footwear exports. The EU must decide at strategic level whether it considers maintaining a manufacturing base to be important. If so, it needs a business-friendly environment. Key issues identified by APICCAPS include:

- effective 'origin labelling' schemes, which it considers are becoming increasingly important for customers;
- reintroducing the temporary increase in the *de minimus* ceiling, below which assistance to companies is not considered as state aid, to €500 000 every three years, rather than reducing it to €200 000; and
- continuing to work to remove tariff and non-tariff barriers to EU footwear exports.

Another barrier, identified by many of the companies we interviewed, was increasing **difficulty in recruiting younger people**, particularly for production roles, to replace their ageing workforce as they retire. The ladies high fashion footwear company has no difficulty hiring cutters, but is finding it increasingly difficult to find lasters and finishers (the company makes its own lasts then send them to Italy for production). The average age of staff with these skills is around 50, so this could become a significant problem in future. The sole manufacturer has a lot of staff who have been with it for more than 20 years. It has found it difficult to recruit young people to industry because of its poor reputation; young people do not envisage a future in manufacturing. The economic crisis has improved the problem of recruiting young people a little; the company trains its own staff. Another example of this problem is shown in Box 3.26.

Box 3.26: Problems with Recruitment

During downsizing, a ladies fashion footwear company tried to retain its most skilled workers. Now, however, the company is experiencing considerable difficulty in replacing production workers nearing retirement – the average age of the workforce is between 40 and 45 years. This will become an increasing problem if the company's own brand grows and production increases.

The CEO believes there are a number of reasons for this. One is the relatively high level of unemployment benefits which, combined with much 'unofficial' work, makes it more profitable for young people not to seek formal employment. The company is only able to afford salary of €600 - €650 per month; this is slightly above the minimum wage but is steady and there are opportunities for promotion, so it should be attractive. The second reason is that factory work is no longer seen as a good job; there are few problems in recruiting for sales, marketing and IT roles. The combination of unattractiveness of the work and relatively low wages means that, even with relatively high youth unemployment in Portugal, filling production rows remains problematic.

Source: Interview with footwear manufacturer, October 2011

The companies we interviewed considered that this is a social problem, which cannot be solved by industry alone. One footwear manufacturing company noted that the footwear training institute has considerable difficulty in recruiting students.

The process equipment supplier considered that the impacts of the recession on the availability of credit are a potential barrier to further development of the company, although the fact that its customers are spread across different sectors and companies may help to mitigate the problem. A ladies fashion footwear manufacturer agreed, noting that the lack of short-term loan finance from the banks means that the company's reserves are taken up in covering cash flow gaps, which limits the funding available for potentially profitable investments. Box 3.27 provides an example of how footwear manufacturers are managing cash flow problems.

Box 3.27: Managing Cash Flow Problems

Cash-flow can be an issue for the ladies high fashion shoe company, and receiving payment is problematic in some countries (particularly Italy, where theft of products during delivery is also a problem). However, the company has only a small number of customers, who are generally good payers. The company requires payment insurance from its customers in Africa and Russia, and these customers have to pay before shipment of products.

Source: Interview with manufacturer, October 2011

Another barrier mentioned by companies that we interviewed was the challenge of **understanding the market** and finding the right niche, then retaining the right agents to sell to that niche. An example of this is given in Box 3.28.

Box 3.28: Understanding the Market and Finding the Right Agents

Finding the right agent is critical for a ladies fashion shoe company. They need to be part of the 'family' and the company is in regular contact with its agents (visiting customers with them). A few agents are exclusive to the company; others also act as agents for other brands (the company needs to know who these are and ensure that they are not competitors before signing contracts with agents). This was difficult in the early days but the company believes it now has a very good network.

However, the system means that the company must produce 3 000 samples twice a year to send out to its agents. 50% of these are the same for every market and 50% are different – agents choose lines for their markets.

Source: Interview with footwear company, October 2011

One potential barrier to further innovation for the sole manufacturer is the protection of its designs. The company has had experience of offering sole concepts to customers who have then used these and patented the resulting design themselves. The company recognises that it may need more protection in future, as not all customers are loyal.

The component company considers that the current process for protection is not really effective. Protecting innovations is costly and takes too long. Just registering a brand can take two years. Companies need expertise to obtain patents and protection inside the EU is not enough. For worldwide protection, though, patents need to be taken out

country-by-country. Simpler procedures for obtaining a patent and assistance with worldwide registration would assist with this problem. The high-fashion shoe manufacturer also recognised the need to seek greater protection for its designs, but had not had the time or resources to do anything about the problem.

3.7 Summary

The footwear industry in Norte has been through several phases of restructuring. During the 1980s, foreign-owned footwear companies moved into Norte to take advantage of lower labour costs, setting up or purchasing their own factories or subcontracting to local companies. This contributed to a rapid growth in footwear exports; it required Norte companies to adopt more modern, large scale production methods.

However, the increased ease of importing into the EU in the 2000s saw many of these foreign-owned firms move their production to countries outside the EU with lower costs, particularly China and India. This led to the closure of many foreign-owned firms and a reduction of output and employment amongst Norte companies that relied on foreign-owned firms for sub-contracts. The average size of firms reduced. Portugal's footwear exports fell significantly during this period and imports of cheaper shoes grew.

Since 2005, the footwear sector in Norte has adapted to the new market conditions through a strategy focused on increased added value, relying on innovation, increased development and promotion of own brands based on fashion and quality rather than subcontracting and the use of technology to improve flexibility. The customer base has widened, with a continuing emphasis on exports. This restructuring has enabled the sector to remain relatively resilient through the economic crisis.

It appears that, during the period of subcontracting, Norte companies often produced the full shoe, with limited disaggregation of assembly and upper production. This had two consequences in the following phase after 2005 or so: firstly, the companies continued with integrated production of the full shoe; secondly, they were able to focus their efforts on new functions such as design, branding, distribution and logistics.

A key reason for the success of the Norte footwear industry in restructuring has been the close partnerships that exist within the industry and with the Portuguese Government. The footwear industry association, APICCAPS, has played a very active role in developing an overall strategy for the sector and assisting companies to implement that strategy. Together with the research institute, CTCP, it has helped to bring researchers, equipment suppliers and manufacturers together to address the challenges of the new market conditions. It has also helped companies to access EU and national funding, for training, research and marketing.

The industry anticipates that that the current trends will continue in future, with further improvements in efficiency, especially in the use of materials, increasing focus

on quality and service and moves into additional export markets. Some key problems remain, however. These include the dependence of the industry on the EU market and difficulties in attracting young people into the production side of the industry.

4. CASE STUDY: VENETO

4.1 Introduction

4.1.1 The Footwear Industry in Italy

Industry Structure and Employment

The number of shoe manufacturing companies in Italy has reduced significantly over recent years. In 2010, there were around 5 800 firms with over 79 700 employees. The number of firms reduced by 3.7%, (with 224 factories closed), in 2010 alone. The number of direct employees at footwear manufacturing companies is estimated to have fallen by 21% between 2004 and 2010.

Table 4.1: Footwear Industry Structure and Employment in Italy, 2004-2010

Year	Number of Companies	Number of Employees	Average number of Employees per Company
2000	7 570	113 100	14.9
2004	7 084	100 934	14.2
2005	6 831	97 005	14.2
2006	6 657	94 143	14.1
2007	6 450	88 668	13.7
2008	6 263	85 918	13.7
2009	6 028	82 907	13.8
2010	5 804	79 709	13.6

Source: ANCI (2011): Shoe Report 2011

Production

The footwear industry in Italy has experienced a sharp decline in production from the mid 1990s, as shown in Tables 4.2 and 4.3. There was an 18% reduction in the number of pairs produced between 2007 and 2009 alone[55]. In 2010 the number of pairs produced increased by around 2.3%, but remained below 2008 levels. Production is currently around 80% of capacity.

The reduction in Italian production corresponded to an increase in imports from Romania, highlighting the outsourcing of production to Romania undertaken by many Italian companies (especially from Veneto and Marche), which began in the late 1980s. Not all the production from Romania is sent back to Italy for distribution; instead some is directly exported from Romania to near-by markets, e.g. Russia, for logistics reasons.

55 ANCI (2011)

Table 4.2: Production, Exports and Imports of Footwear in Italy by Numbers of Pairs, 2004-2010				
Year	**Production (million pairs)**	**Exports[1, 2] (million pairs)**	**Imports[2] (million pairs)**	**Trade Balance**
1997	460.0	414.7	157.6	257.1
2000	389.9	362.4	196.0	166.4
2004	281.0	279.3	311.0	-31.7
2005	250.2	249.0	331.7	-82.7
2006	244.0	243.6	363.6	-120
2007	241.9	245.3	390.0	-144.7
2008	225.2	221.8	352.6	-130.8
2009	198.0	192.3	309.9	-117.6
2010	201.8	223.6	356.5	-132.9
ANCI (2011) The Italian Footwear Industry Preliminary Results, 2010 *Notes:* *1. Includes re-exports* *2. Includes trade with other EU Member States*				

Table 4.3 provides information on the value of production, imports and exports.

Table 4.3: Production, Exports1 and Imports of Footwear in Italy by Value, 2007-2010				
Year	**Production (€ million)**	**Exports[1, 2] (€ million)**	**Imports' [2] (€ million)**	**Trade Balance (€ million)**
1997	8 052	6 365	1 280	5 085
2000	8 269	6 606	1 796	4 809
2004	7 310	6 196	2 577	3 619
2005	6 974	6 093	2 878	3 216
2006	7 199	6 480	3 193	3 287
2007	7 470	6 880	3 202	3 678
2008	7 319	6 915	3 350	3 565
2009	6 468	5 815	3 184	2 631
2010	6 730	6 707	3 707	3 000
Source: ANCI (2011). The Italian Footwear Industry Preliminary Results 2010 *Notes:* *1. Includes re-exports* *2. Includes trade with other EU Member States*				

The economic strains have also been felt throughout the supply chain; in 2010, 452 companies in the leather sector closed, reducing the overall number to 22 459 (a 1.8% drop from 2009)[56].

56 ANCI (2011)

Leather Production

The Italian leather industry accounts for 66% of leather production by value within the EU and 16% of global production. It is composed of around 1 300 companies (mainly SMEs) that employ approximately 18 000 workers, organised in specialised clusters by processing type and product. The two main clusters are located in Arzignano and Chiampo, Veneto (around 8 500 workers, specialised in footwear and upholstery) and Santa Croce sull'Arno, Tuscany (around 5 500 workers, accounting for 35% of leather production and 98% of the leather soles).

After a strong contraction in 2008 and 2009, production increased by 8.5% (in square meters) and 18.1% in value in 2010. The increase was mainly driven by exports (+28%).

Half of the Italian production of leather is bought by footwear manufacturers, followed by manufacturers of handbags, wallets and leather accessories (18%), the furniture industry (17%), clothing (6%) and the automotive industry (5%). Another 5% is used for minor applications (binding etc.).

Twenty five per cent of production is destined for the Italian market and the remaining 75% is exported, with Far East countries (15%), Romania (7%) and Germany (6%) the most important export markets. Altogether, EU countries account for 51% of exports. Premium-, high- and medium-high quality products account for almost 60% of Italian production. The raw materials are imported mainly from other EU countries (45%), South America (19%), Africa (9%), East Europe (8%) and Oceania (8%)[57].

International Trade

Table 4.2 indicates that exports of Italian footwear have been reducing in terms of numbers of pairs since 2004, whilst imports have been increasing. This has led to an increasingly negative trade balance, with imports exceeding exports by 132 million pairs in 2010. However, the picture is different in terms of value of trade, as Table 4.3 shows. The value of exports far exceeds the value of imports, giving a positive trade balance of over €3 billion in 2010. The value of both imports and exports grew until 2008, reduced significantly in 2009, as did the trade balance, then recovered slightly in 2010.

The main export market for Italian footwear remains the European Union; in 2010 intra-EU trade was worth over €3.7 billion. Within the EU, the most significant market are France, Germany, the UK and Spain while important extra-EU markets include the USA (with an export value of $558 million in 2010), Switzerland (€419 million) and Russia (€409 million).

Figure 4.1 summarises information on the main export markets for Italian footwear.

[57] UNIC (2010)

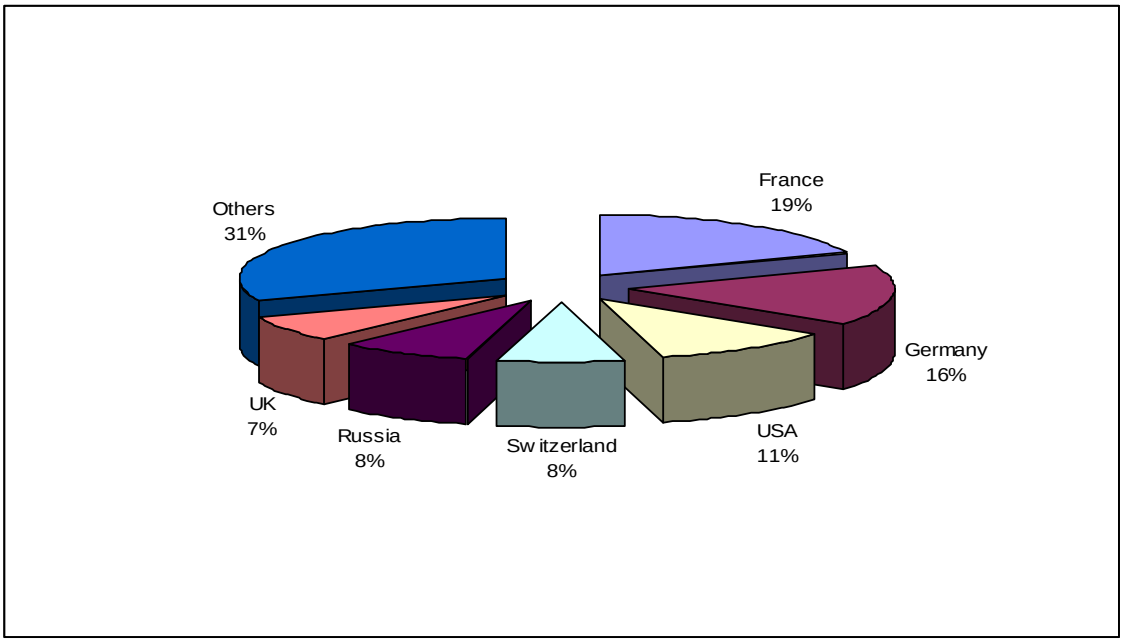

Figure 4.1: Destination of Italian Footwear Exports by Value, 2010 (Source: ANCI (2011))

Based on the figures provided by ANCI, the average price per footwear product sold in the EU market is around €24.78. In external markets the price is higher; in 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 in 2010. Other important sources of imports include Romania, Vietnam, Belgium and the Netherlands. Altogether, over €1 500 million of imports into Italy in 2010 came from other EU Member States, although some of these (for example those from Belgium and the Netherlands) were originally sourced from outside the EU. While the value of footwear products imported 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%. Figure 4.2 (next page) provides information on the main sources by value footwear imports into Italy.

A quantity and price comparison of imported products indicates very different prices per product. In the case of footwear imported from the EU 27, the average price per product is €18.43, while Chinese and Vietnamese imports cost on average €4.74 and €11.58 respectively.

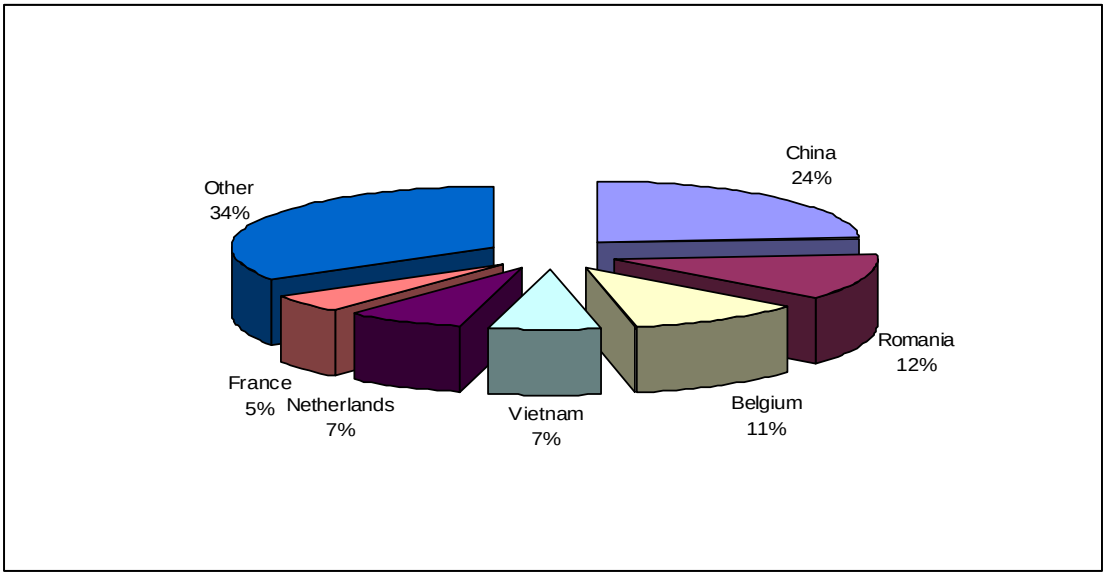

Figure 4.2: Sources of Italian Footwear Imports by Value, 2010 (Source: ANCI, 2011)

Consumption

Table 4.4 summarises the change in consumption of footwear in Italy between 2004 and 2009. Consumption grew slightly between 2004 and 2007, by both volume and value. It reduced in 2008 and 2009. The size of the market is now 160 million pairs, with a value of nearly €6.4 billion, indicating an average price per pair of nearly €40.

Table 4.4: Footwear Consumption in Italy, 2004 - 2009

Year	Quantity (Million Pairs)	Value (€ millions)
2004	158.2	6 185
2005	158.7	6 274
2006	159.4	6 321
2007	165.6	6 715
2008	161.1	6 394
2009	160.0	6 393

Source: ANCI (2011). The Italian Footwear Industry Preliminary Results 2010

Restructuring and Innovation

The sector has undergone a range of changes to cope with the changing market conditions. This includes introducing innovations as well as increasingly targeting the higher price ranges. There is also a long history of locational restructuring of the Italian footwear industry.

Some Italian sports footwear companies had already begun to delocalise production to the Far East in the 1960s, to compete with the big brands in the sports sector. However, these were one-off events, limited to specific product types (running shoes

and sneakers). In the 1990s, the process intensified and production of all types of footwear was outsourced and delocalised. Today, the process of delocalisation is widespread, not only for large companies but even for those of more modest size.

A survey conducted by Osservatorio Socio Economico Montelliano (OSEM) in 2008 showed that offshoring of production was 100% for companies specializing in the production of soccer shoes, cycling, motorcycle boots, ski boots, tennis and running shoes. This percentage dropped 85% for manufacturers of city shoes and between 70% and 80% for boots and snowboard boots. The main destinations for offshoring are Romania (62% of companies surveyed) and China (333%), followed by Bulgaria (14%), India, Vietnam, Ukraine (12%)[58]. The implications for the Romanian footwear industry of outsourcing by Italian companies to are discussed in the Task 3 Report.

4.1.2 The Footwear Industry in Veneto

Veneto is a region in the northeast of Italy, between the Alps and the Adriatic Sea. It is considered one of the most innovative districts in general in Italy.

Footwear production in the region has more than seven centuries of tradition, and the first guild of footwear manufacturers is certified by a document dated 1268 in Venice. The industrial district, in the modern sense of the term, was established towards the end of the 19th century. The region hosts world famous brands like Lotto (sport shoes), Geox (comfort shoes), Tecnica (ski boots) and houses companies designing and manufacturing high brand shoes for luxury labels such as Armani, Gucci and Calvin Klein.

Regional distribution of the companies covers six of the seven provinces and every province has its characteristics (see Table 4.5); the most important provinces for footwear production are Brenta and Montebelluna.

Table 4.5: Characteristics of Footwear Manufacturing Districts in Veneto

- In **Riviera del Brenta** there are 600 companies specialising in the production of fine luxury shoes, for to the most important international labels.
- **Montebelluna** is a footwear cluster of world relevance, with 400 companies specialising in the production of sports shoes, with major international brands.
- **Rovigo** province hosts 100 companies manufacturing medium to high end footwear, 55% for export.
- In the province of **Verona** there were previously large-scale manufacturing plants focusing on the middle segment of the market; however, much of the production has nowadays been outsourced abroad, leaving just design and marketing in the area.
- In the province of **Vicenza** few companies have survived, but those that remain have high expertise and a strong position on their markets.

Source: Interview with regional industry association, October 2011

[58] Intesa San Paolo (2010)

Riviera del Brenta hosts close to 600 companies (9.5% of the Italian total). The majority are small and medium sized enterprises; only four companies employ more than 150 workers[59]. The companies in the cluster can be grouped in the following categories (numbers are estimates[60]):

- shoe manufacturers: about 150 companies;
- accessories, components manufacturers: about 350 companies;
- designer studios: 60 companies; and
- wholesalers: about 50 companies.

Nearly 20 million pairs of shoes are produced in the cluster (28.2% of the regional output and 9.5% of Italian total). The companies in the cluster produce luxury footwear for both men and women and are involved in the design, manufacture and marketing of almost all the "designer label" footwear available on the world market. The majority (95%) of the shoes manufactured in the cluster are bound for export, mainly to the Middle-East, Russia, Northern Europe, USA and Japan. The value of exports is €1.6 billion, which is 48.3% of the regional and 12.9% of Italian total). Around 7 000 people (13.6% of the Italian total) are employed at footwear manufacturing companies, with 2 000 more at components and accessories producers. A further 500 people work for design companies and traders and 1 000 are employed by other suppliers.

Montebelluna is dominant in technologies for the production of ski boots[61]. It is home to the world's largest ski-boot makers, including Tecnica SpA and the boot units of Amer Sports Oyj's Salomon brand and Quiksilver Inc.'s Skis Rossignol. The cluster accounts for more than 50% of the world production of technical mountain shoes, 65% of after-ski boots, 75% of ski boots, 80% of motorbike footwear and almost 25% of in-line skates. Complementary industries are also present in the area, including plastic, moulding and machinery manufacture[62].

Approximately 425 firms (304 producers of footwear and 121 producers of clothing) form the cluster. Although they employ no more than 9 000 people, the firms inside the cluster have a turnover of €1.3 billion. Around 115-120 million pairs of shoes are manufactured yearly; 86% of these are exported outside the region. The most important markets for firms in the region include other EU countries, the US and Japan.

Since the late 1970s, many leading international firms have located research and development departments or started partnerships/collaboration programmes with local firms in the area. According to Belussi and Pilotti[63] (2000), the success of this cluster lies in the existence of an "industrial district with absorption of external knowledge and development of new global knowledge".

59 Companies with over 150 employees may still be SMEs, depending on their balance sheet

60 Interview with regional industry association, October 2011

61 Belussi F and Pilotti L (2000)

62 Sammarra A and Belussi F(2006)

63 Belussi F and Pilotti l (2000)

4.1.3 Organisations Interviewed in Veneto

Table 4.6 lists the organisations we interviewed in Veneto.

Table 4.6: Organisations Interviewed in Veneto		
Type of Organisation	**Main Activities**	**Size**
Regional industry association	Assisting the companies in their internationalisation and collaboration with the unions and public authorities	n/a
Research institute	Research and development, testing and quality control services for the footwear industry	n/a
Footwear manufacturing company	Manufacture of comfort, fashion, classic and casual styles for men, women and children	Large
Footwear manufacturing company	Manufacture of sports footwear and clothing	Large
Footwear manufacturing company	Manufacture of high quality men's shoes and accessories	Large
Footwear manufacturing company	Manufacturer of trekking boots and ski boots	Large
Footwear manufacturing company	Manufacture of luxury ladies footwear	Medium

4.2 Footwear Restructuring in Veneto

4.2.1 Types of Restructuring

In order to remain competitive even with high labour costs and in an increasingly difficult market companies in Brenta have adopted three strategies:

- subcontracting for big label companies which provide a level of security with regards to orders and payments (*reorganisation of sales channels*);
- offshoring part of the production process to countries with lower labour costs (*locational restructuring*); and
- establishing their own labels and strengthening their position in the market by differentiating their products (*product restructuring*).

Relationships between companies are very strong in the region; suppliers work closely with local manufacturers. There is also a high degree of specialization. According to the regional industry association, restructuring in Brenta was self-funded by the companies. This was confirmed by the companies we interviewed.

By contrast, both Italian and international companies in Montebelluna have focused on developing and promoting their own brands, offshoring of production to lower labour cost locations whilst responsibility for design, R&D, marketing and sales remains in Montebelluna.

Further information on each type of restructuring that has taken place is provided below.

4.2.2 Operational Restructuring

During the growth of the industry in Brenta in the 1990s, due to the expansion of sub-contracting, the industry undertook process modernisation took place. Companies invested in research and information technology for the design phase (designing leather models) and modernised production machinery.

Companies in Montebelluna have also reorganised their management processes. For example, Box 4.1 gives the example of a company that needed to restructure its management systems as it grew in size.

Box 4.1: Reorganisation of Management Processes

As the sports footwear company grew in size, it became clear that a more formal management structure was required than its existing ad-hoc system where 'everybody did a bit of everything'. The first reorganisation of management took place in 2000, when a new team was recruited as part of a restructuring of the company's operations. This included establishing for the first time the posts of product managers, each of whom was responsible for one complete product line, from design, through (outsourced) production, to sales and marketing. Prior to this reorganisation, responsibilities were somewhat unclear, which reduced the efficiency of the operation.

A second management restructuring took place once the company had grown further, in response to a reduction in profits. This involved the hiring of additional senior staff to oversee the three main areas of operation; marketing, sales and operations. They worked with the product managers to increase efficiency.

Source: Interview with company, October 2011

Another company, manufacturing sports footwear, has also made increasing use of IT in streamlining its operations (see Box 4.2). A fashion footwear company was of the opinion that the use of the IT is also a way to make the footwear industry attractive for Italians again, by reinvigorating its technological appeal.

Box 4.2: Use of IT to Optimise Production

IT has redefined communication between the production sites, as the company introduced a new software system that enables everyone working on the design and main manufacturing phases to log on in order to follow the production line and the different stages of the process.

Moreover, the system allows for large, graphic files to be sent; therefore prototypes can be viewed in 3D and corrected, even in the design phase. This makes the manufacturing process more interactive and less linear. This also cut costs and increases efficiency.

Source: Interview with company, October 2011

4.2.3 Product Restructuring

As the luxury market has been less impacted by the economic crisis, companies in Brenta that have been producing for major brands as sub-contractors are considering strengthening their position by increasing production capacity for their own luxury labels.

Companies in Montebelluna have developed a number of innovative products for their specialist market areas. Box 4.3 gives an example of this.

Box 4.3: Restructuring through Development of Innovative Products

In 2001, the company developed Geox (patented) leather in its own laboratory. The leather is used in the soles of footwear for its qualities of durability, flexibility and workability. Geox breathable membrane is inserted into the sole to make it waterproof, providing fully waterproof leather shoes.

In 2002 the company patented the side transpiration system, a first in the world of sports footwear which, thanks to the hole in the sole its sides, allowed greater air circulation and a consequent greater breathability of the foot.

The company has continued to add new inventions and patents to its existing line of products. It has also made significant investments in promotion of its brand. Currently it manufactures 21 million pairs per year through sub-contracts with producers in China, Cambodia, India, Vietnam and Brazil..

Source: Interview with footwear manufacture, October 2011

Another company had restructured its products, to be better in line with market requirements, by following fashion trends more closely. For example, the company launched a new line of work shoes and a new line of leisure footwear that are sold via a distribution channel separate from its sports goods. It also differentiated its products from those of its (mainly USA) competitors by emphasizing their Italian origins. A sports and trekking shoe company had also moved into a new product type, to help overcome the seasonality of its main products (see Box 4.4).

Box 4.4: Restructuring through Moving into New Product Types

The managers of a ski boot and trekking footwear company met the Italian owner (originally also from the region of Veneto) of a Brazilian ladies fashion footwear, sandal and flip-flop manufacturer at an industry fair. Following negotiations, the managers agreed to take over the sales and distribution of the Brazilian company's footwear in Europe (this was a restructuring of the sales channel for the Brazilian company).

The Italian company decided to take this step in order to avoid the high seasonal fluctuations of its products. As the trekking and ski boots seasons wore off, the company had time to concentrate on the Brazilian brands.

The shoes of the Brazilian company are distributed separately from the company's own brand. The ladies fashion brand is sold through a mono-brand store in Milan while the others are sold via retailers around Europe.

Source: Interview with footwear manufacture, October 2011

4.2.4 Reorganisation of Sales Channels

Subcontracting to Major Brands

In the middle of the 1990s, an economic coincided with the move of some major fashion brands into the footwear market. Footwear manufacturers in Brenta were faced with a choice of either relocating production of their own brands to other countries, to cut costs, or producing under subcontract for major international fashion brands (including Italian brands such as Gucci and Louis Vuitton). The majority of

the companies had decided on the latter option, as they felt this would not compromise the quality of their products. One company we interviewed indicated that working for the major brands helped to stabilise fluctuations in sales.

This restructuring took place between 1993 and 1995 and is now complete. The major brands have remained with the companies ever since. Nowadays, almost all of the major international fashion groups either own companies in the Brenta area or are have licence agreements with local firms.

Focus on Exports

Companies in both Brenta and Montebelluna have focused increasingly on the export market. An example of this change is given in Box 4.5.

Box 4.5: Increased Focus on Exports

Until 2000, a specialist comfort shoe manufacturing company in Montebelluna focused mainly on the Italian market, mostly to learn to compete in the industry. Once this process was complete, and its financial position had also been strengthened through a stock exchange listing, the company entered the main European markets (Germany, France and Spain). Next, the company began to expand globally, with markets in Japan, Russia and the USA.

Today the company sells only 41% of its products in Italy, while 46% are sold in the rest of Europe, 10% in the U.S. and the remaining 3% in the rest of the world. Most of its growth in sales is in the US and Asia. The company has opened around 140 stores across China.

Source: Interview with footwear manufacture, October 2011

One sports and trekking footwear company indicated that it has stopped selling to Italian clients totally, as they were unreliable in terms of payment. Its main clients now are all outside the EU, in Russia, Turkey, Middle-East countries, Korea, Japan, Chile, Canada and South Africa.

Downstream Integration

One specialist footwear manufacturer in Montebelluna has integrated downstream by establishing its own shops. Its products (footwear and clothing) are sold globally through 1 000 mono-brand shops. The company owns 30% of these shops; the remainder are operating under a franchise agreement. A sports and trekking footwear company is also planning to open its own mono-brand shops in the near future. Currently, its products are distributed via agents to multi-brand stores. Similarly, a fashion shoe manufacturer is looking to open mono-brand shops to increase its visibility and further strengthen the positioning of its brand.

However, another (sports footwear) company had taken the opposite route; moving from mono-brand stores to licencees and multi-brand shops. This enabled the company to expand distribution to around 80 countries without excessive investment. Similarly, a producer of men's fashion shoes has closed seven of its own stores that it considered were not strategically located.

4.2.5 Locational Restructuring

Locational restructuring in Brenta began in the 1990s, with parts of the production (especially of the low end products) delocalised to East Europe and Far East. This was a non-traumatic process for the district, since it took place in a period of expansion of the market and because the manufacture of the high end and more complex products was kept in the cluster, with the major multinational fashion brands coming to produce there.

After the collapse of communism in 1989, firms in the Montebelluna cluster took advantage of access to cheaper labour in East European countries to increase their competitiveness, through the relocation and international subcontracting of simple and labour intensive phases such as shoe assembly (see Box 4.6).

Box 4.6: Relocation of Production Within Europe

The sports footwear company started 20 years ago with six people; currently it has 60 workers in Italy, 90 working in its factory in the Czech Republic and 150 in Romania. The company produces 650 000 pairs of shoes per year. Out of this, 350 000 are produced in two factories in Romania and 150 000 are produced in the Czech Republic.

The Romanian company was bought 10 years ago from another Italian footwear company, with the existing staff, while the one in the Czech Republic opened in 1994. The latter started out as a production facility for uppers but has now switched to producing complete shoes, as skills have improved.

In both outsourced locations an Italian manager oversees the production process and it operates under the *lohn* system, where all materials are shipped from Italy.

Both restructuring processes are now complete and the management is quite happy with the results. The short distance between the factories makes it easy to transport materials and in both locations the availability of skilled staff made it very easy to achieve the desired production capacity quickly.

Source: Interview with footwear company, October 2011

Shoes for Montebelluna-based companies are now produced by subcontractors in Romania, Cambodia, China, India and Vietnam. An example of the different stages of locational restructuring is given in Box 4.7.

Box 4.7: Stages in Relocation of Production

A sports footwear manufacturing company based in the region initially outsourced its manufacture to Romania. However, it experienced major economic problems at the end of the 1990s, due to increased competition, and was in serious debt. At this time, its factories in Romania were closed down and production was relocated to Asia.

Restructuring then continued, with a reorganised company structure that was more streamlined and flexible in terms of offshoring. During 2000 and 2001, new company offices were opened in Hong Kong (as the regional hub) China and Indonesia.

Production is entirely outsourced to third parties; these third parties are changing as new factories are being built in new regions in China with cheaper labour. The overall aim is to set up and operate a global strategy that is flexible in line with market and trend shifts.

Source: Interview with footwear company, October 2011

Some companies that have not yet outsourced production are considering doing so in future. For example, a company making men's fashion shoes has been exploring options to outsource at least part of its production processes. It is considering Eastern European countries, Turkey and Northern Africa as possible locations. However, some companies have experienced problem in managing production at such a distance, and are considering moving production back to Europe (see Box 4.8), while others have investigated relocation but decided against it as they felt that the quality of production could not be maintained.

Box 4.8: Outsourcing Production

The sports footwear company contracted its production process to third parties from the beginning, which allowed the company to focus on business operations upstream (R & D) and downstream (Marketing, Distribution and Sales).

At the beginning, subcontracting was within the district of Montebelluna. Later on, production was moved elsewhere. In addition to four factories in Treviso (in Veneto), the company built a plant in Romania and one in Slovakia in 1997. Prototypes, however, are still sourced from the district of Montebelluna, as well as Marche (in central Italy).

Around the Romanian site (which cost over €10 million), the company developed over time a "shoe minidistretto", attracting various Italian suppliers (mainly from the regions of Veneto and Marche) specializing in individual stages of the production process, such as cutting or assembly. In addition to a factory in Timisoara, a school for the training of technicians was also set up.

Since 2003, a significant percentage (around 80%) of production is manufactured under sub-contract in the Far East, thanks to an agreement with the second largest Chinese footwear group. The factory site in Timisoara was closed down and the company focused its production in Asia.

The main reason for this move was that labour costs were lower in Asia. However, the company indicated that management and communication with Chinese factories is causing sufficient problems for the company to consider moving its operations back to Europe.

Source: Interview with company, October 2011

Due to the relocation process, the Montebelluna cluster has lost the more standardised end of the manufacturing process but has retained the highest value-added and creative phases of the sportswear sector: product design, prototyping, research and development, specialised components production, design and fashion analysis, manufacturing low volume and high quality production, marketing and distribution.

4.2.6 Closure

Between 2000 and 2010, about 402 companies in Riviera del Brenta went out of business, of which 287 were involved with the manufacture of the final product and 115 in the corresponding activities[64]. This resulted in a reduction in the number of employees in the sector of around 3 600 people, of which around 1 400 were employed in the manufacture of the final product and 2 200 in corresponding activities

[64] Uppers and soles factories, cutting and stitching factories, accessories factories, printing companies, design studios, footwear machineries production companies, etc.

In Montebelluna, the number of companies decreased from 464 to 384 between 2001 and 2010, a loss of 80, of which around 40% were involved in the manufacture of the final product. In the period 2001-2009, around 1 700 jobs were lost (from 8 950 to 7 250).[65] Statistical data about the Sport system district of Montebelluna need to be looked at with caution, as a single company (which increased jobs by 130 in 2008) accounts for approximately 40% of the turnover and 60% of the production of the district. Figure 4.3 shows changes in the number of companies in Brenta and Montebelluna and Figure 4.4 shows changes in employment.

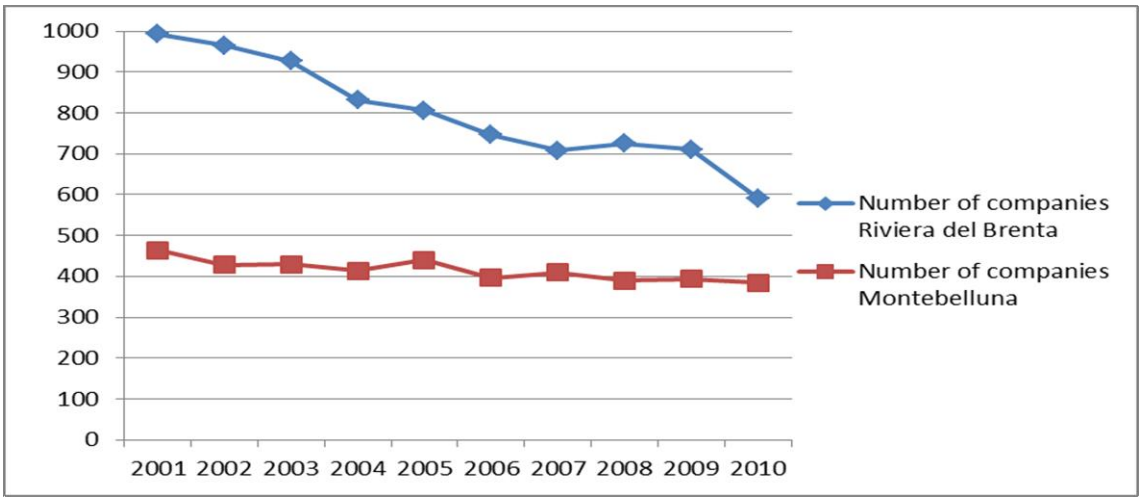

Figure 4.3: Number of companies in Riviera del Brenta and Montebelluna Districts (2001-2010) (Source: OSEM Reports (2002-2009))

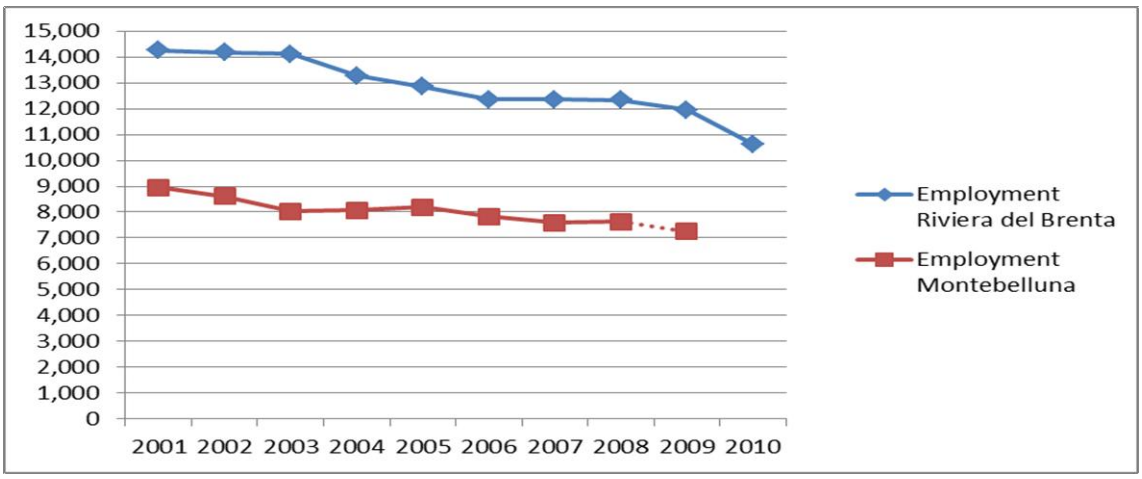

Figure 4.4: Employment in Riviera del Brenta and Montebelluna Districts (2001-2010) (Source: OSEM Reports (2002-2009))

[65] OSEM reports (2002-2008) by Veneto Banco Holding and *Rapporto Annuale sull'Economia Trevigiana 2010.*

4.2.7 Merger and Acquisition

The entry of multinationals into Brenta has contributed to increased competitiveness among local firms, accelerating an exit process among the less competitive. In addition, many firms have merged and new Italian companies have been created.

In the Montebelluna district, multinational groups have acquired a number of historic local brands. For example, the Dutch-Austrian sportswear and equipment Head-Tyrolia-Mares group merged with Montebelluna-founded Brixia, incorporating the historical brands Munari and San Marco. It now sells products under the HEAD (tennis, squash and racquetball racquets, tennis balls, tennis footwear, badminton products, alpine skis, ski bindings and ski boots, snowboards, bindings and boots and sportswear), Penn (tennis and racquetball balls), Tyrolia (ski bindings) and Mares (diving equipment) brands..

Montebelluna-based companies have also acquired foreign brands. For example the ski boot company Tecnica acquired Asolo (trekking boots) and Nordica (ski boots) from Benetton, the Italian Think Pink sportswear manufacture and the German Lowa (outdoor, ski boots and military boots) (see Box 4.9).

Box 4.9: Restructuring and Expansion through Mergers and Acquisitions

Tecnica started in Montebelluna in 1960 making work boots. It enjoyed its first worldwide success in 1970 with the Moon Boot after-ski footwear.

Following series of successive mergers and takeovers, the Tecnica Group is one of the world's leading companies in the ski boots, "outdoor" footwear, after-ski and winter footwear as well as in-line skates. It produces over five million pairs of footwear per year.

In addition to Tecnica products, the Tecnica Group is the parent company to the following brands: Nordica (skis and ski-boots), Blizzard (skis), Dolomite (ski-boots, outdoor clothing and footwear), Nitro (snowboards and snowboard boots), Lowa (outdoor footwear and ski-boots), Rollerblade (in-line skates), and Think Pink (sportswear).

The Group's products are distributed in all the main world markets, it employs over 1 560 people and has a turnover of around. €410 million and more than 10 000 sales stores worldwide

Source: Company web site http://www.tecnica.it/company/company-profile

This is part of a wider trend in the sports footwear and clothing sector to widen the range of its brands to other sports and to recreational clothing and footwear, especially given the downturn in ski boot sales that followed a series of mild winters in the 2000s. Other examples include:

- US firm Nike, which has a major base in Montebelluna, bought the fast-growing Canstar (a Canadian company leading in the production of hockey equipment); and
- the French Rossignol ski wear and accessories company bought the ski boots manufacturers Lange (from the US) and Caber.

One sports shoe company based in Montebelluna acquired a US manufacturer of

running, bowling and golf shoes in 2006 to maintain influence and access in the American market. The US manufacturer has a 130 year history and has significant share in the golf and bowling shoe market segments. The acquisition allowed the company to strengthen its US market position significantly.

4.2.8 Best Practices in Restructuring

Companies in Riviera del Brenta retained their manufacturing operations in the area, as well as the design and marketing phases. The "big brands" bought some facilities from local companies, aiming to benefit from the strong know-how in the district. The presence of education and training facilities in the region is also an advantage, as it provides continuity with regards to human resources. There have been joint training projects with other countries, including China, Brazil, Argentina and the USA.

The regional industry association considers that the "secrets" of Montebelluna's success are the high level of integration of the production cycle, along with the presence of a highly specialised supply chain (see Box 4.10). For example, an innovative rubber and plastics manufacturing cluster with important outputs in terms of applied research was created to complement to the footwear sector.

Box 4.10: Importance of the Cluster in Supporting Restructuring

For a specialist sports footwear manufacturer, the main advantage of the cluster is the availability of suppliers, the presence of footwear manufacturing enterprises.

The location of the company in Montebelluna has enabled it to take advantage of a range of resources, including skilled labour. The company supported a network of laboratories around the area of Montebelluna, in order to study the feasibility of a novel shoe concept and to launch the product on the market.

Source: Interview with footwear manufacturer, October 2001

A sports and trekking footwear manufacturer considered the proximity of suppliers to be a major success factor. The company obtains 97% of its raw materials within Italy. This is a significant advantage, as the company can oversee the suppliers and materials.

The regional industry association believes that, as general rule, the success of the footwear industry is a mix of technology and tradition in an entrepreneurship-oriented region. However, one company considered that being part of a cluster had brought disadvantages, as it enabled competitors to learn from its success (see Box 4.11).

Box 4.11: Disadvantages of Being Part of a Cluster

One innovative sports footwear company considered that its success had served as a catalyst for other companies in the region. In most cases, this has simply involved recognising the importance of investment in research and communication, together with decentralisation of production.

However, one competitor has gone further and developed a product very similar to the company's patented technology and using a very similar marketing approach. The company took legal action against its competitor, but was unsuccessful.

Source: Interview with footwear manufacturer, October 2001

4.3 Drivers for Restructuring

4.3.1 Main Reasons for Restructuring

Restructuring in Brenta took place in the middle of the 1990s when an economic crisis, smaller scale than today, hit the market. At the same time, some major fashion labels (Louis Vuitton, Gucci etc) that had not been producing footwear previously began to enter the market and sought contractors to produce their new line of products. This gave companies in Brenta the opportunity to switch to a new business model.

Companies were faced with a choice; either cut costs and move production to other countries or to take up work for the fashion labels. The majority of the companies decided on the latter option, as they felt in this way they would not compromise the quality of their products (see Box 4.12).

Box 4.12: Drivers for Subcontracting to Major Brands

About 10 years ago a fashion footwear company started to work under sub-contract to major brands. This radically altered its production, as previously 90% of its operations were focussed on producing its own brand; this has now reduced to 30%.

A mixture of reasons that led to the decision to work for major brands; these included the increasing cost of production (including rising labour costs) and the increasing competition from major brands that had previously not produced shoes. A completely new market opened as the brands started shoe production under their own names. In addition, at the end of the 1980s the US market was lost due to protectionism and exchange rate fluctuations; later on, the crisis of the Japanese economy severely affected the market there and the market trend towards casual shoes also caused difficulties for the company.

Source: Interview with company, October 2011

Economic factors were also key drivers for restructuring in Montebelluna. One company indicated that offshoring was the most cost-efficient way to start building a company. Lack of skilled workers was an additional reason for the company to move abroad as production increased. This factor was also important for another Montebelluna company. The company had more orders, needed to grow and not enough skilled staff were available in Italy. Also, the management found that, administration-wise, it was easier to open new factories in Romania and the Czech Republic than in Italy.

For another company, the restructuring process was prompted because the market was saturated. In order to provide a competitive advantage, companies were seeking to cut costs of their products. As its main competitors from the US had moved to third party manufacturing in Asian countries, the company had to follow suit in order to remain competitive.

Another company indicated that it was the complicated and time-consuming administrative procedures in Italy that prompted locational restructuring. The

company found it was easier to open new factories in Romania and the Czech Republic than to expand within Italy[66].

4.3.2 International Competition

The regional industry association indicated that trade policies, in particular the opening up of EU markets to Chinese footwear, had been a major driver for restructuring, as it introduced strong cost competition.

The fragmentation of the EU market, prior to enlargement, had influenced locational restructuring. One company supported this view, indicating that the lack of a single market in Europe during the 1990s was a major factor in its move from outsourcing in eastern Europe to offshoring to Asia (see Box 4.13).

Box 4.13: Significance of Trade Policies to Restructuring Decisions

The company initially moved production to Romania in the 1990s. This provided access to cheap labour but, as the country was not then a member of the EU, tariffs were in place on imports to the EU. The company's subsequent move to subcontracting to factories in China allowed it to further cut costs and be more competitive in terms of price, whilst still facing tariffs.

Whilst Romania's entry into the EU removed tariff barriers, this was not sufficient to outweigh the lower costs of production in China. Costs in Romania have also increased since it joined the EU.

Source: Interview with company, October 2001

4.3.3 Availability of Funding and Other Assistance

According to the regional industry association, the restructuring process in Brenta did not benefit from any community or government funding, so this was not a driver. This was supported by companies that we interviewed in both Brenta and Montebelluna.

One company in Montebelluna indicated that it approached the Italian Government to seek support for a training initiative from the European structural fund, but was told that its project did not fit with the lines of development suggested in the funding mechanism. Similarly, a men's fashion shoe company tried a couple of years ago to obtain support for a children's shoes project together with a tannery, but it found the administrative work involved in obtaining funding too overwhelming. In the company's view, a new person would have to be hired just to get a proposal together and handle the administrative tasks.

[66] The company's concern was about general administrative procedures rather than a specific piece of legislation. It is notable that the World Economic Forum (2012) ranked Italy as amongst the worst in terms of the burden of government regulation and the efficiency of the legal framework in settling disputes.

4.4 Impacts of Restructuring

4.4.1 Negative Impacts

The main negative impacts of restructuring have been the closure of around 330 companies in Brenta in the 1990s and early 2000s, and a loss of jobs in Montebelluna. Table 4.14 illustrates the overall change in employment in the Textile and footwear sectors in Veneto between 2007 and 2011.

Table 4.14: Change (%) in Employment in the Textile and Footwear sector in Veneto[67]

	2007	2008	2009	2010	2011
Micro enterprises	-2.5	-1.9	-2.3	-1.9	-1.0
Small and medium enterprises	-2.7	-1.1	-3.1	-1.9	-1.0
Total	-2.7	-1.2	-3.0	-1.9	-1.0

Source: Veneto Congiuntura http://www.venetocongiuntura.it/it/topind/2011/2d-trim-2011-ind.html

Relocation of production by some companies based in Montebelluna, from Europe to China and elsewhere in Asia, resulted in job loss in Europe. For example, one company closed down its manufacturing plants in Romania and Slovakia, with the loss of 1 500 jobs. However, companies have also developed training programmes within the region, to train staff for the functions that remain in Montebelluna (see Box 4.14).

Box 4.14: Training of Staff for Non-Production Roles

In 2001 a company established a training school at its headquarters in Montebelluna, intended to train managers and technicians, top managers and recent graduates.

Now young graduates in chemistry, engineering, mechanics and economics are offered the opportunity to participate in courses organized by the company, which includes in-depth theory in a single discipline and a field work. The course lasts from four to six months. At the end of the course the participants, who are now trained in the specific needs of the organization, are employed within the company.

The company currently spends €500,000 to €800,000 on training, including e-platforms for shop assistants, managers, retail managers. The company also organizes IT and language courses for its employees.

Source: Interview with footwear company, October 2011

For companies in Brenta that act as sub-contractors for major fashion brands, the negative impact has been some loss of independence. The fashion brands are now their major customers and distribution of the companies' own brands has generally taken a back seat. This makes them more dependent on the fashion brands are more vulnerable, despite long-term contracts, should the fashion brands decide to move their production elsewhere.

[67] All the data refer to the second trimester

4.4.2 Positive Impacts

The restructuring process in Brenta was a success for most companies in the region, as it allowed them to reposition themselves. By producing for the major brands, companies gained in stability and were protected from the seasonal fluctuations of the market.

Companies based in Montebelluna also considered restructuring to have been successful, and identified different aspects of the process as having had the most positive effects. For many companies, locational restructuring has enabled companies to expand their output and turnover (see Box 4.15, over page).

Box 4.15: Increased Output and Turnover from Restructuring

For a sports footwear manufacturer, the main impact of restructuring was that the company was able to increase its production capacity, as there was a lack of available skilled workers in Italy. With opening of the factories in Romania and then offshoring operation to Asia, production levels could be maintained and the company was able to maintain its market position. By relocating, the company was also able to keep costs of production, including labour costs, down which improved its profitability.

Similarly, a ski boot and trekking footwear manufacturer had been able to grow its production significantly through relocation; the company considered that such growth would not have been possible if it had remained in Italy

Source: Interview with company, October 2011

Companies in Montebelluna that had undergone locational restructuring indicated that this had improved their flexibility. One company considered that restructuring led to a very flexible system that can adapt easily to market requirements. Time to market has not been reduced significantly (the company is rather new and so no major changes occurred in this regard); however, communication and on-going training of employees has allowed the company to be in control from its headquarters in Italy, even though its production facilities are widely dispersed (see Box 4.16).

Box 4.16: Business Gains from Locational Restructuring

Moving the manufacturing process out to third countries has allowed the company to remain cost competitive and at the same time to increase its output.

As a start-up company that had no real information, did not have the know-how on some of the key aspects of footwear manufacturing, the company made a good decision to be looking outside the district, thereby putting emphasize on the best production mechanisms that are most suitable for their operation.

Source: Interview with footwear company, October 2011

One Montebelluna company indicated that changes in production costs were difficult to measure, as there is no comparison between Italy and outsourcing locations. Labour costs are much higher in Italy then in the two outsourced locations. In the Czech Republic labour costs are twice as much as in Romania. However, restructuring has meant that the company has been able to grow despite the financial crisis.

Restructuring has also proved profitable for companies in Brenta; subcontracting for major brands has provided stability and growth. It has allowed the companies to remain in the market without having to enter into cost competition with other producers and relocate production that would have meant difficulties in controlling and maintaining the quality of their products.

In Brenta, restructuring led to the need for additional staff. The major fashion brands demanded so much in terms of product output that the regional manufacturers had difficulties recruiting people locally. Therefore, the local industry association entered in agreement with the province of Lecce (in the southern tip of Italy) to recruit people who had been made redundant from footwear manufacturing companies in that region. One company we interviewed noted that number of people necessary to maintain production has increased since it began manufacturing for major brands. It no longer has sufficient staff to carry out the technical parts of the job and therefore the company has turned to another factory to help out.

A company that has relocated production to its own factories elsewhere in Europe indicated that one of the advantages of locating in Romania and the Czech Republic was the availability of skilled staff. In the Czech Republic, the Bata school was a reassurance of that workers had up to date skill, while in Romania footwear manufacturing has been one of the traditional sectors. The owners felt that, by contrast, education and training in the sector in Italy is misguided, as it fails to bridge the gap between the theories taught and the practicalities expected at the factory. (The issue of training and its match to skill requirements is investigated in the Task 5 report).

Another positive impact of restructuring in Brenta was the repositioning of the manufacturers in the market. Producers in the area are associated with high quality, luxury brands. Similarly, the response of companies in Montebelluna to the declining demand in ski boots due to milder winters has led to better market positioning. Some companies have updated the old ski boot designs and introduced lightweight and more colourful models. Other companies have expanded into other areas of sports footwear, such as hiking boots and motorcycle boots, through acquisition of companies with expertise and brands in these areas. Another successful area of product development was in-line skates, which became a top product in the early nineties. Companies also diversified into the production of sports apparel[68].

4.4.3 Changes in Business Partnerships and the Supply Chain

In general, footwear manufacturing companies in the region indicated that there had been few changes in business partnerships as a result of restructuring. One company indicated, for example, that no new suppliers have been sourced as the operation is still managed and organised from the company's headquarters in Italy, and all the material is sent from there to its production sites in Romania and the Czech Republic.

[68] Federazione dei Distretti Italiani & Unicredit (2010)

Companies on the Riviera del Brenta obtain the majority of their raw materials from within Italy in the case of companies in Montebelluna, the picture is more mixed. Companies that have outsourced production to Asia use a range of suppliers, whereas those that have maintained EU production facilities tend to use Italian raw materials.

One sports and trekking footwear manufacturer noted that it obtains 97% of its raw materials within Italy. This is a significant advantage, as the company can oversee the suppliers and the materials. It uses eight different suppliers. The company has found it more difficult to find the right quality materials in recent years, as many suppliers went out of business during the last couple of years of the economic crisis.

In Montebelluna, though, the delocalisation of production has had a significant impact on footwear component suppliers in the region. The relocation of the large and medium sized footwear manufacturers forced the component suppliers to follow suit, especially in case of countries that were within easy reach, such as Eastern Europe. Today, the network of footwear manufacturers from Montebelluna covers Eastern Europe (mainly Romania), the North African coast (Morocco and Tunisia) and South America (Brazil).

Restructuring has also affected partnerships with retailers. For one company, it has led to the setting up of mono-brand stores; with effective training of retail staff (see Box 4.17).

Box 4.17: Successful Restructuring through Training of Retail Staff

The company considers that staff training has been one of the most effective aspects of restructuring. Training is mainly aimed at retail staff and involves both direct and E-learning. The amount of training varies for different types of employee. For example, a store manager will receive training on HR, cash flow, organization, leadership, logistics and public speaking, culminating in a Masters award. By contrast, non-management personnel will be trained in product information and sales techniques. This approach has been used in Italy and will be rolled out in France later this year and Germany in 2012.

Source: Interview with footwear company, October 2011

For another company making sports footwear, restructuring resulted in a move away from the mono-brand stores it owned in the 1990s to selling through specialist multi-brand stores. It also switched to using licencees to distribute its products in Middle East markets.

For the ski boot and trekking shoe company, distribution channels have widened as a consequence of its agreement to distribute Brazilian footwear brands (ladies fashion shoes, sandals and flip-flops). A mono-brand shop had been opened for the fashion brand in Milan; in addition, different agents have been used to market the products in Europe.

4.5 Effects of the Economic Crisis

The economic crisis did not have a significant impact on Brenta. Although about 330 companies have gone out of business during the last 15 years, the majority of this occurred during the 1990s and the early 2000s. Demand from the major fashion labels was not reduced by the economic crisis, so the change to a sub-contracting business model in the late 1990s and early 2000s insulated the companies from the impacts of the crisis.

Similarly, a manufacturer of fashion shoes in the €300 - €400 retail price bracket was able to withstand the negative impacts of the crisis, as the luxury segment was not impacted and demand was unchanged. The company has even had to increase the number of workers it employs. The company's main markets are Russia, the Ukraine and Middle East countries

The sports footwear companies in Montebelluna appear to have been more affected by the crisis, as this particular market segment suffered more of a downturn. One sports footwear company based in Montebelluna indicated that it was significantly affected by the economic crisis. The company had been experiencing an annual growth in turnover of over 30% until 2009, and increasing profits. In 2010, however, it just managed to break even and is not expecting to be profitable in 2011 either. Sales continue to decrease in Europe, but they are now increasing in the USA and Asia. Another sports footwear company had suffered a 20% reduction in turnover between 2008 and 2009.

However, one snow boot manufacturer had not been as significantly impacted by the economic crisis. Its growth had reduced in 2011, though, to a 15% turnover increase, as opposed to the trend of 30% growth in the previous years. This company also sells and distributes high-end fashion footwear for women, flip-flops and sandals for a Brazilian company.

4.6 Future Trends in Restructuring

4.6.1 Expectations of the Industry

According to the regional industry association, sub-contracting for major fashion brands will continue to be the main strategy for companies in the Brenta region. The influence and the sales potential of the major brands has not suffered at all and the quantity of orders they are placing is not expected to reduce. There is a risk to the region, though, should the brand owners decide to move their production elsewhere. For this reason and to protect their independence, companies are also now aiming, as far as possible, to launch their own collections (see Box 4.18).

Box 4.18: Increasing Emphasis on Own Brands

A fashion footwear company which undertakes sub-contracting for major brands is hoping to rely more on its own brand production and become more independent, as the brands can put pressure on production capacity, especially in peak seasons.

Producing for the major brands rather than own label is the easier option, but this does impose restrictions on the freedom of companies to develop new styles. Also, the company is looking to open mono-brand shops to increase its visibility and further strengthen the positioning of its brand.

Source: Interview with footwear company, October 2011

Companies in Montebelluna plan to continue with the promotion of their brands and the development of international markets. For example, the sports shoe manufacturer is hoping to increase its profile and sales in Asia, especially in China and India.

The sports shoe manufacturer also anticipates that distribution mechanisms will change in future, but it is not yet clear in what way. Currently, distribution is very expensive. The wide use of internet is putting pressure on the distributors. Internet shopping, including payment and returns, are becoming more standardised.

4.6.2 Remaining Barriers and Action to Address Them

Several companies we interviewed indicated that shortage of skilled staff is a potential barrier to further restructuring (see Box 4.19).

Box 4.19: Shortages of Skilled Staff as a Barrier to Restructuring

A company manufacturing for major brands, as well as producing its own fashion brand, has been unable to recruit sufficient staff with technical skills to maintain production. The average age of its employees is 30-40. It was common practice in the factory for older, more experienced workers to train and teach the younger staff. Unfortunately not many young Italian are interested in working in this field and the company therefore relies on migrant workers from Romania, Bangladesh etc. The company has also subcontracted some work to another factory, to help out with its capacity problems.

Source: Interview with footwear manufacturer, October 2001

4.7 Summary

The Veneto region hosts a number of different footwear clusters. The 600 companies in **Brenta** produce medium and high price ranged footwear. The majority are small and medium sized enterprises; only four companies employ more than 150 workers. By contrast, **Montebelluna** is dominant in technologies for the production of ski boots; the biggest shoe manufacturers for football, cycling, basket, tennis and athletics and cross-country race are also based here. Although the 425 firms employ no more than 9,000 people, the firms inside the cluster have a turnover of €1.3 billion. In both cases, however, the majority of footwear output is exported.

The two clusters have adopted very different approaches to restructuring. In order to remain competitive and in an increasingly difficult market, companies in **Brenta** have adopted three strategies:

- subcontracting for big label companies which provide a level of security with regards to orders and payments (reorganisation of sales channels);
- offshoring part of the production process to countries with lower labour costs (locational restructuring); and
- establishing their own labels and strengthening their position in the market by differentiating their products (product restructuring).

About 330 companies in Brenta have gone out of business the last 15 years; the entry of multinationals into the region contributed to increased competitiveness among local firms, accelerating an exit process among the less competitive. However, many firms have merged and small Italian multinationals have been created. For the remaining firms, restructuring has proved profitable; subcontracting for major brands has provided stability and growth, allowing them to remain in the market without having to enter into a cost competition with other producers and relocate production. The price that Brenta companies have paid for restructuring is that their independence has been compromised. They depend on orders from major brands and are finding it difficult to enter the market with their own product, as much of their workforce is kept busy with subcontract orders.

By contrast, companies in **Montebelluna** have focused on developing and promoting their own brands, with offshoring of production to lower labour cost locations whilst responsibility for design, R&D, marketing and sales remains in Montebelluna. Through this process, the Montebelluna cluster has lost the more standardised end of the manufacturing process but has retained the highest value-added and creative phases. Locational restructuring has enabled companies to expand their output and turnover rapidly in a cost efficient way. The region has also benefitted from an inflow of companies. Since the late 1970s, many leading international firms have located research and development departments or started partnerships/collaboration programmes with local firms in Montebelluna. A number of multinational groups have acquired historic local brands; local companies have also acquired foreign brands.

Companies in both clusters plan to continue with their current strategies in future. Work for major brands will continue to be the main strategy for companies in the Brenta region. The quantity of orders placed by the major brands is not expected to reduce. However, companies are also now aiming, as far as possible, to launch their own collections to enable further diversification. Companies in Montebelluna plan to continue with the promotion of their brands and the development of international markets. One potential barrier to this strategy is a growing shortage of skilled staff, which companies are trying to overcome both through developing their own training programmes and attracting employees from other parts of Italy, where the footwear industry has been contracting.

5. CASE STUDY: SOUTHERN POLAND

5.1 Introduction

5.1.1 The Footwear Industry in Poland

Industry Structure and Employment

The footwear industry has a long history in Poland, with the first shoemakers' guilds formed in the 13th and 14th centuries. Under the former communist regime, large factories with production levels of 4-10 million pairs of shoes per year were built up, which produced shoes mainly for the USSR.

The introduction of market economy in Poland in 1989 resulted in a significant drop in industrial production across all sectors, including footwear. Between 1989 and1999 there was a 30% decline in raw materials production, while the drop in the consumer goods production (light industry, including footwear) was much higher. One of the main reasons for this reduction was competition from imported goods. Another reason, particularly important for footwear, was the collapse of trade with the USSR.

In response to increased competitive pressure, changes in production methods and quality were accompanied by transformation in the structure of the industry. Along with the structural changes came an increase in the value of private sector industrial output, resulting in an increase in the number of employees in private enterprises. The changing balance between public-sector participation was further fuelled by the privatization of national assets. During the period from 1990 to 1996 various forms of privatization of state enterprises took place, including privatisation of three footwear conglomerates: Radom, Chelmek and Podhale. Between December 1990 and the end of 1996, 5 592 (66.2%) of the total of 8 841 state enterprises existing at the outset of the process had initiated transformation processes, but only 1 898 (22.4%) had managed to complete it.

In addition, private sector development through the establishment of new companies was of particular importance in Poland in the 1990s. Between 1989 and 1996, the number of private businesses owned by individuals nearly doubled, from 813 000 to 1.95 million. Starting up a small private business was relatively uncomplicated due to liberal commercial regulations and an easy registration process, as well as the ability to buy, at comparatively low prices, properties previously owned by the state. This is regarded as a success story of the privatization. In contrast, the ability to attract the foreign investors was initially limited due to high risks resulting from a high inflation rate, unresolved problem of foreign debt, possible negative effects of the reforms and a general lack of trust in foreign investment. However, this situation changed after 1993, when foreign debt was restructured and Poland became an attractive market for investors[69].

[69] Blaszczyk B and Woodward R (1999)

In the early 1990s, state-owned footwear factories were sold to number of private investors, who were free to decide whether they wished to carry on the original activities of the enterprises. Currently, there are no big state owned footwear manufacturing conglomerates and it was estimated that 97% of Polish firms are in private hands and 90% of firms are Polish owned.

The main areas of the country for footwear manufacturing include Malopolska and Silesia in Southern Poland. However, the Polish Chamber of the Shoe and Leather Industry is located in Lodz, where one of the large state-owned footwear companies was formerly located.

Data on the number of footwear companies operating in Poland vary, probably due to differences in definitions of the 'footwear sector'. For example, the Polish Statistical Office includes footwear manufacturers with other leather industry companies, such as manufacturers of footwear components, accessories and shops[70]. According to data from the Polish Statistical Office provided during one of our interviews, there was a slight reduction in the total number of footwear manufacturing companies in Poland between 2009 and 2011, to a total of 4 600. According to this source, there were around 1 650 companies based in Malopolska and 1 010 in Silesia. However, SATRA[71] and Sroka[72] and the CBI survey[73] indicate that the numbers of companies are much lower. The varying estimates are summarised in Table 5.1 (below).

Table 5.1: Footwear Industry Structure and Employment in Poland, 2007-2011

Year	Source							
	Polish Statistical Office		**SATRA (2011)**		**Sroka (2010)**		**CBI (2010)**	
	No. Companies	No. Employees	No. Companies	No. Employees	No. Companies	No. Employees	No. Companies	No. Employees
2007	-	-	200	28 000	500	371 500	-	-
2008	-	-	-	-	-	-	261	5 615
2011	4 600	40 000	-	-	-	-	-	-

Estimates of the number of employees also vary widely; as shown in Table 5.1. The Polish Chamber of the Shoe and Leather Industry[74] indicates that the footwear sector in Poland "provides employment to approximately 40 000 people working directly in shoe factories as companies strictly related to the leather industry (e.g. producers of components, chemicals, glues, soles etc.)".

70 Polish Chamber of Shoe and Leather Industry (2011). *Personal communication*

71 SATRA (2011): **World Footwear Markets, 2010**.

72 Sroka J (2010): **Representativeness of the European Social Partner Organisations: Footwear Industry – Poland.** Eurofound, Dublin. Document PL0907019. Downloaded from: http://www.eurofound.europa.eu/eiro/studies/tn0907017s/pl0907019q.htm

73 CBI (2010d). **Market Survey. The Footwear Market in Poland**. Centre for the Promotion of Imports from Developing Countries, Ministry of Foreign Affairs, the Netherlands

74 Polish Chamber of Shoe and Leather Industry (2010a). **Social and Environmental Report of the Polish Leather Industry**. Downloaded from http://www.cotance.com/socialreporting/reports/PolandSER.pdf

According to the CBI, only about 100 of the companies operating in the footwear industry are of medium size, with most employing not more than 100 workers. The rest of the industry comprises very small and micro enterprises with 'craft workshop' characteristics. There are only a few significant domestic companies, such as But-S, Eksbut, Juna, Rylko, Bata, Conhpol, Lesta and Wojas[75]. The very small companies are responsible for 50% of employment and 50% of shoes manufactured that were sold. They are generally not equipped with any advanced technologies[76].

Production

The CBI market survey[77] indicates that Poland is the fifth largest footwear producer in Europe, after Italy, Spain, Portugal and France. According to the CBI, production volume fell between 2004 and 2006 but has been rising since 2006 due to increased demand in the domestic market and increased exports to the EU Member States following Poland's accession to the European Union. However, other sources contradict this view of the change in production, although data are more consistent than for numbers of companies or employees. Table 5.2 presents data from the Polish Chamber of Shoe and Leather Industry, SATRA and the CBI on production for the Polish footwear sector. During our interviews in Malopolska, the Institute of the Leather Industry (ILI) indicated that between 40 and 50 million pairs of shoes are manufactured yearly in Poland.

Table 5.2: Varying Estimates of Production by the Footwear Sector in Poland (Million Pairs)

Year	Source		
	Polish Chamber of the Shoe and Leather Industry[1]	**SATRA (2010)[2]**	**CBI (2010)**
2004	-	46.6	52.0
2005	-	45.4	
2006	-	45.1	41.0
2007	43.5	43.6	
2008	36.5	41.0	44.0
2009	35.8	-	
2010	-	37.4	

Notes:
1. *Includes rubber footwear*
2. *Excludes rubber footwear*

The three estimates are of a similar order of magnitude, although SATRA and Polish Chamber of the Shoe and Leather Industry data indicate a reduction in output between 2006 and 2008, whilst CBI data indicate an increase. However, data from the Polish Chamber of the Shoe and Leather Industry include rubber footwear, whereas the

75 Sroka J (2010): **Representativeness of the European Social Partner Organisations: Footwear Industry – Poland**. Eurofound, Dublin. Document PL0907019. Downloaded from: http://www.eurofound.europa.eu/eiro/studies/tn0907017s/pl0907019q.htm

76 Sroka J (2010): *op cit*

77 CBI (2010a). **Market Survey. The Footwear Market in Europe**. Centre for the Promotion of Imports from Developing Countries, Ministry of Foreign Affairs, the Netherlands

SATRA estimates do not (the CBI report is not clear on this). This is problematic because, as Table 5.4 shows, rubber footwear accounts for around 56% of the total output included in its data.

Table 5.3: Production of Footwear in Poland by Type 2007-2009 in Million Pairs			
Year	**Total Production (including rubber footwear)**	**Shoes with Leather Uppers**	**Shoes with Textile Uppers**
2007	43.5	15.1	8.8
2008	36.5	13.7	7.0
2009	35.8	11.4	8.7
Source: Polish Chamber of Shoe and Leather Industry (2010a)			

Data on the value of production are only provided by the CBI, which indicates that the total value was €253 million in 2008, compared to €247 million in 2006 and €286 million in 2004.

International Trade

According to the CBI[78], Poland's imports of footwear in 2008 were valued at €533 million, or 81 million pairs; this compares to a figure of 91 million pairs from SATRA. The CBI indicates that between 2004 and 2008, Poland's footwear imports grew by an average of 15% per annum in value, from €303 million and fell by 2.3% in volume, from 89 million pairs. SATRA data show that imports grew between 2004 and 2006, and then began to reduce. Both sources agree that Poland has a significantly negative balance of trade in footwear. Data from SATRA[79] are shown in Table 5.4.

Table 5.4: Poland Balance of Trade in Footwear, 2004 – 2010 (Millions of Pairs)			
Year	**Imports[2]**	**Exports[1, 2]**	**Balance of Trade**
2004	86.3	16.7	- 69.6
2005	100.6	15.0	- 85.6
2006	110.1	26.5	- 83.6
2007	101.3	28.7	- 72.6
2008	91.2	27.6	- 63.6
2010	102.5	31.0	- 71.5
Source: SATRA (2011) *Notes:* *1. Includes re-exports* *2. Includes trade with other EU Member States*			

According to APICCAPS[80], footwear exports from Poland were valued at €315 million in 2010, representing 25 million pairs. The data in Table 5.4 indicate that

78 CBI (2010d)

79 SATRA (2011)

80 APICCAPS (2011b)

between 2004 and 2010, exports grew by 19% in volume but significantly more by value.

Figure 5.1 shows that the main destinations for exports by value in 2010 were Germany, followed by Russia, Ukraine and the Czech Republic. The order is the same in terms of volume. Unfortunately, no data are available on the types of footwear exported to different markets.

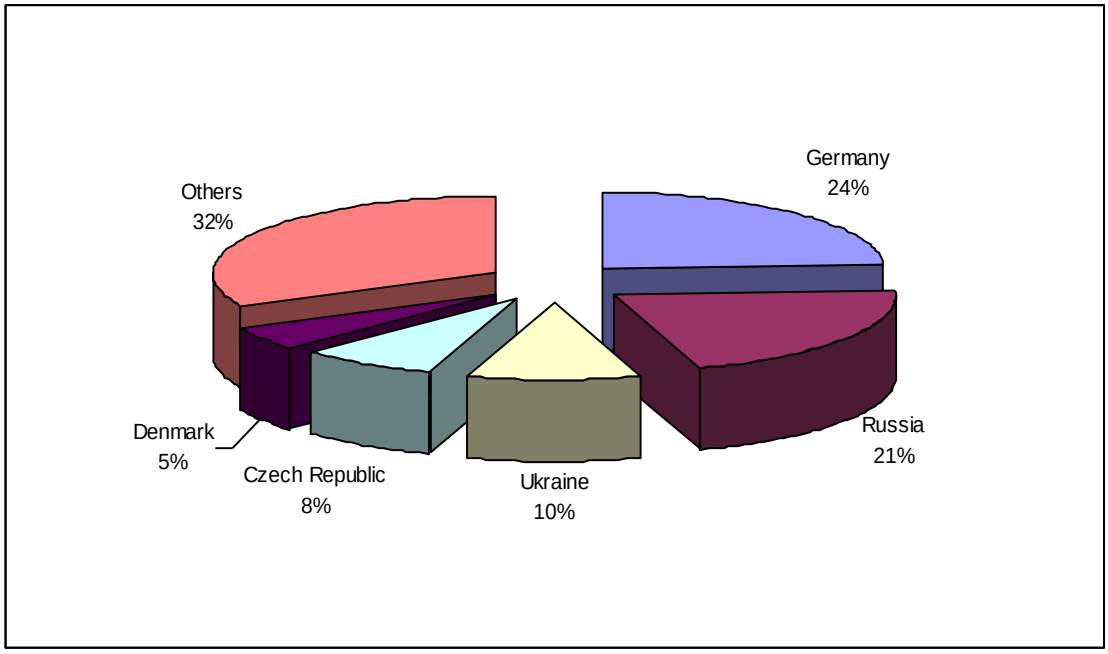

Figure 5.1: Destination of Polish Footwear Exports by Value, 2010 (Source: APICCAPS (2011b))

APICCAPS data on sources of footwear imports into Poland in 2010 are shown in Figure 5.2. The data indicate that the majority of imports by value came from Germany, (€245 million) with China the next most important source (€106 million).

By volume, the order is reversed, with 28 million pairs imported from Germany and 47 million pairs from China. Germany is therefore Poland's largest trading partner in terms of both imports and exports by volume. However, imports from Germany into Poland may well include re-exports by German retailers and wholesalers of shoes originally produced in China, given that German production in 2010 totalled only 25.6 million pairs (see Table 6.3 in section 6.1).

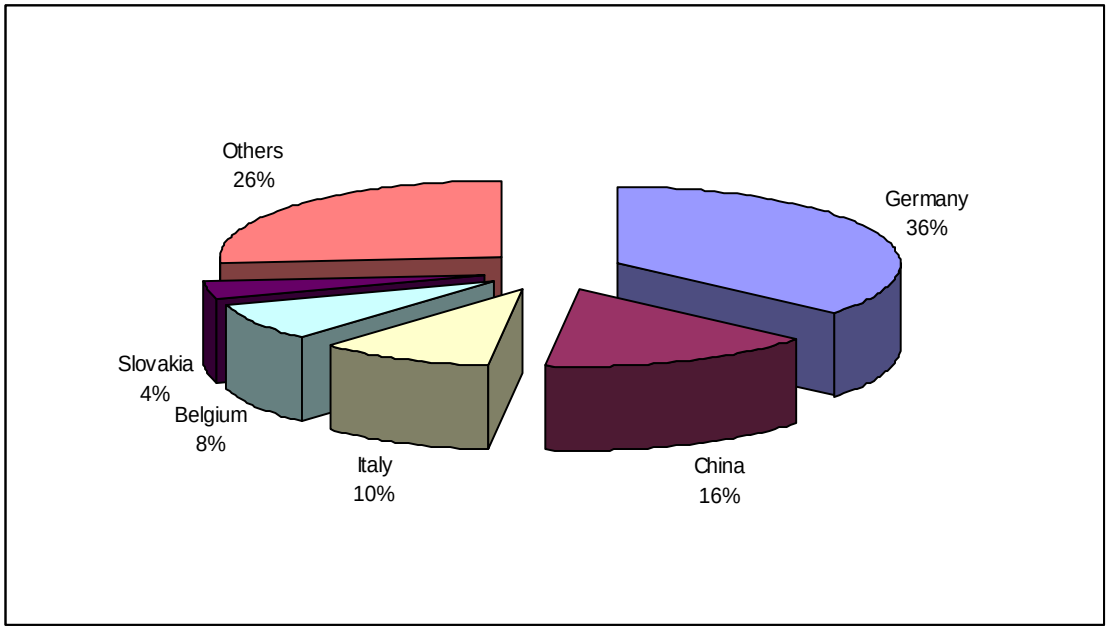

Figure 5.2: Source of Polish Footwear Imports by Value, 2010 (Source: APICCAPS (2011a))

Consumption

The CBI report indicates that the footwear market in Poland was valued at €1.9 billion in 2008, registering an average annual increase of 3.1% since 2004, well-above the EU average of 0.3% over the same period. By volume, Polish people bought 156 million pairs in 2008, of which at least one fourth was made by Polish manufacturers. This is equivalent to 3.0 pairs per capita, spending €52, half the EU average of €100 per capita in value (4.2 pairs). SATRA data on consumption indicate a lower volume of shoes bought nearly 105 million pairs.

Consumption grew between 2004 and 2006, but has fallen since then and is now below the level in 2004 (see Table 5.5). Domestic producers retain an important place in the domestic market, despite competition from international brands and as low cost imports.

Table 5.5: Footwear Consumption in Poland, 2004 - 2008	
Year	**Quantity (Million Pairs)**
2004	116.2
2005	131.1
2006	128.6
2007	116.2
2008	104.5
Source: SATRA (2011)	

According to the CBI[81], growth in footwear consumption has been fuelled by the establishment of new shopping centres and a growing middle class, with many Polish consumers having a greater interest in fashion. While older Poles have conservative design tastes, younger consumers and working women are much more fashion conscious. Part of the recent increasing market value was due to consumers trading up to higher quality and comfortable footwear. Despite the global economic slowdown, Polish consumers have kept up-to-date with international fashion trends. Sales of luxury branded footwear have grown strongly.

Restructuring and Innovation

The major restructuring of the Polish footwear industry took place in the 1990s. The Polish Chamber of the Shoe and Leather Industry notes that many modern, private companies started their business at that time and have been successful until today. According to the CBI[82], more recent trends in production include:

- **the industry has become better organised** in order to face the sustained competition from cheap imports, particularly from China. Companies are active in finding counter measures with other EU countries in order to deal with dumping practices, grey market channels and counterfeit products;

- **cooperation with other EU companies in the supply chain has increased**, for example Polish children's shoe manufacturer Befado produces children's shoes for the German shoe retailer Deichmann to sell under its own brand;

- **more production for EU retailers:** as Polish companies are able to deliver fast and in smaller quantities than Asian competitors; and

- **greater specialisation:** Polish manufacturers are putting more emphasis on specialisation. This could be in a particular type/style of footwear (e.g. orthopaedic footwear), or in high designed footwear, or in more comfort in footwear using advanced technology.

5.1.2 The Footwear Industry in Southern Poland

Malopolska and Silesia Regions in Southern Poland have the highest density of footwear manufacturers. According to the Polish Statistical Office, there are around 1 650 leather and footwear-related companies based in Malopolska and 1 010 in Silesia. This is partly due to the fact that, 25 years ago, the major state owned shoe manufacturing conglomerates were located in these two regions. There are no longer any big state owned manufacturing conglomerates in the region and almost all of the firms are privately owned by Polish people.

81 CBI (2010d)

82 CBI (2010d)

Malopolska region is situated in south-central Poland. The capital city is Krakow, which is the second largest city in Poland with almost 800,000 inhabitants. Malopolska is the second region in Poland in terms of R&D expenditure after Mazowieckie and is characterised by very high concentration of research organisations and innovative companies. The Krakow branch of the Institute of Leather Industry (ILI), formerly the Central Laboratory of the Footwear Industry, is a research and development organisation, which has been active in the field of development and innovation in Polish shoe and leather industry for 40 years.

The region of Silesia is situated in southern Poland, adjacent to Malopolska, and is one of the most important industrial regions of the country. Its capital is Katowice and it has good connections with the trans-European transport network. Silesia is 14th in terms of the area occupied, a 2nd in terms of population in Poland. The region borders the Czech and Slovak Republics. Within 600 km from Katowice there are six European capital cities: Warsaw, Prague, Bratislava, Vienna, Budapest and Berlin.

The ILI estimates that the level of employment in the shoe manufacturing sector in Malopolska represents between 70% and 80% of total employment in the sector in Poland. Malopolska also hosts 36% of all shoe manufacturing companies, indicating that companies in Malopolska are larger than average in terms of numbers of employees. Manufacturers in Malopolska often produce shoes under contract for other companies, for example large companies from Germany. A number of well-known Polish companies are based in Malopolska, including Wojas, Cohnpol and Rylko. Most companies are located outside the cities. The footwear industry in Silesia is concentrated in Czestochowa and Myszków. Companies mostly manufacture shoes in low and medium price range.

5.1.3 Organisations Interviewed in Southern Poland

Table 5.6 (below) lists the organisations we interviewed in Southern Poland.

Table 5.6: Organisations Interviewed in Southern Poland

Type of Organisation	Main Activities	Size
Research institute	Research and development, quality control , expert advice and training for the footwear and leather industry	n/a
Footwear manufacturing company	Manufacture of children's shoes	Small
Footwear manufacturing company	Manufacture of women's fashion shoes	Small
Footwear manufacturing company	Manufacture of men's, women's and children's textile shoes	Large
Footwear manufacturing company	Manufacture of comfort, casual and sports shoes for men, women and children	Medium
Footwear manufacturing company	Manufacture of shoe soles and other rubber and plastic products	Medium/small[1]

Notes
1. The company is medium in terms of employees but small in terms of turnover

5.2 Footwear Restructuring in Southern Poland

5.2.1 Types of Restructuring

Companies in Southern Poland have undertaken a range of different types of restructuring, with the focus on Operational restructuring (particularly the purchase of new equipment) and reorganisation of sales channels.

5.2.2 Operational Restructuring

Several of the companies we interviewed had adopted new production technologies to increase their competitiveness, such as stitching machines, laser cutters and injection moulding machines (see Box 5.1). One company had purchased three new laser cutting machines and a new stitching machine in the last five years, enabling the factory to increase annual capacity of production.

However, the ILI considers that there will be a further need to introduce new technologies in future to remain competitive.

Box 5.1: Operational Restructuring to Maintain Competitiveness
The company, which produces soles, recognises the need to continually develop new technologies to remain competitive. It has recently purchased a new multi-injection moulding machine, which has increased production rates. This is particularly important when competing with China at the lower end of the shoe market. For example, Chinese companies are now able to sell slippers at a cost lower than the company can purchase the raw materials.
Source: Interview with company, October 2011

According to the ILI, one key development in terms of Operational restructuring has been the introduction of the quality management system standard, ISO 9000, by a number of companies in Southern Poland. This process was developed and enforced with a high level of involvement of the ILI. The process began in late 1980s and was competed in 2007.

5.2.3 Product Restructuring

Companies are also seeking to enter new markets, both within the shoe sector and outside, to remain profitable. Children's shoes are a key area for product restructuring (see Box 5.2). The ILI acts as a platform for cooperation amongst manufacturers of children's shoes. This segment of the market was recognised as a promising source of revenue; therefore, various different manufactures decided to cooperate in expanding their presence in the market. However, the companies were not able to come to an agreement themselves; therefore the ILI was asked to act as intermediary.

Box 5.2: Success Through Focusing on Children's Shoes

The company was established in 1992 with around 14 employees and has remained successfully in business ever since. Its brand is well known in Poland for designing and producing high-quality, 'healthy' shoes for children.

Its production rate is typically 60-80 pairs/day, five days/week. The shoes are primarily aimed at the Polish market with typical prices of up to PLN 80 (€20) for winter shoes and up to PLN 70 (€17) for spring/summer shoes. There are two collections per year with a few new models (and associated colour variations) appearing each time. New models are largely based on reviewing what else is on the market, including fashion shows.

Source: Interview with company, October 2011

Another manufacturer, of rubber soles, has developed a slipper with a textured plastic suede-like upper. It has recently begun production, and it the company hopes that the product will account for 5% of production next year. The company is also seeking to enter non-footwear markets, such as producing rubber car mats, using the expertise it has developed with footwear.

The ILI is also seeing growing interest amongst manufacturers in specialist shoes, such as those for hospitals (comfort shoes) and the forestry industry (safety shoes). Other areas of product development where the ILI is carrying out research include:

- the functionality, comfort and usability of footwear;
- examination of the feet of children, adults and people with foot problems;
- the use of innovative materials and plastics, including nano materials; and
- modern footwear design.

5.2.4 Reorganisation of Sales Channels

According to the CBI[83], Poland has one of the least concentrated retail sectors in Eastern Europe. The independent sector continues to dominate, but it is coming under pressure from the expanding presence of hypermarkets and international clothing chains that hold the major positions in the shopping centres. Many independent retailers are part of a large (German) trading group, Garant Schuh+Mode, and some wholesalers have also begun to open their own stores[84].

Polish shoe shops tend to be financially weak and unable to maintain a wide range. Nevertheless, independent shoe shops maintain their customer base by providing good quality products and good advice, especially in small cities, towns and villages. Indeed, one of the interviewees said that designs are often developed in consultation with retailers. Nevertheless, some Polish manufacturers have developed their own retail stores to widen their customer base. One example of this is given in Box 5.3; in addition, a number of major shoe manufacturers in the region have opened their own mono-brand chains of retails stores across Poland.

83 CBI (2010d)

84 CBI (2010d)

Box 5.3: Opening of Retail Stores by Footwear Manufacturers

Two manufacturers, one of women's shoes and one of men's shoes, used to sell their products via wholesalers. They then decided to cooperate by opening a shop selling both ranges, which of course do not compete with each other.

Initially, this appeared to be successful, as it made the companies' products available to a wider group of customers. However, some drawbacks were identified. These included the fact that the manufacturers were competing with their loyal retail customers and the fact that diverting resources to their own shop limited their opportunity to increase sales elsewhere.

Source: Interview with footwear research institute, October 2011

Another company had changed its distribution model from wholesalers to individual retail stores, making use of IT to facilitate the process (see Box 5.4).

Box 5.4: Change of Sales Channels from Wholesalers to retailers

In the early 2000s the manufacturer of textile shoes decided to begin marketing to single individual shops rather than selling to wholesale trader, as prices were low with wholesalers.

The company has a regional representative in each of 16 regions of Poland. The representatives have a laptop with an integrated online order system and the managers of shops the representatives visit can make instant orders. On average, each shop is visited twice a week by a representative.

Currently the company has around 1 500 individual customers. The minimum order is 40 pairs of shoes; however, a lower smaller order can be processed provided the customer pays the delivery costs. The company promises to deliver in between 48 and 72 hours, mainly using two major international delivery companies.

Source: Interview with company, October 2011

Internet sales are also growing, and some wholesalers have started selling direct to consumers via the Internet. Some manufacturers have also started direct internet sales (see Box 5.5).

Box 5.5: Internet Sales by Footwear Manufacturers

A company manufacturing children's shoes makes most of its sales via local shops and agents.

It also has an online shop, essentially a website which displays the various models, which has been operational for 18 months. This is primarily for individuals but has led to some international sales, which are assumed to be to Polish emigrants and their families (as the site is in Polish only). However, this is not the whole story, as the company had a recent order internet order from the Ukraine for 50 000 pairs.

Source: Interview with company, October 2011

For most of the companies we interviewed, the domestic market is still the most important. However, one manufacturer of ladies' fashion shoes exports 40% of its total production, and 50% of its main brand. Its main export markets are Germany, Belarus, Latvia Ukraine, Czech Republic, Slovakia, occasionally Canada and UK. Similarly, a large producer of textile footwear (children's shoes, adult slippers) exported 35% of its production, mainly to Germany, Czech Republic, Slovakia,

Bulgaria, Armenia, and Ireland. This includes around 300 000 pairs produced for a major German retailer under the retailer's own brand.

5.2.5 Locational Restructuring

The ILI indicated that offshoring of production is a common form of restructuring among shoe manufacturers in Southern Poland, with production transferred mainly to Turkey and Romania. Also, in the light of the skill shortages in the footwear sector, shoe manufacturers have begun to cooperate with companies from neighbouring countries (Slovakia, Czech Republic, Ukraine, Russia). Two ladies fashion shoe companies that we interviewed sub-contracted certain operations to local companies, for example stitching.

5.2.6 Closure

A large number of insolvencies of shoe manufacturers in Poland occurred in late 1990s, according to the ILI. This was a particular problem when large, state-owned enterprises were privatised. However, the break-up of the enterprises after closure sometimes gave rise to new companies forming. An example is given in Box 5.6.

Box 5.6: Bankruptcy Following Privatisation of a State-Owned Enterprise

The company is part of the former state-owned shoe manufacturing facility which used to produce ten thousand pairs per day. The facility was privatised and went bankrupt in 1994. The facility was then broken up and the company was formed in April 1994. The company manufactures a range of rubber and plastic (including PVC) products, primarily shoe soles but is now diversifying into other products such as car mats. In the mid-1990s, it employed 160 people but this has now reduced to 75.

The company produces 400 000 pairs of soles per year with 40% going to shoe companies in the Malopolska region, 40% to the rest of Poland and 20% exported (to countries including Slovakia, Lithuania, Hungary and Germany). It specialises in soles for military shoes.

Source: Interview with company, October 2011

5.2.7 Mergers and Acquisitions

Mergers and acquisitions in the Polish footwear industry are mainly limited to the privatisation of formerly state-owned companies. Although in most cases this is complete, for some companies the process is ongoing (see Box 5.7).

Box 5.7: Acquisition of a Formerly State-Owned Company

The textile footwear company was first established in 1929 by private investors. In 1945 it was nationalised. In July 2008 the ownership structure changed again to a limited company; however 100% of shares remained in the hands of the Government.

The Ministry of Industry decided in 2011 to put 85% of the company's shares on sale and four companies showed interest; two foreign investors and two Polish ones, including one of the company's competitors based in northern Poland. The remaining 15% of shares will be distributed between employees who have completed a number of years' employment in the company (in line with the Polish decree on privatisation).

Source: Interview with company, October 2011

5.2.8 Best Practices in Restructuring

The best practices in restructuring in Southern Poland have been carried out by individual companies and focus on improved product design and better routes to market. According to the ILI, the main trends in product development are increased fashionability and variety in products (particularly colour), together with a focus on children's shoes and niche markets. The companies that we interviewed indicated that their products were subject to continuous development, in line with market requirements. Two companies had also increased the number of collections per year, for part at least of their product range, from two to four.

Shoe manufacturers in Southern Poland have made a number of changes to the way their products are distributed and sold, including:

- opening their own stores (either mono-brand or in cooperation with other manufacturers);
- selling direct to retailers rather than through wholesalers;
- manufacturing under sub-contract for retailers; and
- developing internet sales.

The approaches vary between different manufacturers, based on individual views of what will work best for the company.

5.3 Drivers for Restructuring

5.3.1 Main Reasons for Restructuring

Most of the companies we interviewed indicated that the main driver for restructuring was the need to remain competitive, through the development and adoption of new products and technologies.

ILI indicated that the main drivers for restructuring were fast fashion, leading to a shorter time to develop collections, and the extended range of colours and designs for shoes demanded by customers. In response to these pressures, shoe manufacturers are interested in innovation and new products to enable them to respond with more flexibility to new market demands.

5.3.2 International Competition

Competition from countries with lower production costs, particularly China, was identified as an important issue. In addition, the ILI identified the availability of non-compliant products on the market, and a lack of tariff protection against unfair competition as key issues to be addressed.

5.3.3 Competition within the EU

One ladies' fashion shoe manufacturer indicated that competition from Italy was an important driver for better quality products. In turn, the need to maintain quality within the context of a faster design process and smaller product runs was a key driver for purchasing new, more efficient equipment.

5.3.4 Availability of Funding and Other Assistance

Most of the companies we interviewed had funded restructuring from their own resources. One manufacturer had employed a consultant to try and access EU funding when purchasing new equipment, but this had not been successful. However, another company had obtained some national Government funding for a non-shoe development project.

The ILI indicated that obtaining financial support from structural funds has become more difficult in recent years, as the European Commission has classified shoe manufacturing as a traditional economy sector. Fewer funds are available for traditional sectors, as they are considered less valuable for the overall economy in comparison to R&D sectors, for example. In addition, the company where ownership remained in Government hands could not access EU funds because of this.

There appear to be no regional industry associations within Southern Poland; the Polish Chamber of the Shoe and Leather Industry is located in Lodz. However, the ILI acts as a regional centre of expertise. The organisations that we interviewed indicated that, until recently, there was very little cooperation between companies in the region, or with training and research organisations. The ILI's comments on this issue are summarised in Box 5.8.

Box 5.8: Cooperation between Companies and Organisations

The ILI indicated that, on a positive note, the willingness of footwear companies to cooperate with each other and with other organisations had increased recently.

However, this applied only between larger players in the market. SMEs still do not see the need to cooperate with their competitors within the sector. This appears to be a cultural issue, based on a lack of trust (which was reflected in our interviews with individual SME companies). It seems that larger companies are overcoming this lack of trust, but SMEs have so far failed to do so.

Source: Interview with ILI, October 2011

Some companies recognise this as a missing link in the region. Comments on this issue from one manufacturer are summarised in Box 5.9.

Box 5.9: Comments on the Need for a Regional Organisation
An industry association acting on behalf of its members is lacking in the region, and the general opinion was that an industry association could potentially achieve more rather than single companies (in discussions with public authorities, for example). Several companies noted that footwear firms in the region (usually SMEs) do not appreciate that closer cooperation among manufacturers may bring positive impact on the region. Instead, shoe manufacturers are suspicious of each other and treat each other as competitors only.
Source: Interviews with companies, October 2011

5.4 Impacts of Restructuring

5.4.1 Negative Impacts

As Tables 5.2 and 5.3 in section 5.1 showed, overall output of footwear in Poland, and the turnover of the industry continue to decline. For some companies we interviewed in Southern Poland, restructuring has led to reductions in the numbers of employees. For example, the company producing rubber soles had reduced its workforce through greater automation. In the 1990s it employed 160 people; this has now reduced to 75 (a 53% reduction over 20 years). Similarly, a large formerly state-owned company had reduced the number of employees by 40% in the last four years through investment in new equipment which increased efficiency.

One family-owned company had maintained production at a fixed level, as its capacity is limited by the size of the premises and associated planning conditions. It also appeared that the decision not to increase the company might be motivated by a wish not to disrupt the owners' lifestyle.

A number of aspects of restructuring worked less well than expected for the companies we interviewed. For example:

- the sole manufacturer noted that not all its new product developments have been successful; and
- the two manufactures that set up a joint retail store experienced problem of competition with their customers and diversion of resources.

One negative impact of the restructuring sales channels identified by a company that produced footwear to the design of a major German retailer was its increased vulnerability, because of the possibility that its customer could withdraw production at any time (see Box 5.10).

Box 5.10: Drawback of Manufacturing under Contract to a Retailer

The children's shoe company would like to maintain its business relation with the retailer, as this represents nearly half of the company's export production. However, there is no formal contract between the two companies to maintain a relationship longer than one collection (three months, as there are four collections per year for children shoes).

Therefore, every three months there is a risk that the company may be turned down as a subcontractor. The retailer is able to do this because it owns the lasts used in the factory. If the retailer changed its sourcing policy for example seeking cheaper labour costs, the lasts and production can be moved somewhere else at short notice.

However the company noted that the retailer had tried producing its children's branded shoes in India, but this had been very unsuccessful.

Source: Interview with company, October 2011

5.4.2 Positive Impacts

The companies we interviewed noted that restructuring had led to increased efficiency, greater competitiveness and reduced production costs, as well as the potential to enter new markets. One company specified the overall benefit simply as survival of the company.

Another company we interviewed identified the main impact of Operational restructuring as being an increase in production rates through increased automation, especially the use of multi-injection machines. The ladies fashion shoe manufacturer indicated that Operational restructuring had allowed it to become more flexible, with a shorter time to market and smaller production runs.

The main benefit identified by the ILI is that continuing investment in the quality of products helped footwear companies in the region to remain profitable in difficult conditions. According to the ILI, restructuring has resulted in introduction of more colour variety in shoes, more collections per year and faster production cycle. The sole manufacturer also noted that Operational restructuring had enabled a greater range of products to be produced.

5.4.3 Changes in Business Partnerships and the Supply Chain

The organisations we interviewed did not identify any particular recent changes to suppliers or customers (although all were affected by the break-up of state enterprises in the 1990s). One of the major tanneries has its main factory within Malopolska; its leather comes mainly from within Poland or from Italy.

Several of the companies we interviewed now work closely with customers and suppliers on designing new products. Two examples are given in Box 5.11.

Box 5.11: Partnerships with Customers on Footwear Design

The children's shoe manufacturer often develops its designs in consultation with customers (retailers) and with one of its two sole suppliers. This sole producer is not allowed by contract to copy the design for use elsewhere. The other sole supplier makes soles to the company's design.

The second sole manufacturer has three main types of business partnership:

- it designs its own soles and then markets them (less common);
- it works with shoe manufacturers to design and then produce soles suitable for their products; or
- it provides soles as directed by a shoe manufacturer on a contract basis.

Source: Interview with company, October 2011

According to the ILI, there has been some improvement in cooperation between footwear companies in recent years. For example, shoe manufacturers in Malopolska have developed a new co-operative approach to relationships with their suppliers (see Box 5.12).

Box 5.12: Cooperation in Raw Material Purchasing

Footwear manufacturers in Malopolska have adopted a new organisational approach towards purchasing of raw materials. If a raw material can only be purchased in large quantities, smaller companies come together to place a single order to meet the minimum order quantity.

An alternative approach is for one company to purchase the raw material and then re-sell it to its competitors in the region.

Source: Interview with footwear research institute, October 2011

In addition, one company we interviewed is participating (with five other partners from across the EU) in the *Naturalista* project which is an EU funded eco-innovation project exploring ways of recycling old shoes into new products (both shoe and non-shoe).

5.5 Effects of the Economic Crisis

According to the ILI, the economic crisis did not have a significant impact in Southern Poland, which have seen the number of footwear companies increase in the last two years.

One company we interviewed noted that the economic crises have led to uncertainties over the (likely) value of the Euro, which could create difficulties when trading with eurozone countries such as Germany and Italy.

5.6 Future Trends in Restructuring

5.6.1 Expectations of the Industry

The companies we interviewed identified continuing competitive pressure as a key future challenge. They planned to respond to the challenge by further investment in equipment to increase efficiency, by improved product design and quality, and by effective marketing. The sole manufacturer also planned to increase its production of non-footwear products.

5.6.2 Remaining Barriers and Action to Address Them

According to the ILI, the future of the entire sector depends on the European approach toward shoe manufacturing, and in particular whether it will maintain its classification as a traditional sector (which limits the funding available for research and innovation). If this issue is resolved, companies in Southern Poland are likely to maintain their good position in the market, as their brands, quality of products and service are well recognised in the region. There are also opportunities to explore further sub-contract production for brands outside Poland (e.g. Germany). Alternatively, with no change in the approach towards the shoe manufacturing sector, companies may outsource production to Romania, Turkey and Asia, where costs are lower. There are also internal challenges. For example, from January 2012, VAT on children shoes will increase from 8% to 23%. This may impact upon the performance of shoe manufactures within this part of sector; however, the potential impact is not yet clear.
To address these challenges, the ILI considered that marketing should be based on cooperation rather than competition between individual manufacturers; manufacturers of different types of shoes will create consortia to open retail stores. Quality control should also be strengthened, as not all the products meet minimum health and safety requirements and the quality of products will be a main driver for expansion. To support this, all illegal non-conforming products should be removed from the market and custom fees should be managed in order to protect the market from unfair competition.

The ILI considers that other challenges include a shortage of staff, particularly skilled workers such as stitchers (this was confirmed by one of the companies we interviewed. In addition, positions involving manual skills are not popular among young people. Several training schools have therefore closed, on the ground of insufficient recruitment. One children's shoe manufacturer we interviewed indicated that finding staff was not too difficult, but it took six to 12 months to train them before they could make an effective contribution to the business. A further barrier to restructuring identified by the ILI was the lack of accessible financial support to footwear manufacturers.

According to the CBI[85], copying of designs is an issue in Poland and manufacturers are not yet inclined to register new products. This fact was supported by the companies we interviewed. Two of the companies had developed innovative products

[85] CBI (2010d)

but had not yet taken action to protect them. However, another company indicated that its main source of new designs was copying other products on the market and then developing their own products based on these.

Unlike Veneto and Norte, neither Malopolska nor Silesia really functions as a cluster and this may act as a barrier to future restructuring. The ILI indicated that consideration was given to the creation of a formally-recognised cluster in Malapolska, which could potentially attract Government funding and external investment. However, no steps were taken to achieve this. Several companies that we interviewed commented that the notion of a cluster is difficult to apply in Poland.

5.7 Summary

The footwear industry in Southern Poland underwent major restructuring in the 1990s, when the large state-owned footwear manufacturers were first privatised and then, when they proved unable to compete in a market economy, broken up. Most footwear production is now undertaken by private firms with fewer than 100 employees, with many small or micro enterprises.

In response to competition from cheap imports, production of footwear in Southern Poland has reduced significantly and continues to decline. Although data on employment in the sector are sparse and contradictory, the consensus amongst interviewees was that it has also reduced significantly. China is the main source of imports. Exports are much lower than imports and are mainly to neighbouring countries.

Recent restructuring in the footwear industry has focused on technology upgrading and reorganisation of sales channels. There has been some offshoring of production, mainly to Turkey and Russia, and this may increase in future due to skill shortages. Companies are also continuously developing their products in response to market demands, particular to become more fashionable.

Investments in new technology had been made by several companies we interviewed, in order to improve productivity in response to competition and to increase flexibility to meet consumer demands for more frequent collections, more variety and a faster time to market.

Many of the companies considered that improving their access to the market was a priority. Poland has one of the least concentrated retail sectors in Europe, and companies were exploring a range of ways to make their products accessible to a wider range of consumers, including setting up their own retail stores, closer cooperation with retailers and use of the internet.

Southern Poland shoe manufacturers expect to face continued competitive pressure in the future; there are also concerns about potential skill shortages. However, the remaining companies believe that they have good products and recognised brands which will enable them to compete on the basis of quality rather than price. In order

to address the future challenges, it may be important for companies to overcome their apparent distrust of each other and to work more closely with each other and with industry organisations. There are some indications that this is happening for the larger companies, but SMEs seem to remain focused on competing rather than cooperating with each other.

6. CASE STUDY: RHEINLAND-PFALZ

6.1 Introduction

6.1.1 The Footwear Industry in Germany

Industry Structure and Employment

The number of German footwear companies is the subject of some uncertainty, due probably to the use of different definitions. The latest report of Federation of the German Footwear Industry (Bundesverband der Schuhindustrie, HDS) on the status of the German shoe industry[86] indicates that there are **80 shoe-producing companies** in the country, whilst data from some other sources indicates a much higher number of companies in the sector[87].

After a long period of reduction, employment levels in the German shoe industry have stabilised and even increased. Table 6.1 provides available data on employment levels.

Table 6.1: Changes in Employment in the German Footwear Industry, 2000-2010

Year	Number of Employees	Data Source
2000	16 858	Federal Ministry of Economics[88]
2008	13 165	SATRA[89]
	19,165	CBI[90]
2009	10 766	Federal Ministry of Economics
2010	10 874	Federal Ministry of Economics
	11 500	Federation of the German Footwear Industry[91]

The German footwear industry is divided into two very different segments:

- the sports footwear sector, which includes very large companies, such as Adidas and Puma (see Box 6.1); and
- the fashion and comfort footwear sector, which consists mainly of small and medium-sized family-owned companies, with only around 5% of the firms having at least 500 employees. The HDS data indicate that 45 of its member companies that produce footwear have over 50 employees, whilst the remaining 35 are small companies.

86 Bundesverband der Schuhindustrie (2011)

87 For example, the private data bank Hoppenstadt indicates that there are around 480 footwear producing companies in Germany whilst the CBI report suggests that there were 1 132 companies in 2008

88 Bundesministerium für Wirtschaft und Technologie (BMWi) (2010)

89 SATRA (2011)

90 CBI (2010c)

91 Bundesverband der Schuhindustrie (2011)

Box 6.1: The German Sports Footwear Manufacturing Sector

German companies Adidas and Puma are two of the largest sports footwear manufacturers in the world. Adidas was founded in 1948 by Adolf Dassler, following the split of *Gebrüder Dassler Schuhfabrik* between him and his older brother Rudolf. Rudolf established Puma in 1949. Both Adidas and Puma have headquarters in Herzogenaurach in Bayern.

The Adidas Group consists of the Reebok sportswear company, TaylorMade-Adidas golf company (including Ashworth), and Rockport. As well sports footwear, the company also produces bags, shirts, watches, eyewear, and other sports- and clothing-related goods. The company is the largest sportswear manufacturer in Europe and the second-biggest sportswear manufacturer in the world, with American rival Nike being the biggest. The Group's net sales in 2010 were nearly €12 billion and it has 42 000 employees worldwide, with more than 3 000 working at the company's headquarters.

Puma produces athletic shoes, footwear, and other sportswear. It is part of the French PPR group. Puma's brands include PUMA (football, running, motorsports, golf, and sailing clothing and footwear), Cobra Golf (golf equipment) and Tretorn (leisure shoes, rubber boots and tennis balls). The company is known for its football shoes. Puma's sales in 2010 were €2.7 billion and it employed over 9 000 people.

Both companies follow a similar business model, focusing on design, distribution, marketing and sales whilst production is sub-contracted to third parties, often through long-standing partnerships. This gives flexibility as well as cost savings. Manufacturing for Adidas is carried out by more than 1,230 independent factories in 69 countries. Many of these are in China, India, Indonesia, Thailand or Vietnam. The main suppliers for Puma are located in China and Vietnam, in addition to Indonesia, Cambodia and Bangladesh. Both companies produce only samples in Germany, but import and then re-export large numbers of pairs from their German distribution centres.

Sources: http://www.adidas-group.com; http://about.puma.com/category/company/glance/

The main locations of the footwear industry in Germany are in the Rheinland-Pfalz (particularly the Pirmasens area), where around 25% of footwear firms are located, Bayern (where Adidas and Puma are based), Nordrhein-Westfalen and Baden-Württemberg states.

Production

Data on production is subject to some uncertainty, because of differences in definitions. According to the HDS, German footwear companies currently produce around 500 million pairs per year, whilst the CBI gives a figure of 193 million pairs in 2008, with a value of €8.5 billion. However, Federal Ministry of Economic Affairs data indicate that only a small proportion of these pairs were produced within Germany, quoting a production value of €756 million in 2010[92]. The remainder were produced either by German owned-plants or under contract for German manufacturers outside Germany. SATRA indicates that production actually within Germany amounted to 25.6 million pairs in 2008, rising to 29.2 million pairs in 2010.

HDS data for the 1st quarter of 2011 show a 0.9% increase in the number of pairs produced. The results were particularly strong for three product sectors: men's leather walking shoes experienced an 11.2% increase, women's leather walking shoes an 8.5% increase and safety shoes with leather uppers a 19.6% increase. Information

92 Bundesministerium für Wirtschaft und Technologie (BMWi) (2010)

from APICCAPS indicates that, after a long period of reduction in output, the German shoe industry's production increased by 13% in 2010 compared to 2009[93].

Table 6.2 provides information on production, exports and imports by number of pairs between 2004 and 2010, derived from estimates by SATRA, while Table 6.3 provides information by value for 2000, 2009 and 2010, from the Federal Ministry of Economics.

Table 6.2: Production, Exports and Imports of Footwear in Germany by Numbers of Pairs, 2004-2010

Year	Production (million pairs)	Exports (million pairs)[1, 2]	Imports (million pairs)[2]
2004	29.7	94.7	412.0
2005	28.8	141.8	484.0
2006	24.5	122.5	438.4
2007	26.8	141.0	497.5
2008	25.6	156.4	498.5
2010	29.2	172.3	532.7

*Source***:** *SATRA (2011)*
Notes:
1 includes re-exports
2. Includes trade with other EU Member States

Table 6.3: Production, Exports and Imports of Footwear in Germany by Value, 2000-2010

Year	Turnover (€ million)	Exports (€ million)[1]	Imports (€ million)[1]
2000	3 025.8	1 457.2	4 539.1
2009	1 890.8	2 526.2	4 824.4
2010	2 190.6	2 772.4	5 458.6
Change 2010/2009	+10.7%	+9.7%	+13.1%

Source: Federal Ministry of Economics BMWi (2010)
Notes:
1. Includes trade with other EU Member States

Table 6.4 (over page) provides a breakdown of production by type. Leather footwear accounts for around 80% of production by type, with sandals, safety footwear and women's shoes being particularly important. The low number of sports shoes produced within Germany reflects the business model of the major sports shoe companies, which is based on sub-contract production, mainly outside Europe.

93 APICCAPS (2011b)

Table 6.4: Production of Footwear by Type in Germany, 2004-2008 (million pairs)					
	2004	2005	2006	2007	2008
Men's	2.4	2.4	2.0	1.8	1.6
Women's	5.8	5.9	4.1	3.6	3.3
Children	1.3	1.4	1.4	1.4	1.0
Sports	0.6	0.7	0.8	0.9	0.9
Safety	4.0	3.7	3.8	4.0	4.1
Slippers and Others	0.9	0.8	0.8	1.0	1.0
Sandals	9.2	8.5	7.2	8.6	8.7
Total-leather	24.2	23.5	20.1	21.3	20.6
Non-leather	5.5	5.3	4.4	5.3	5.0
Total	**29.7**	**28.8**	**24.5**	**26.8**	**25.6**
*Source***:** *SATRA (2011): World Footwear Market 2010*					

International Trade

German exports of footwear are strongly influenced by the presence of Adidas and Puma, which produce only samples in Germany, but import and then re-export large numbers of pairs from their German distribution centres. According to the HDS[94], German shoe exports rose from 90 million pairs in the first six months of 2010 to 103 million pairs in the first six months of 2011, a 14.6% increase. The average price per pair rose from €13.96 in the first six months of 2010 to €14.44 in the first six months of 2011 (a 4.2% increase).

Around 86% of all shoe exports went to EU countries (see Figure 6.1); the Netherlands was the main destination, followed by Austria and Poland. Exports to Russia have fallen since 2008; the HDS believes that this may be due to German companies exporting direct to Russia from countries of production outside Germany, rather than importing the shoes into Germany and re-exporting.

Germany's trade balance in footwear remains strongly negative, with a excess of imports over exports of €2.6 billion in 2010, a 17% increase compared to 2009[95].

94 Bundesverband der Schuhindustrie (2011)

95 BMWi (2010)

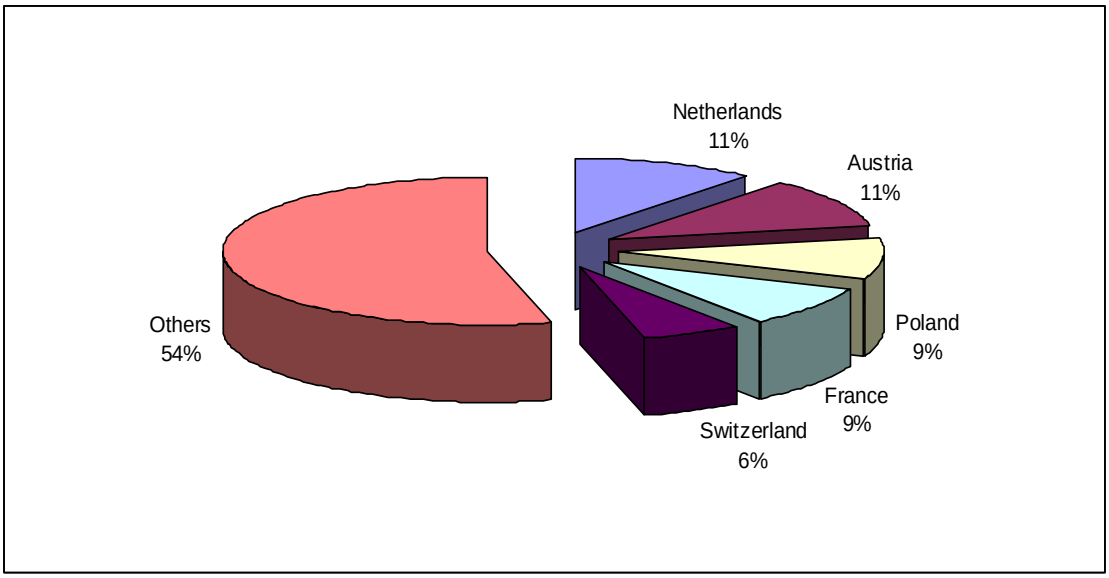

Figure 6.1: Main Destinations of German Footwear Exports by Value, 2010 (Source: APICCAPS (2011a))

As Tables 6.2 and 6.3 show, Germany, imported footwear valued at nearly €5.5 billion, 533 million pairs, in 2010. It was the largest EU importer of footwear by value in 2010, and the second largest by number of pairs behind the UK[96]. According to the HDS[97], shoe imports into Germany increased by 13.8% between the first half of 2010 and the first half of 2011.

Non-EU countries accounted for over 80% of all imports by volume; the majority of imports were from China (56%), Vietnam (18%), Indonesia and India (3% each). EU countries accounted for 12% of imports by volume (although imports from the Netherlands, which has no footwear production, may also have come from outside Europe), but 35% by value. The main sources of EU imports were Italy (8% by volume) and Portugal (3%).

However, non-EU imports were only 65% by value, with Italy the third largest source of imports by value, after China and Vietnam (see Figure 6.2). Average prices of imported shoes, which have steadily increased since 2008, increased by a further 11.3% in the first six months of 2011, to €9.53 per pair. The increase was particularly marked by the average prices of Chinese shoe imports, which rose 15.8% from €4.67 to €5.41[98].

96 APICCAPS (2011b)

97 Bundesverband der Schuhindustrie (2011)

98 Bundesverband der Schuhindustrie (2011)

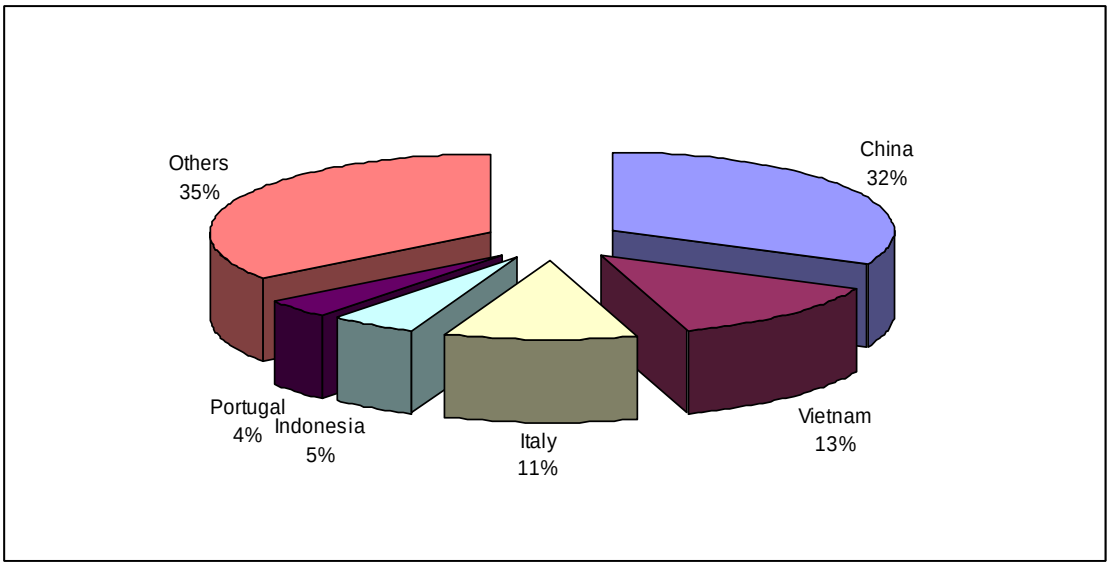

Figure 6.2: Main Sources of German Footwear Imports by Value, 2010 (Source: APICCAPS (2011a))

Consumption

Germany has the most valuable footwear market in Europe, valued at €8.6 billion in 2008 in terms of retail sales; however, by volume it was the third largest market after France and Italy. German people bought 390 million pairs in 2010, an increase of nearly 12% over the previous year[99]. On average, German people each own 11 pairs of shoes[100].

Restructuring and Innovation

Restructuring has been a long-term process for the German footwear industry, which began in the early 1980s. The major trends and characteristics of restructuring in footwear production in Germany are:

- **offshoring** is well advanced. The majority of production of sports footwear, together with some fashion and casual footwear has transferred to China and Vietnam, where costs of production are lower and quality standards can be high. For fashion and casual footwear, EU countries such as Hungary, Romania and Portugal remain important offshoring destinations. Nevertheless, many companies retain their head office in Germany, and control design, marketing and distribution from there;

99 BMWi (2010)

100 Bärwald, I (2011)

- **environmentally friendly technology** is becoming increasingly important in many countries, but Germany has been a leader in this, driven by the tough regulatory framework in the country;

- German manufacturers use **innovative technologies** to compete;

- comfort and fit are seen as one of the traditional key competences of German footwear producers. Most **product innovations** in recent years are focussed on increasing comfort combined with fashion to attract a younger group of customers; and

- there is a **focus on niche markets** and an emphasis on adding value and producing for the premium market, both at home and abroad.

Impacts of Restructuring

Table 6.5 summarises the impact of the restructuring of the German footwear industry over a 10-year period, from 1997 to 2007, based on data from HDS.

Table 6.5: Impacts of Restructuring of the German Footwear Industry, 1997 - 2007

	1997	2007	% change
Number of employees	55 000	12 500	- 77%
Number of manufacturing companies	464	55	-88%
Turnover (€ billion)	2.2	2.8	+24%
Production (million pairs)	115	30	-74%
Imports (million pairs)	0.2	0.5	+191%
Exports (million pairs)	0.02	0.14	+610%

Source: Bundesverband der Schuhindustrie (2010): Statistiken der Schuhwirtschaft: Der 30-Jahres-Vergleich

Table 6.5 shows that the numbers of companies, numbers of employees and production of the German shoe industry have fallen by around three quarters over the 30 year period, while turnover, imports and exports have all increased.

Restructuring has also affected the retail sector. Although Germany still has a relatively large number of specialist shoe shops, around 5 000, this has reduced by around 25% over the last decade as small and medium shop owners went out of business[101]. Two processes have contributed to the consolidation of the retail market. Firstly, increasing horizontal concentration through mergers and acquisitions and secondly, further expansion of the largest footwear discounters, Deichmann and Reno. As a consequence, the five largest retail companies have a share of about one third of the total domestic footwear market[102] . Specialist retailers were further affected by a 90% increase in online sales (although the largest online retailer, Zalando, makes losses) in 2010 and the fact that more and more shoes are sold via the mono-brand

101 Anon (2011a)

102 Bertram H (2008)

shops of the own- brand clothing companies[103]). Some small specialist retailers were also family businesses, which ceased trading when the owner retired[104].

6.1.2 The Footwear Industry in Rheinland-Pfalz

Rheinland-Pfalz is one of 16 German states; it is located on the borders of France, Luxembourg and Belgium. The West Pfalz sub-region, in which Pirmasens and Zweibrücken are important centres, is characterised by medium-sized businesses and industries, including shoe-making. Pirmasens specialises in ladies shoes (Baden-Würtemburg is the centre for men's shoes with major sports footwear companies based in Bayern).

Shoe production has a long tradition in West Pfalz, with regional expertise in both leather and footwear. The origins of shoe production in Pirmasens can be traced back to the 18th century. The cottage production and selling of shoes was one of the only ways of making a living in an area with few natural resources and far from established trade routes. The development of industrialised shoe production in the city from 1840 onwards led to a geographical expansion of markets, with shoes from Pirmasens being sold throughout Europe and overseas. In the 1950s the city developed into a "shoe metropolis", with visitors from across the world attending the international shoe fairs held in the city. The 1970s saw growing competition from Asian producers, forcing domestic shoe manufacturers to relocate their production. By the middle of the 1990s, Pirmasens was showing signs of a major crisis amplified by the announcement of the American military forces, one of the city's major employers, to shut down a number of its bases in the Rheinland-Pfalz region and in Pirmasens itself[105].

Despite these challenges, Pirmasens is still the capital of Germany's footwear industry and hosts the International Shoe Competence (ISC) Center Pirmasens, a subsidiary of the Pirmasens Testing and Research Institute. Regional training institutes include the Vocational School Pirmasens (Berufsbildende Schule Pirmasens), which also hosts the German College of Footwear Design and Technology Pirmasens (Fachschule für Schuhtechnik*)* and the Pirmasens Faculty of the University of Applied Sciences of Kaiserslautern (Fachhochschule Kaiserslautern). West Pfalz is also an important centre for shoe retailing; initiatives such as the Shoe City discount centre in Hauenstein, allow producers to get their products on the shelves locally. There is also a shoe museum within the region.

Pirmasens was formerly an integrated footwear cluster, comprising a range of equipment manufacturers, suppliers and footwear assemblers. However, it now has few companies manufacturing shoes, as production has been relocated to countries with lower labour costs. The region still retains a small number of footwear assemblers (some of which buy in uppers from eastern European countries) and there is one integrated producer remaining. Many of the firms in the area are family-owned, ranging from SMEs to large companies. In addition, some of the largest

103 Heinick H (2011)

104 Information from the BDSE, a retail industry association in Germany

105 Weck S (2011)

footwear import and retail companies, as well as brand owners/importers, have their headquarters, design laboratories and logistics departments in the region.

There are no definitive statistics on the number of footwear companies within the Pirmasens region. Over the last 10 years, according to the regional office of the HDS, numbers have reduced from around 30 to around 20 (in the late 1970s there were up to 300 local firms). The number of employees has reduced from around 27 000 to around 1 600 in production and around 3 000 in administrative roles.

Most restructuring took place at the end of the last century and the industry has stabilised in the last eight years, although a small number of firms have gone bankrupt within this period. There have also been new companies formed (although one of these went bankrupt five years later). The companies that are still around remain in business because they are the best. Each has developed its own market niche. Despite this decline, the shoe industry still remains one of the most important sources of employment in this sub-region.

6.1.3 Organisations Interviewed in Rheinland-Pfalz

Table 6.6 lists the organisations we interviewed in Rheinland-Pfalz.

Table 6.6: Organisations Interviewed in Rheinland- Pfalz

Type of Organisation	Main Activities	Size
Industry Association	Assistance and advice to footwear companies	n/a
Chamber of commerce	Trade promotion, vocational training, regional economic development and general services to members	n/a
Local authority	General support to local industry, including footwear	n/a
Federal Employment Agency	Advice and assistance on recruitment	n/a
Footwear manufacturing company	Manufacture of women's comfort shoes	Medium
Footwear manufacturing company	Manufacture of women's, men's and children's comfortable fashion shoes; footwear retail	Large
Footwear manufacturing company	Manufacture of women's comfort shoes; footwear wholesale and retail	Large
Footwear manufacturing company	Manufacture of clogs; production of textiles for the footwear sector	Small
Footwear design consultancy	Assistance to trading companies with design of footwear for production under sub-contract	Small

6.2 Footwear Restructuring in Rheinland-Pfalz

6.2.1 Types of restructuring

Companies in Rheinland-Pfalz have undertaken a number of types of restructuring. The most dominant types, however, are locational restructuring (with most production now outsourced, either within the EU of elsewhere) and, more recently, reorganisation of sales channels. Mergers and acquisitions have also been important, both of other

footwear companies and brands and of retailers and there has been steady development of the types of products offered.

This restructuring has taken place over a number of years and, for most companies we interviewed, this has been a gradual process.

6.2.2 Operational Restructuring

There have been a number of phases of Operational restructuring of the German footwear industry. The first phase was during the 1980s and 1990s, when production was fragmented into different steps and upper production was outsourced to Portugal, eastern Europe and China. The current emphasis of technology innovation is on improving production technologies for efficiency in small batch production and fast access to the market, which has been accompanied by relocation of some production back to eastern Europe from China.

For example, one company interviewed had recently opened a new, state-of-the-art factory in Hungary to meet increased demand in the most cost-effective way. Another company had recently made changes to its production plant in Germany to increase efficiency and flexibility (see Box 6.2). This had been made possible because a formerly insolvent company, which had not invested in new technology, was acquired by a new owner which provided the funds for upgrading – an example of acquisition (see Section 6.2.7).

Box 6.2: Operational Restructuring to Improve Efficiency

The whole production operation of a women's comfort shoe producer has been streamlined to make it more efficient and reduce overheads. The restructuring has enabled the company to produce smaller batches and to reduce time to market. The time for product development has been reduced to eight weeks to allow products to be presented at early trade fairs abroad.

The production process has been streamlined in layout (from two buildings into one) and technology (with the purchase of new equipment, including an oscillating blade cutting machine at a cost of around €200,000.)

Source: Interview with company, November 2011

6.2.3 Product Restructuring

According to the HDS, the main focus for product restructuring in the Pirmasens region has been in branding and design, with changes made at different rates depending on the company's market. For example, one very traditional brand in the higher price bracket has had to undergo many internal changes in recent years to enable it to add more fashionable designs to its product range. By contrast, a second firm in the same price bracket has been able to modernise its product range more quickly to make it more fashionable. A safety footwear company in the region has also been very innovative in product design.

Each firm in the area has developed its own market niche and developed or restructured its brand (through targeting new markets, acquiring brands etc). An

example of product innovation by one company is given in Box 6.3.

Box 6.3: Product Innovation Through New Brands

The company aims to produce 'fashionable, sporty shoes with comfort', designed to avoid stresses on the foot and remain comfortable through long periods of standing or walking, using specially-designed injection-moulded soles. It has two brands; sporty comfort shoes in the middle-upper price range (€70 - €150) and second brand combining comfort and fashion which it acquired in 2005. It also produces children's and men's classic city shoes brands.

The company has recently started a new fashion brand based on celebrity marketing and in the lower-mid price range (€59-€79). The aim is to raise the profile of the company at a time when retailers are under pressure.

Source: Interview with company, November 2011

One manufacturer of comfort shoes indicated that product innovation is complex, because it has to offer innovative products as well as pleasing its traditional customer base. The main issue is that the shoe fits; it is easier to produce a good looking than a well-fitting shoe.

The focus on comfort combined with style is common to footwear companies within the region. One company has developed a particular product design to achieve a high level of comfort (see Box 6.4).

Box 6.4: Product Innovation for Increased Comfort

The key selling point of this ladies footwear brand is the combination of comfort with style. The shoes all have removable cork insoles. Removable insoles are not unique; the key feature of the brand is the technique for making the insole removable (it works even in sandals) and the fit, which is typically longer than the foot, but narrower at the sides to hold the foot in place.

The shoes are produced in different width fittings (demand for narrow fittings is growing as well as for wider fittings) and in half sizes. The standard removable insoles can be replaced by orthopaedic insoles, so that women who need such insoles can use them in a range of styles.

The key innovation is in combining completely new footwear designs with traditional competence in comfort and fitting to be competitive in the comfort segment.

Source: Interview with company, November 2011

Other companies have focused more on fashion and design. One innovative approach in the area has been taken by a company which produced textiles for the footwear industry. The company used its expertise in textile printing to offer an innovative product (see Box 6.5).

Box 6.5: Innovative Products Based on Printing Expertise

A footwear company has been spun-off from a company producing textiles for the footwear sector, orthopaedic products and the automotive industry. It is based on a process where an image is printed on leather, which is bolted to a wooden sole.

Customers can select from three types of wooden soles, with a print either designed by the customer or selected from the company's collection of designs. Approximately 300 to 400 are sold each month. A pair of clogs costs €69.90. There is a very high degree of customisation and design depends, for example, on the shoe size.

Source: Interview with company, November 2011

Some companies, though, have undertaken a more drastic form of product restructuring, by totally changing their business model. For example, one company that had previously been involved in footwear production had transformed itself into a service company, offering assistance to footwear companies worldwide (including Australia, the UK, Vietnam and Israel) on an agency basis (see Box 6.6).

Box 6.6: Change of Business Model from Production to Service

Eight to ten years ago, the design consultancy decided to sell its knowledge of footwear production on an agency basis. The owner's family had been involved in last production for several generations but could not survive as the local manufacturing industry declined.

An examples of the type of services that the company offers is given below:

- the client (mostly a trading company which owns a brand name) comes with an idea for a product at various stages of development; sometimes the client even knows where it wants to produce (e.g. in China);
- the next step is the fitting phase; each company has a different fitting philosophy (so that when two companies produce a shoe of the same size, they will be different);
- then the characteristics of the sole need to be determined; this can significantly impact on the final cost and also highlights how important it is to know which market segment the company is aiming for);
- next the company will work with the client to determine the colours and materials to use;
- it will produce sketches, initially line drawings which take into account the relevant technical requirements (this is a different approach from the one taken in Italy and France which draw these sketches rather to please the eye and do not worry too much about the practical aspects at this stage);
- the final stage is technical design involving construction of outsole and pattern-making for the upper. After computer simulation, this is moulded out (this can be done by hand, which has the disadvantage of there then being only one mould, but direct injection is expensive - costs up to €5000; and
- the output is then handed over to the client, who proceeds with manufacturing of the shoe.

Source: Interview with company, November 2011

6.2.4 Reorganisation of Sales Channels

Sales channels have been one of the main focuses of restructuring for the footwear industry in Pirmasens. Companies recognise that, although they must have good

products, marketing is the most important factor for success. This has involved two main activities:

- vertical integration of retail functions; and
- internationalisation and access to foreign markets.

Traditionally, German footwear companies sold to the specialist retail sector, which has been in decline for some time. Companies have adopted different strategies to address this issue and ensure that they maintain access to the market. Some have opened mono-brand stores, but others do not plan to do this. An example of a company adopting a combination of strategies to ensure sales channels is given in Box 6.7.

Box 6.7: Combination of Strategies to Ensure Sales Channels

Reorganisation of sales channels has been a key focus of restructuring for the manufacturer of women's, men's and children's comfortable fashion shoes, ensuring that it has access to a number of different routes to market. This includes:

- it has had three factory outlet stores (selling its own brand of discounted products only) for some time, including one next to its headquarters in Rheinland-Pfalz);
- it also has stores in outlet malls (selling discounted products of a range of manufacturers) in Copenhagen, Oslo and Switzerland which are very successful; it does not have stores in similar outlet malls in Germany as these would compete with its retail customers. It also has stores within six malls on US airbases (which only accept typical regional products);
- 21 mono-brand stores in Germany. These were set up from scratch by the company, with an ecological theme;
- a new initiative is multi-brand stores in Moscow and Leicester, selling a larger range of the company's products plus 8-12 brands which have similar qualities (including Austrian brands);
- in 2010 the company purchased 49% of the shares (but has 51% of the controlling interest) in Germany's largest specialist footwear retailer, with 142 stores, which is one of the company's largest customers; and
- the company does sell through cheap retailers, but only when it has a particular need (otherwise this could affect its main retailers).

Source: Interview with company, November 2011

A second manufacturer of women's comfort shoes had taken a similar approach, setting up a wholesale business for its own footwear and for a Danish brand that it represents in the German, Austrian and Polish markets. The company also acquired 17 shops in outlet malls (selling discounted products of a range of manufacturers) from a retail company.

Companies integrating retail functions (via various forms of retail) have been able to introduce modern IT based merchandise management systems. However, it is still difficult to establish such systems across sectoral borders between the footwear producing and footwear distributing companies. The German footwear industry association, HDS, has just started a joint venture for IT based general merchandise management systems, ECC (european-clearing-center.net).

The companies we interviewed had mixed views about the benefits of online retailing. Box 6.8 (over page) gives an example of this. Another ladies comfort shoe manufacturing company we interviewed does not sell its shoes via its own website, as this would be seen as competing with its customers. However, it does sell through internet retail sites such as Amazon. The company would like to expand this cooperation, potentially through giving the sites internet access to stocks.

By contrast, the company producing customised wooden clogs sells via the internet to allow consumers to customise their clogs with their own design, although the company noted that this facility had not been used as much as expected, as customers tend not to be very creative with their designs. Additionally, the clogs are also sold at several local shops using the company's own designs.

Box 6.8: Mixed Views on the Benefits of Online Retailing

One manufacturer women's, men's and children's comfortable fashion shoes considered that, despite online sales increasing, this is a risky area for the sector. There is a customer perception that shoes can be returned, even if they have been worn, leading to high return rates; the company understands that the largest online retailer has a return rate of 70%. This retailer offers free returns and a long return period. This has been abused by some customers order five pairs of a particular model in the same size but different colours, clearly aiming to buy only one pair. Others had returned pairs claiming they did not fit, even when they had clearly been worn for some time. Only a few small specialist online retailers have return rates below 50%, and returned shoes cannot be sold through the site for normal prices if they have been worn

However, online retailing does force the industry to be closer to the market, providing a better understanding of what the customer wants. The company has an online store but does not promote this widely; it sells a few thousand pairs per year. It also sells through the online site of the retail group that it owns.

Source: Interview with company, November 2011

The focus for internationalisation and access to foreign markets is again on getting access to the consumer via the retail trade. However, forms of retail trade (such as in China) are quite different from those in Germany, as there is no special retail trade in many countries.

The companies we interviewed had different strategies with regard to exports. Examples of this are given in Table 6.7 (over page). Interestingly, the design consultancy uses very traditional sales channels; it mainly contacts clients through attending trade fairs to network with industry professionals (who tend to stay at the same hotels).

Table 6.7: Export Markets for Footwear Manufacturers Based in Rheinland-Pfalz				
Germany	**Other EU**	**Outside EU**	**Notes**	**Production and Market Segment**
70%	30%	0	The company has agents in the Netherlands and the UK and is considering moving into Poland and Slovakia in the meantime. In the longer term, it may take the brand to the US, where its parent company has a partnership with a retail chain	200 000 pairs per year, women's shoes with cork insoles in the €80-€99 price bracket
75%	~25%	[small]	Main markets are Benelux, France, Switzerland and Austria, with smaller amounts to Japan, Canada and Russia	520 000 pairs per year of women's comfort shoes with removable insoles in the price bracket €69 - €99 for standard models of women's shoes and €99-€149 for special models and boots
40-45%	35% - 40%	20%	The main markets outside the EU are the US, Canada, Australia, Hong Kong and the Middle East	Women's comfort and fashion shoes, medium-high price segment (€70 - €150)
Source: Interviews with companies in Rheinland-Pfalz, October 2011				

6.2.5 Locational Restructuring

Increased competition over the past 20 years has forced many German producers to gradually close their factories in Rheinland-Pfalz, or significantly reduce output, and shift production to Eastern Europe and Asia. The focus of restructuring in the area has been on moving to a globalised network for manufacturing and selling footwear. A number of models have been adopted, for example:

- importers that buy in ready-made shoes and sell them on to discount retailers. These companies can be large (employing hundreds of people) or small (consisting only of an office that organises purchasing, sales and logistics); and

- companies that have their own design and retail operations in Germany, subcontracting manufacturing to plants based elsewhere.

The companies we interviewed had all adopted the second model, with manufacturing plants in Europe or China/Vietnam. Some overseas plants are owned by the German company; in other cases, manufacturing is outsourced. In general, ownership of manufacturing plants is more common in European countries, due to their proximity to Germany and similar cultural (and legal) practices. Manufacturing in China and Vietnam is more often carried out through outsourcing, because of the potential costs and difficulties of setting up and managing plants at such a distance and because there is a network of sub-contractors, sometimes owning a large number of manufacturing plants, who are able to take on sub-contracts. However, each company takes a

business decision on whether to set up its own plants or outsource, based on a judgement of what is best for the company.

According to the HDS, even some companies that have relocated most of their manufacturing continue to manufacture in Germany in order to retain the technical competence that can assist them with shoe design. It also allows them to manufacture smaller-run brands, for example ecological or 'Made in Germany' brands, to explore the market potential. For example, one ladies comfort shoe manufacturer assembles a proportion of its footwear in the region in order to use the 'Made in Germany' logo.

Most companies remaining in the region have relocated a significant proportion of their production, but the three largest companies still have some local manufacturing. One of these companies manufactures in Germany and Portugal In its own plants), another mainly in eastern Europe (in its own plants) but also in Asia (through outsourcing), whilst the third produces in its own plant in Germany and outsources in Brazil. Another major company produces mainly in its own plants in Hungary and Germany. Box 6.9 provides an example of this combination of manufacturing approaches.

Box 6.9: Example of a Combination of Locational Restructuring

Most of the company's women's, men's and children's comfortable fashion shoes – around 85% - are produced in company-owned plants in eastern Europe, mainly in Hungary, the Czech Republic, Romania and Bulgaria. The company has just built a new factory in Hungary. There is also a small amount of production in Rheinland-Pfalz, known as the 'glass shoe factory'; it is open to the public to see shoes being made. The company had another German plant, in Trier, but this was closed, partly because of difficulties in finding qualified staff.

The remainder of production is via outsourcing in China, Vietnam and India; this is shrinking because of the newly-opened factory in Hungary. Costs of producing in eastern Europe have increased dramatically, but this is offset by greater control over the factories and speed to market. Design, development and prototype manufacture remain in Rheinland-Pfalz.

Source: Interview with company, November 2011

Even where companies have relocated the majority of their production outside the country, responsibility for design, marketing and distribution remains in the region (see Box 6.10 over page).

Box 6.10: Examples of Different Types of Locational Restructuring

A men's shoe manufacturer has its headquarters in Pirmasens; this is responsible for design, management, materials purchase and quality control. Assembly of the footwear is carried out in the company's own factory in **Portugal**. Finished shoes are then transported to Pirmasens where they are checked (and minor quality problems can be addressed) and packaged before being dispatched to customers. Both lead times and transport times are relatively short.

A manufacturer of women's medium-range footwear designs and makes samples of footwear in Pirmasens which are then exhibited at the GDS shoe fair, where orders are taken from retailers. The CAD designs are then sent to **China**, to reduce lead times, where the shoes are produced under sub-contract. The finished products are transported back to Germany by ship, which increases the transport time. Re-stocks are sent by plane to reduce transport times.

A women's shoe company designs and develops all its products at its HQ in Germany. It still finishes a third of its shoes in its plant in Germany, using uppers from **Bulgaria**, but the majority are manufactured by subcontractors in Bulgaria and **India** or purchased ready-made from **China**. The company provides raw materials to subcontractors in Bulgaria and India and sends technicians to provide supervision. This increases lead times and transport times, but increases the company's control over production.

Source: Interviews with companies and industry association, November 2011

One manufacturer of women's comfort shoes, which had transferred production to its own plant in Hungary, had not seriously considered offshoring to China or other Asian countries because of concern about quality and the distances involved. It had also subcontracted some manufacturing to Romania and Croatia, but the quality was inadequate and so it had withdrawn from those countries.

According to the industry association, some companies that initially outsourced production to China have relocated back to eastern Europe, either to their own plants or to subcontractors. Such moves are very individual to companies and the reasons are not often publicised. However, they include:

- increased costs of manufacturing in coastal China and companies' reluctance to move to other parts of China because of the hassle of keeping relocating; and

- the need to be prepared for economic instability by having more options open, not relying on a single source for products. One large company recently bought a bankrupt plant in the Pirmasens region to run a parallel branding and licensing operation. It took on some of the 80 staff of the previous operation. This process could also lead to companies returning to Romania, where there are also bankrupt plants.

One manufacturer based in Pirmasens has transferred back to Europe part of the production that was previously subcontracted to China (see Box 6.11, over page).

Box 6.11: Relocation of Offshored Production Back to the EU
A manufacturer of women's, men's and children's comfortable fashion shoes has expanded the production capacity of the plant it owns in Hungary through an investment worth €4.44 million. The boost was necessitated because the group has decided, as a result of increasing costs and more limited production control, to transfer part of its manufacturing back from sub-contractors in China and Moldova to its own plant in Hungary. The facility in Hungary will produce 8,000 pairs of footwear a day when production is at full capacity. The construction of the newest 1,800 square-metre plant cost some €1.04 million and the company spent €3.41 million on direct injection moulding machines used to produce soles for the groups product ranges
Source: Interview with company 2011; Press release issued 29 May 2011

Some equipment and component suppliers have also recently relocated to the area or established an outpost and a small number of new entrepreneurs are entering the industry, although not always successfully (see Box 6.12).

Box 6.12: New Footwear Enterprises in Pirmasens
A company manufacturing specialist fitness footwear, which was established five years ago close to the Swiss border, moved to Pirmansens. The reason for the move was to be close to the International Shoe Competence Centre. However, this company has now gone out of business.
Source: Interview with industry organisation, November 2011

6.2.6 Closure

The effects of decline in importance of shoe manufacturing have been particularly pronounced in the region around Pirmasens. Only about 20 of the 300 or so footwear companies that were based there in 1960 are still operating.

There is no definitive list of closures available, as there is no comprehensive list of existing firms[106]. However, Table 6.8 (over page) lists examples of closures, obtained from press coverage and personal information.

[106] For example, the data provider Hoopenstedt offers nearly 500 addresses of footwear producers in Germany while the industry association HDS has approximately 120 members, suppliers included. Even some large footwear producers prefer not to be member of the association.

Table 6.8: Examples of Footwear Firm Closures in Pirmasens, 2002 - 2010		
Company	Year of Closure	Details
Fasan Schuhfabrik, Dahn	2010	Insolvency and closure, brand bought by Lugina-Waldläufer, Lug.
Topstar Schuhe	?	Closure of footwear production (wedding and costume shoes) because of lack of a successor to the owner. The firm had an outstanding distribution system as it sold only to specialist retail wedding clothes shops. Approximately 20 employees involved.
Delta Schuhfabriken Vertriebs-Gmbh	2006	Insolvency, 50 employees. Founded in 1972, the company had already closed production and only designed shoes and produced patterns at the location. Production in Eastern Europe and Asia.
Kinderschuhfabrik Heinz Hummel Gmbh	2005	Closure because of age and poor health of owner. 14 employees involved.
Bauernfeind Shoe Division GmbH & Co KG	2004	Closure of the distribution centre Berkemann Sandals in Schwanheim / Southwest Pfalz and relocation to a production plant in eastern Germany (Zeulenroda/Thuringia). 25 employees dismissed or invited to move to Thuringia. Bauernfeind/Zeulenroda took over Spiess/Pirmasens in 1998 (brands "Spiess" and "Unikat"), which at that time had 77 employees. In 2000 it closed production (and dismissed 77 employees) because of negative financial results.
Trettal Schuhfabrikation GmbH	2004	Closure of the company producing children's shoes because of lack of a successor (the owner was 78 years old at that time). Production had been relocated abroad many years earlier.
Kästner Damenschuh, Lemberg	2003	Closure of women's shoe production after insolvency in the previous year (58 employees involved), 25 employees at the time of closure.
Schuhfabrik Klein, Münchweiler	2003	Closure and insolvency of orthopaedic shoe production (still in full production until closure at the location), 22 employees involved.
Navajo-Dr. Geneger Schuhfabrik GmbH, Hinterweidenthal	2002	Insolvency and closure of a company which had started in 1998 with a new, innovative concept. 18 employees involved.
Sources: Pirmasenser Zeitung (local newspaper), Steptechnik (trade journal), personal information from HDS		

6.2.7 Mergers and Acquisitions

The German footwear industry has experienced a series of significant acquisition deals in recent years. For example in 2003, some footwear assets of Salamander AG were purchased by trading organisation Garant Schuh + Mode AG[107]. Mergers and acquisitions have also been a significant feature of the industry in the region. For example:

[107] In 2003, Garant Schuh + Mode AG took over some parts of the shoe division of Salamander AG. This included 230 retails stores in nine European countries, the rights to the Salamander brand and licence for the children's shoe brand Lurchi as well as a production facility in Martfu, Hungary.

- a company manufacturing 'fashionable, sporty shoes with comfort' acquired a more fashionable brand from a company that had gone bankrupt. The acquisition widened the company's offering to the market and also targeted different export markets. Whilst the first brand was more orientated to a northern European market sensibility (e.g. with visible hand stitching and slightly more masculine design), the brand it acquired is more oriented towards the French market in styling; and

- a manufacturing company acquired a controlling interest in a major retail chain that was threatened with bankruptcy, in order to avoid the chain being sold to a buyer that might no longer stock the company's shoes.

In addition to these acquisitions by companies based in the region, local companies have also been acquired by external investors (see Box 6.13).

Box 6.13: Acquisition of a Rheinland-Pfalz Company by an Overseas Buyer
The company was an old family-owned German brand of comfort footwear for women, manufacturing in Rheinland-Pfalz. The company went into administration in 2007 and was bought by an Israeli group, the largest footwear manufacturer and retailer (with 70 stores) in the country, which was seeking access to the larger market in Europe.
Source: Interview with company, November 2011

6.2.8 Best Practices in Restructuring

The best practices in restructuring in restructuring in the region relate to the ability of companies to remain in business in the face of significant market pressures, by separating product design and marketing from production. This has enabled companies to remain profitable and retain high-value added operations within Germany, whilst offshoring production to countries with lower labour costs.

Although this approach led to significant reductions in employment in the area, employment is now increasing (although from a low level). A second area of best practice relates to the problem of attracting young people to the industry to meet the demand for increased employment. A local campaign to attract young people to the industry, Step up Shoes, has been developed by the local employment agency and industry representatives (see Box 6.14, over page). This has proved successful and is now being transferred to other regions.

Box 6.14: The Step Up Shoes Initiative

The 'Step up Shoes' campaign is a joint initiative between local companies and the industry association, the ISC and the Federal Employment Agency to encourage young people to apply for jobs in the footwear sector and overcome the negative perceptions of the industry.

It involved presentations to students, including a fashion show where companies exhibited their products. Cards were provided for attendees to indicate their interest in learning more. This was very successful in raising interest amongst students and a joint open day for companies is planned to be held at the ISC for the interested ones, to provide more detail.

Key selling points are the international nature of the industry (so employees have opportunities for travel as well as the ability to find work locally) and that it is possible to advance to a senior level without necessarily having a formal university education.

Source: Interviews with companies and local organisations, November 2011

6.3 Drivers for Restructuring

6.3.1 Main Reasons for Restructuring

The drivers of restructuring depend on the types of restructuring undertaken. The main driver for locational restructuring is the impact of international competition and the need to reduce the costs of production by transferring it to countries with lower labour costs. The main driver for restructuring of sales channels is concern that changes in the structure of footwear retailing could restrict companies' access to the market.

6.3.2 International Competition

Trade policies were not mentioned explicitly by many of the companies we interviewed as a reason for restructuring. However, the extent of offshoring of production to China, Vietnam and other Asian countries indicates that the removal of trade barriers must have been a significant driver in the past. In addition, several companies indicated that enlargement of the EU has made working in eastern European countries (such as Hungary) easier, although it has increased costs in these countries.

One company indicated that it was not competition as such, but poor management response to competition, which had necessitated restructuring. This is described in Box 6.15 (over page).

Box 6.15: Restructuring Driven by Poor Management Response to Competition

The original women's comfort shoe company went insolvent due to a lack of (and poor) investment, spending money on the wrong markets, with the financial pressures meaning that new collections could not be developed.

An overseas manufacturer and retailer acquired the company in order to break into the EU market. It had not been able to achieve this before, even though it marketed successfully in the USA and Canada. It was interested because the original company was a known brand, and there was an opportunity to reorganise the company, internationalising the brand as well as introducing the overseas brand to Europe. The new company had to win back customers that were lost because of lack of development of the brand.

Reorganisation and offshoring of production was driven by a need to manage costs and reduce overheads, while product restructuring is driven by the need to increase sales by tapping into new markets, as well as winning back previous customers.

Source: Interview with company, November 2011

6.3.3 Competition within the EU

Other sorts of competition have been important, particularly in relation to sales channels. One company indicated that it's restructuring of sales channels was largely driven by competition concerns (see Box 6.16).

Box 6.16: Competition as a Driver for Restructuring of Sales Channels

One reason for a manufacturer of women's, men's and children's comfortable fashion shoes focusing on different ways to access the market was the threat to traditional multi-brand retailers, including competition from other manufacturers to turn them into mono-brand stores. For example, the company had an excellent multi-brand retail customer in Birmingham, which regularly sold 3,000 pairs of its shoes per year. However, the customer was bought out by a competitor and tuned into a mono-brand store, so the company lost a key sales channel almost overnight. This is an extreme example but is part of a wider trend. City centre stores are increasingly being taken over by manufacturers while a competitor took over a major retailer.

The company purchased a controlling interest in a large retail group just before it went bankrupt, to avoid another company buying the chain and restricting the company's access to the stores.

Source: Interview with company, November 2011

6.3.4 Availability of Funding and Other Assistance

Restructuring in the region was primarily self-funded (from companies' own resources), together with loans from regional banks.

One company noted that funds were formerly available from the Federal Government for special projects, but this has not been the case for the past 10 years. One company noted that the shoe industry has always been a small part of the German economy, so is not influential at federal Government level. The sports shoe sector is more influential, but it operates quite separately from the remainder of the industry (although an important supplier of soles for sports shoes is located in Pirmasens). The sports shoe sector has been global for over 25 years.

The City of Pirmasens authorities would like to do more to access EU funding for restructuring and innovation. The day after our interview, a representative of the authority was due to attend a Federal Government seminar giving guidance on EU funding availability.

The role of the industry association, HDS, in Pirmasens is to provide member companies with help and advice, covering labour law, standards, negotiations etc. It undertakes consultancy for individual firms but also has a wider advocacy role. It has therefore not acted as a direct driver for restructuring in the region, but has responded to companies' requests for assistance.

The HDS is now working to bring companies together; previously companies in the region saw each other only as competitors, now they are beginning to work together more effectively. This does not have particularly concrete outputs (although there is now a round table for the industry seeking to make it more attractive to young people); it is more about informal discussion and sharing of experience. The reason for this better cooperation is a combination of a reduced number of firms, making it easier to bring people together, the fact that competition is global and a new generation of managers, who do not have the history of conflict. One of the key issues being addressed by the regional association is the problem of attracting young people into the industry in the region.

6.4 Impacts of Restructuring

6.4.1 Negative Impacts

The main negative impacts of restructuring have been a significant reduction in the numbers of footwear firms, the number of employees and production of footwear in the region. Prior to restructuring, there were a large number of firms in the region, selling primarily to the German market (although there was always some export). Now the number of firms is much lower, and some of those remaining are very small. This is reflected in reduced output. However, most of this restructuring took place in the 1990s and early 2000s. Since then, a small number of firms have gone bankrupt, but the remainder have been fairly stable.

Employment has reduced significantly since the heyday of the industry in the early 1980s; employment in footwear production in Rheinland-Pfalz is now around 2 150, with 1 600 of these in the Pirmasens region[108], together with a further 3 000 in administrative roles. According to the local office of the HDS, this reduction continued until 2009; employment is now increasing a little, as 2010 - 2011 have been good ones for the industry (although the October and November 2011 have been less good). This is reflected in the focus of labour advice given by HDS; previously the focus was on redundancies; now it is on hiring.

[108] Anon (2011b)

One company that had been acquired by foreign investors following insolvency noted that its workforce had significantly reduced, but most of this reduction took place at the time it was in administration, before the acquisition. After the acquisition, the remaining staff were retained. The number of production staff has increased since the acquisition (by two, to 45). This workforce is mostly female and is ageing; the company would like to introduce new blood but does not want to make existing staff redundant and, in any case, it is hard to attract new people to the footwear industry

Locational restructuring has resulted in a major loss of jobs in the Rheinland-Pfalz region and the creation of jobs outside Germany. Table 6.9 illustrates the significant decline in employment in the Pirmasens region due to restructuring (more than 65% reduction over the period from 1997 to 2010).

Table 6.9: Decline of Employment in Footwear Production in the Pirmasens Area

Year (31/12)	Pirmasens Region			Pirmasens Town	
	Employees[1]	Low Paid or Part Time Employees[2]	Unemployment Rate (%)	Employees[1]	Low Paid or Part Time Employees[2]
1997	4 831	-	14.5	-	-
1998	4 624	-	13.3	-	-
1999	4 407	-	12.5	1 995	-
2000	4 192	271	11.2	1 962	74
2001	3 997	266	10.2	1 940	62
2002	3 355	229	10.5	1 588	58
2003	2 613	274	12.1		70
2004	2 135	246	12.4	1 119	62
2005	1 990	222	13.5	1 074	56
2006	1 954	235	11.0	1 062	55
2007	1 766* (1 940)	242	9.6	1 067	69
2008	1 678* (1 847)	247	8.7	1 074	75
2009	1 622*		9.4		
2010	1 557*				

Source: Bundesagentur fuer Arbeit, personal communication, 18.03.2010
Notes:
1. People in the area subject to social insurance contributions
2. Employees earning less than €400 per month (so-called Minijob)
** New system of sector classification introduced under NACE rev.2; figures in brackets are those under the old classification*

Although most companies did not believe that there had been significant problems with restructuring, one company commented that it was too slow to make the changes needed internally. It was difficult to balance making necessary changes and maintaining the motivation of staff. The company, which had been acquired by a foreign investor, had also made mistakes in terms of integration (see Box 6.17).

Box 6.17: Mistakes from Attempting Too Rapid Integration
A German ladies shoe manufacturer was acquired by an overseas manufacturer and retailer. One mistake following the acquisition was to try to integrate the two sales teams too quickly. This didn't work with customers and sales were lost. Retailers were confused by being offered another brand; instead of increasing their overall purchases, they simply substituted one brand for another (e.g. ordering the same number of pairs, but now 80% of the German brand and 20% of the overseas brand). There are now separate sales teams for each brand.
Source: Interview with company, November 2011

6.4.2 Positive Impacts

The companies that we interviewed indicated that the most successful aspects of restructuring had been the ability to keep growing; one company noted that potential demand is higher than its current output, so there is scope for further growth in future. The industry association noted that companies recognise the need for 'permanent revolution', continuously generating new ideas in types of shoes, materials etc. Change is getting faster.

All of the companies that we interviewed indicated that restructuring had led to business gains. These included increased efficiency of production and the ability to sell their products successfully on the international market. The greatest business gain was that companies remained in business, despite challenging conditions on the international market. Even where the majority of production has been relocated, a significant number of jobs may be retained in the region, as this remains the company headquarters, with design, management and logistical functions retailed.

Companies that have remained in business indicated that restructuring had enabled them to grow and be profitable. One noted that, although there were problems initially (with its acquisition by an overseas company), the company is now in a much better position compared to insolvency. If not for the acquisition, the company would have gone out of business.

Another positive impact of restructuring has been increased flexibility. In general, the companies that we interviewed had not increased the number of collections they produce. One manufacturer commented that this was not a significant trend (see Box 6.18 over page). Another noted that it was not so high-fashion that it needs more than two collections per year. Customers are happy with this, as once they find a style they like that fits well, they want to be able to keep buying it. However, the company now produces in smaller batches than in the past and is able to have a faster time-to-market from its production in Germany and Bulgaria.

Box 6.18: Manufacturer's Comments on Numbers of Collections per Year
The ladies comfort and fashion shoe company produces two main collections per year. For most manufacturers, in-between ranges are much smaller in number and not really meaningful. Most in-season buying is of products that were shown to the retailer at the beginning of the season but which they were not ready for (e.g. fur-lined boots are ordered when it snows, rain boots when it rains). More frequent collections are also not really practical; if you are not selling your current collection (e.g. because of the weather), you do not have the money to invest in a new one.
Source: Interview with company, November 2011

The company that had transformed itself into a service provides noted that flexibility was a key aspect of the change, both for the company itself and for clients. The company derives its competitive edge from offering a range of services in-house; this provides flexibility and speed (which are the company's main selling points) but one of the advantages of this is also a high degree of confidentiality for the client, minimising the risk of its designs being copied. This is also the biggest difference between this company and its competitors which tend to be sourcing agencies.

6.4.3 Changes in Business Partnerships and the Supply Chain

According to the local industry association, the Pirmasens cluster is shrinking, but still operates (and in fact is operating better because of closer cooperation between firms). A number of international firms have retained their headquarters in the region, although production has been largely outsourced. One reason for this is that many of the companies remain family-owned and the families retain loyalty to the region. The main assets of the area are good products and effective marketing, big brands, efficient production and expertise in making and selling shoes, which is protected by the presence of the ISC.

These assets have been of benefit to the companies we interviewed. For example, the company that had transformed itself into a service provider closely co-operates with local companies (e.g. last manufacturers) and with physicians and universities on design and technology. The director also has many contacts in Pirmasens and this is an advantage; for example, when the company needs some leather, there is always someone to buy it from. Similarly, the company printing textiles for the footwear industry took part in a research project into shoes for diabetics which received funding of €135,000 from the Federal Ministry of Economy (under the ZIM Programme for SMEs, Zentrales Innovationsprogramm Mittelstand). Its partners in this study were the PFI (Prüf- und Forschungsinstitut für die Schuhherstellung e.V., - Test and Research Institute for Footwear Production in Pirmasens) and a physician.

The cluster also provides a range of training institutes, where many of the staff of companies in the region have studied. This includes the University of Applied Sciences, the vocational school (Berufsschule Pirmasens*)* and the Deutsche Schuhfachschule.

Restructuring of the footwear industry in the region has been matched by restructuring in the supply chain. The region first lost some of its suppliers; those that had

developed expertise in injection moulding found more lucrative markets in the automotive industry and moved away from the sector. They were followed by equipment suppliers. Some of the companies that once specialized in supplying the footwear industry in the region have been able to reduce their dependence on the footwear sector by establishing themselves in different markets, e.g. plastics and equipment manufacturers becoming suppliers to the automobile industry and transport suppliers becoming more general logistics companies.

Because of the reduction in size of the footwear industry in the region, suppliers have had to diversify to remain in business. For example, the logistics industry has expanded from serving the footwear industry to wider markets. The chemical industry in the region developed to supply the footwear sector but now has a much wider focus.

The companies that we interviewed described a number of changes in business partnerships as a result of restructuring. The most significant were changes in relationships with customers through reorganisation of sales channels, including acquisition of retail companies and owning their own retail facilities.

Changes in distribution and sales channels have been one of the key areas of development for companies that we spoke to, including opening their own stores and acquisition of existing retail chains. There have been major changes to the footwear retail sector in Germany in recent years. Although Germany still has a relatively large number of specialist shoe shops, around 5 000, this has reduced by around 25% over the last decade as shop owners went out of business (due to a range of factors including competition for retail sites in city centres and from shoe sales through supermarkets and department stores). This has been a significant factor in action by shoe manufacturers to restructure their sales channels.

One company that had been acquired by a foreign footwear manufacturer and retailer noted that one benefit from the acquisition was the ability to exchange staff and experience between the two companies. For example, the German company had no experience of retailing, while the overseas buyer did. The scope for cross-fertilisation was limited, though, as the main markets of the two companies function quite differently (even in things as basic as how much of a reduction you need to offer to attract people to the sales).

6.5 Effects of the Economic Crisis

According to the HDS, the economic crisis did not have a major impact on the footwear industry, the market for shoes stayed pretty stable, and few firms took advantage of the financial support available from the Federal Employment Agency for short-time working. There was a 10% reduction in turnover in 2009, but this recovered rapidly in 2010/2011. Restructuring was largely complete before the crisis and the business model adopted by most firms (with outsourcing of production) allows for rapid response to changes (e.g. simply through reducing the number of pairs ordered from subcontractors). The credit crunch has had an effect on the

availability of funds, but the situation is not as bad as it was 10 years ago. Companies obtain funding from regional banks, not the large national banks, which helps. The footwear market in Germany was not at all hit by the crisis. Instead, sales in the price segment of €75 and over nearly doubled in size between 2008 and 2011[109].

A manufacturer of ladies comfort shoes indicated that there was some moderate impact and the company turnover declined by 5%. There was some impact on the market segment in which the company is active, but it is a well established company and is supported by shoe shops which, however, are under pressure. Another manufacturer indicated that weather unpredictability had had more impact than the economic crisis. The bad European winters of 2009 and 2010 increased sales of boots by 20% and the good summer between increased sales of sandals. The combination of a poor summer and a mild winter in 2011 has been very bad for the industry. Another company commented on the effects of the economic crisis on retailers (see Box 6.19).

Box 6.19: Effect of the Economic Crisis on Retailers

The economic crisis led retail customers of the ladies' comfort shoe manufacturer to become much more risk-averse, ordering smaller batches and less expensive models. The manufacturer's response was to offer better customer service and rapid restock (orders used to be 80% up-front and 20% restock, now it is only 40% - 50% up front). This means producing for stock, which is riskier for the manufacturer. However, the company also owns its own retail stores, which gives the company a buffer against this risk.

Source: Interview with company, October 2011

6.6 Future Trends in Restructuring

6.6.1 Expectations of the Industry

The industry association, HDS, has a quite optimistic view on the future of the sector in Germany. It considers that most of the Southern European countries now are in a process of relocation which happened many years before in Germany. Although at a low level, employment in the sector seems to be increasing at the moment.

Although the majority of restructuring has taken place, the industry is now one of continual change. HDS expects that the manufacturing industry will continue pretty much as now, but with an increase in online retailing, which will affect the retail sector. The biggest growth area for customers is through online retailing sites like Amazon. Some manufacturers have their own online sites, but many of these have not been very successful (though some have). The impact of online sales will depend on whether it becomes truly borderless and you can buy shoes direct from Chinese producers.

For most companies, locational restructuring is complete and only minor changes are envisaged in future. However, changes to sales channels are likely to continue. This

[109] Heinick H (2011)

will include both changes in the type of stores in which products are sold and a continuing focus on exports. For example, one manufacturer of ladies comfort footwear expects to enter the UK market in the next five years. Another company, acquired by an overseas investor, intends to use this to expand its markets (see Box 6.19).

Box 6.20: Future Expansion into New Markets

The focus for the manufacturer of women's comfort shoes will be on closer integration of the German brand and that of the overseas company that acquired the German company, to provide greater continuity of styles.

The company also aims to become more international; model development has been advanced eight weeks to allow the company to exhibit at the US shows (exhibiting at fairs is very important in the EU, as well). The company needs to make sure that it has the right distributor in each country and fairs are a good way to meet them.

Source: Interview with company, November 2011

6.6.2 Remaining Barriers and Action to Address Them

The companies we interviewed anticipated a number of challenges for the sector. These included:

- the availability of skilled staff to replace an ageing workforce;
- the continuing decline of traditional specialist shoe shops, which could have a significant impact on companies that reply on these sales channels; and
- increases in the prices of raw materials, particularly leather. As it will be difficult to pass these costs on to customers, especially in the current economic crisis, this could lead to pressure on profit margins. Alternatively, increasing prices could reduce sales, as fewer customers will be able to afford the higher prices.

One consequence of the fact that employment in the footwear sector is now stabilising is that maintaining a **qualified labour force** is a challenge, both at the level of the shop floor (qualified footwear technician) and supervision (footwear engineers). The industry association, HDS, sees the recent creation of the International Footwear Centre as a major step towards better education and training but considers the speed of change rather low. For example, education for qualified footwear technicians is part of the public school system. This, however, is neither flexible in the view of the industry nor willing to cooperate with private companies.

Linked to this issue is the problem of **attracting young people** into the industry. The Bundesagentur fuer Arbeit (Federal Employment Agency, BA) carried out a review of the current workforce in the sector in the region as part of a national 'employment monitor' initiative, which mapped the characteristics of the labour force and provided an analysis of future trends both in relation to skills demand and supply. (Previously it had not focused on the shoe sector because it was not offering jobs). The BA study found that production staff in the sector have an age structure of 41% in the 50-65

group; most of these will leave in the next 5-10 years. It has been difficult to recruit young people into the sector because of the adverse effect of previous job losses; shoe making is seen as an industry with no future. However, companies in the region indicated that there was a need to recruit, even in production jobs. Continuation and extension of the local campaign to attract young people to the industry, described in Section 6.4.4, should help to address this problem.

According to HDS, one area of concern is **family firms**. These still tend to seek new managers within the company, which requires the younger generation to be engaged and not want to sell up. However, some of the larger and most successful firms in Germany are family-based. It is rare for a company or entrepreneur with no footwear experience to enter the sector, but companies in the apparel and related industries may move into footwear.

Another barrier, mentioned by several of the companies that we interviewed, is **copying of designs**, especially by retailers selling own label products. The retailers know what will sell, from their closeness to the consumer, and need high margins to afford their city-centre locations. They therefore have cheaper copies of brand designs made in China for their own label, but sell them for only a little less than the brands, around 10% cheaper. The quality of the copies is poor, which could be damaging to the brand as customers may perceive them to be the same. The retailers are now under pressure from consumers to improve the quality of their own label products to justify the prices, so have asked brand manufacturers to supply them with cheap products – but the only benefit for the brands would be a saving in marketing costs, and these are not sufficient to offset the reduced price the brands would receive.

This barrier could be overcome by making it simpler to obtain action against copying. The company has taken the retailer to court twice for copying one of its products which had very distinctive features, which made the case easier to prove. However, although the company has won twice in the courts, the retailer is delaying action by appeals, which means it continues to gain the benefits from selling the copy.

6.7 Summary

The Rheinland-Pfalz region previously hosted an integrated footwear cluster, of equipment manufacturers, suppliers and footwear assemblers. The number of footwear companies and employees has reduced significantly (more than 65% reduction in employment over the period from 1997 to 2010). Many of the firms remaining in the area are family-owned, ranging from SMEs to large companies.

During the 1980s and 1990s (phase 1), German footwear companies learnt to separate production into different steps (e.g., upper production and final assembly and/or mass production and sample production) and outsourced upper production to Portugal and East Europe and mass production to Asia. The main driver was lower wages in these countries, which reduced costs. This also was the phase of Operational restructuring in processes.

From the 2000s onwards (phase 2), the focus became restructuring of product quality, design and improvement of own brands and the search for market niches. The drivers were increasing international competition and the decline of the middle range segment at traditional markets.

Currently (phase 3), restructuring is even more focused on investment in design and product quality, maintaining the market niches, and increased efforts to ensure access to sales channels. Part of this strategy is to improve production technologies for efficiency in small batch production and fast access to the market which results in a current trend of relocation back to Europe (but not Germany) from East Asia. Drivers are the rising costs in China and the awareness that relocation to other (low-cost) countries in Asia (such as Indonesia) means high learning costs at the beginning. At the same time, proximity to the market is increasingly required due to the requirements for product quality, flexibility, speed to market and due to changing retail structures.

This restructuring has taken place gradually over a number of years. Restructuring in the region was primarily self-funded, together with loans from regional banks. Companies that have remained in business indicated that restructuring had enabled them to grow and be profitable. In some cases, without restructuring, the company would have gone out of business.

The economic crisis did not have a major impact on the footwear industry in the region, the market for shoes stayed fairly stable, and few firms took advantage of the financial support available from the Federal Employment Agency for short-time working. Restructuring was largely complete before the crisis and the business model adopted by most firms (with outsourcing of production) allows for rapid response to changes in demand.

The sector anticipates a number of challenges in the coming years, including:

- recruiting skilled staff to replace an ageing workforce; a campaign to attract young people to the industry, Step up Shoes, has been developed. This has proved successful and is now being transferred to other regions;
- the continuing decline of traditional specialist shoe shops, which could have a significant impact on companies that reply on these as sales channels; and
- increases in the price of raw materials, particularly leather, which will be difficult to pass on to customers.

7. CASE STUDY: RHÔNE-ALPES

7.1 Introduction

7.1.1 The Footwear Industry in France

Industry Structure and Employment

The French footwear manufacturing industry comprises mainly SMEs. By 2010, the number of companies producing footwear in France had reduced to 90, employing less than 6 300 people[110]. This compares to 121 companies and 9 600 employees in 2006 (see Table 7.1). There are also 40-50 tanneries.

Table 7.1: Footwear Industry Structure and Employment in France, 2006-2010

Year	Number of Companies	Number of Employees	Average number of Employees per Company
2006	121	9 602	79
2010	90	6 208	69

Source: CTC

While there has been a significant drop in employment in the French footwear industry, manufacturers try to keep on key members of staff as their skills can be in short supply, especially at the luxury end of the market. According to CTC, many of the French footwear industry employees who did lose their jobs during the economic crisis have managed to find employment in other leather-using industries, e.g. production of handbags.

The majority of French footwear manufacturers are located in five main regions. The largest footwear producing area is Pays de la Loire, accounting for around 34% of the French footwear industry turnover. Other important areas are Rhône-Alpes, which produces mainly luxury footwear; Aquitaine, where indoor footwear and children's footwear are produced; Lorraine and Poitou-Charentes.

Production

Total production of footwear in France has been declining over the years, from 54 million pairs in 2007[111] to 26 million pairs in 2010, a reduction of 52%. This is shown in Table 7.2 (over page). However, Table 7.3 (also over page) shows that production value reduced by only 15% over this period. This is explained by a greater emphasis on the production of high-end luxury footwear.

110 Fédération Française de la Chaussure (2011)

111 Fédération Française de la Chaussure (2011)

Table 7.2: Production of Footwear in France by Number of Pairs, 2004-2010	
Year	**Production (millions of pairs)**
2004	54
2006	44
2008	31
2010	26
Sources: CBI (2010b), Fédération Française de la Chaussure (2011)	

Table 7.3: Production, Exports and Imports of Footwear in France by Value, 2004-2010			
Year	**Production (€ billion)**	**Exports (€ billion) [1]**	**Imports (€ billion) [1]**
2001	1.73	0.93	3.30
2004	1.07	1.07	3.38
2005	1.11	1.11	3.62
2006	1.13	1.22	3.81
2007	1.10	1.34	3.99
2008	0.96	1.37	3.88
2009	0.85	1.30	3.88
2010	0.90	1.49	4.38
Source: Fédération Française de la Chaussure (2011) *Notes:* *1. Includes trade with other EU Member States*			

The French Footwear Federation has sub-divided the 2010 production value in into categories (see Table 7.4). Fashion and leisure footwear accounts for the majority of French footwear production, followed by indoor wear. Sports and other footwear account for only a very small share of total production.

Table 7.4: Value and Production Share by Footwear Type, 2010		
	Value (€ million)	**Production Share**
Fashion and leisure	497.7	55.3%
Indoor wear	261.9	29.1%
Working and safety shoes	120.6	13.4%
Sports and others	19.8	2.2%
Source: Fédération Française de la Chaussure (2011)		

International Trade

In 2010, France exported footwear valued at € 900 million. As Table 7.2 (above) indicated, exports have increased by nearly 40% since 2004, to the point where exports exceed production, indicating that re-export is increasingly important. Figure 7.1 shows the sources of footwear exports from France in 2010. Most exports are to other EU countries, but exports outside the EU include very high average price per pair exports to Hong Kong, the USA and Japan.

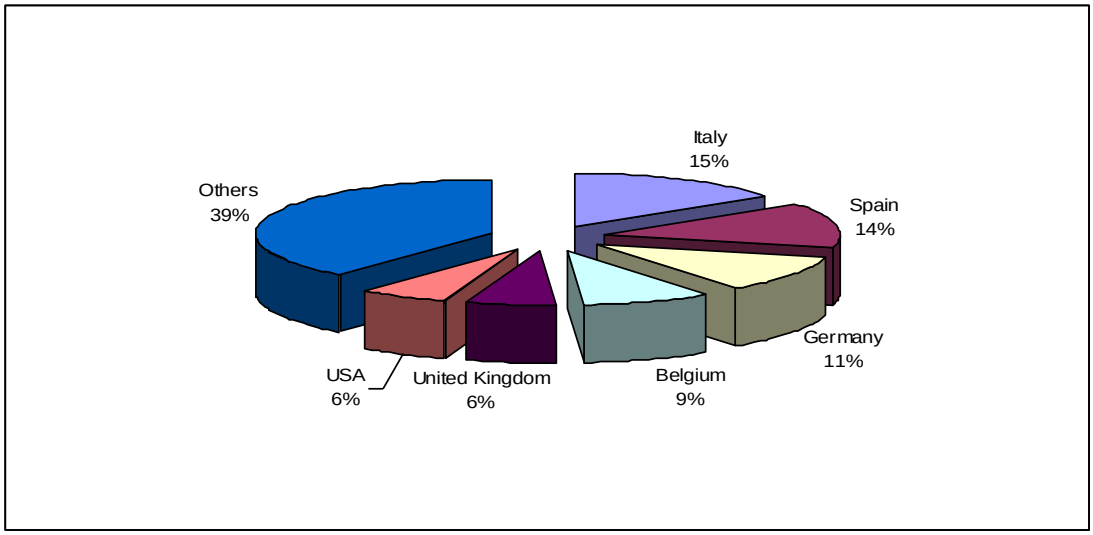

Figure 7.1: Destination of French Footwear Exports by Value, 2010 (Source: Fédération Française de la Chaussure (2011))

The majority of exports by value (60%) are of leather shows, whilst exports by volume are more evenly split between leather shoes (31%), synthetic and rubber shoes (36%) and textile shoes (22%).

France is also an importer of footwear. In 2010, France imported footwear valued at around € 4.4 billion. As Table 7.3 (above) indicated, this represented a nearly 30% increase in value since 2004. Figure 7.2 shows the source of imports of footwear into France in 2010. China and Italy are the main exporters to France, with a notable difference in prices; the average (wholesale) price of a pair of shoes imported from China is €4.53, whilst the average price of a pair of Italian shoes is €26.31.

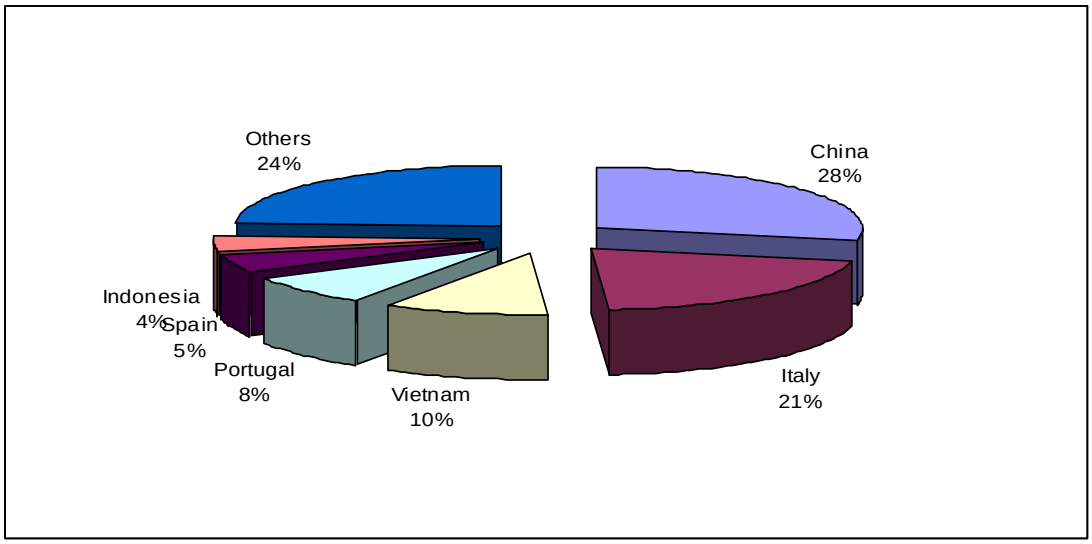

Figure 7.2: Sources of French Footwear Imports by Value, 2010 (Source: Fédération Française de la Chaussure (2011))

Consumption

According to the French Footwear Industry Association (Federation Française de la Chaussure)[112], retail sales in the French footwear market were valued at € 8.6 billion in 2010, an average annual increase of 0.2% since 2004. By value, France accounted for 17.0% of all footwear sales in the EU, the second largest EU consumption market for footwear, just below the leading retail market of Germany. French people bought 415 million pairs in 2010, 6.4 pairs per capita, spending € 132 per year (well above the EU average of € 100 per capita and 4.2 pairs). In 2008, the footwear market grew in volume, despite the global economic downturn. By value, the growth in footwear sales has remained relatively static since 2006; however, volumes grew by 3.4% between 2008 and 2009.

Restructuring and Innovation

The footwear manufacturing industry in France has reduced significantly over the last decade and was further affected by the economic crisis of 2008-2009. As a result, there are now only a small number of companies that still manufacture in France, and those tend to be the high-end manufacturers with specific expertise. These manufacturers also focus on short series production runs that need to be on the shelves quickly. Most companies have relocated all or part of their manufacturing capacity abroad.

The main changes in production trends and characteristics over the last decade in the French footwear industry include[113]:

- **Offshoring**/outsourcing is widely used by French manufacturers. Production has been transferred to near-shore locations such as Portugal, Romania, Tunisia, Morocco, Croatia, Turkey and Algeria as well as far-shored to China and other Asian countries;

- **SMEs** have focused on **specially designed and innovative footwear,** in order to counteract the competition from China and other Asian manufacturers; and

- **high-end manufacturers tend to be in a stronger position;** luxury brands have been more resilient than other brands that do not have such a strong franchise and brand name.

The manufacture of luxury shoes for women has almost ceased in France, in favour of Italian subcontracting. France retains the ability to remain in the luxury shoe segment for woman, if it successfully outsources part or all of the production process to production units providing good value for money.

112 Fédération Française de la Chaussure (2011)

113 CBI (2010b)

7.1.2 The Footwear Industry in Rhône-Alpes

Rhône-Alpes, one of 26 regions of France, is located in the south-east of the country and borders on Italy and Switzerland. It is a traditional area for the textile, clothing, leather and footwear industries. The region also hosts the Centre Technique du Cuir, Chaussure, Maroquinerie (CTC), a technical centre for footwear and leather goods

Rhône-Alpes is one of the more traditional footwear manufacturing areas in France. Production is located in particular in the city of Romans-sur-Isère. Romans has specialised in leather production and footwear manufacturing since the 1850s. While the Rhône-Alpes region is not the most significant footwear producer in France in terms of volume, turnover or employment, it is nonetheless one of the most famous shoe-producing regions in the country. This is due to the historical influence the luxury brands from Romans have had on the sector as a whole. Such brands have been instrumental in creating and promoting France's image as a producer of luxury footwear. The Rhône-Alpes - based producers of luxury footwear are small relative to the large French producers of luxury goods, though. The region is also home to a number of component manufacturers.

The footwear industry in the Rhône-Alpes region has declined significantly recently, with the number of companies in the region falling from 12 in 2006 to seven in 2010 and the number of employees by nearly 52%, from 843 to 408, over the same period. The fact that so few footwear companies are still active in the region made it difficult to arrange interviews. We therefore supplemented the interviews with two local companies by speaking to a further company located just outside the region and to CTC, which has member companies within the region as well as across France.

7.1.3 Organisations Interviewed in Rhone-Alpes

Table 7.5 lists the organisations we interviewed in Rhône-Alpes.

Table 7.5: Organisations Interviewed in Rhône-Alpes

Type of Organisation	Main Activities	Size
Research institute	Research and quality control for the leather and footwear industries	n/a
Footwear manufacturing company	Manufacture of sports footwear and equipment	Large[1]
Footwear manufacturing company	Manufacture of women's and men's luxury footwear	Medium
Footwear manufacturing company	Manufacture of safety footwear	Medium

Notes:
1. Overall company is large in terms of turnover but the footwear operation is micro in terms of number of employees

7.2 Footwear Restructuring in Rhône-Alpes

7.2.1 Types of Restructuring

The main types of restructuring carried out by French footwear companies are product restructuring, locational restructuring and reorganisation of sales channels. Mergers and acquisitions, and closures of plants, have also been important.

7.2.2 Operational Restructuring

The luxury footwear and sports shoe manufacturers we interviewed had not undertaken major Operational restructuring. The luxury footwear company in the region indicated that mastery of old technologies (e.g. Goodyear welting) is more of an issue than developing new ones.

However, the safety footwear manufacturer considered investing in technological innovation to be a critical factor in responding to competition from cheap imports. The company allocates 1.5% of its turnover to innovation. It noted that time to market is reducing, which has required the adoption of software tools for design and fast prototyping. However, the costs of such tools can be a problem, particularly for SMEs.

In addition, CTC has worked with companies, in the region and elsewhere in France, on a range of technological innovations including:

- high-tech systems for detecting defects in leather;
- biomechanical systems to help improve shoe comfort;
- new, clean technologies for materials (including leather and PVC); and
- cost management software.

7.2.3 Product Restructuring

Since the 1970s, the focus of footwear producers in Rhone-Alpes, and particularly in Romans, has been on luxury footwear[114]. This continues today, with companies aiming to develop their brands for new markets. For example, a luxury footwear manufacturer was focusing on designing a range specifically for the Chinese market, following its takeover by a company based in China which could provide access to 400 retail stores.

By contrast, a manufacturer of safety footwear has new materials as its main area of product development. This includes fire resistant materials, abrasion resistant materials or very light components and eco-friendly materials such as chrome-free leather, natural fibres and recycled materials. The company has also developed shoes for workers on forestry that are resistant to chainsaw impacts.

[114] Anon (2001)

One unusual example of product restructuring in the region is the entry into the sports footwear market of a company previously involved in making sports equipment (see Box 7.1).

Box 7.1: Product Restructuring by Entry into the Footwear Market
The company started out as a string manufacturer in the 19th century. It began making tennis rackets in 1994, then tennis balls in 2001. It has been making sports shoes (tennis, badminton and padel, an Argentinian racket game) since 2003. Its shoes are in the €70 - €125 price range, putting them in the medium to high end segment. It aims to make desirable, high quality tennis shoes aimed at the keen amateur sportsperson. It produces around 500,000 pairs per year across 30 models through outsourcing to a single factory in Dongguan, China.
Source: Interview with company, October 2011

7.2.4 Reorganisation of Sales Channels

The majority of French-produced shoes are sold domestically. According to the French statistical office, INSEE, 25% are exported, with 78% of these going to EU countries[115]. However, producers of luxury shoes also focus strongly on export markets, with the US and Europe being the largest markets historically. For example, one luxury shoe maker based in Romans estimates that 60% of its shoes are exported, a figure the management hopes to increase to 80% in the coming years.

Recently, Russia has also become an important consumer of luxury goods. While other emerging markets such as China are not significant consumers of luxury products yet, this is currently changing and demand from such markets is expected to increase significantly in the future. For this reason, French manufacturers of luxury footwear are developing strategies to increase their presence in emerging markets in general and China in particular.

Sales of footwear within France are shared between a number of different market channels. For example, the sports shoe manufacturer sold through sports shops and department stores, relying primarily on its pre-existing retail network (for sports good) to sell its shoes. Table 7.6 shows the breakdown of sales between different channels in France in 2010.

Table 7.6: Footwear Sales in France by Market Channel	
Sales Channel	**%**
Large specialised chain stores	22.5
Sports shops	20.0
Independent retailers	20.0
Chain boutiques	14.5
Large supermarkets	6.5
Mail order	6.5
Clothes shops	5.0
Other	5.0
Source: Fédération Française de la Chaussure (2011)	

115 INSEE (2012)

7.2.5 Locational Restructuring

According to the CTC, many companies in the Rhône-Alpes region outsource at least part of their production to North Africa (Tunisia and Morocco). Luxury shoe-makers tend to outsource the component production (particularly uppers) to North Africa, with final assembly happening in France. This allows manufacturers to affix the "made in France" label on their products (see Box 7.2).

Box 7.2: Outsourcing by Luxury Shoe Makers

A footwear manufacturer based in Romans has three brands; luxury men's and women's range, together with a mid- to high-end segment range.

For the luxury brands, manufacture of the components is outsourced to Portugal and Morocco, with the final product assembled in France in order to maintain the 'Made in France' label. For the mid- to high-end range, making of the whole shoe is outsourced to Portugal and Morocco.

Source: Interview with company, October 2011

Offshoring began in the 1970s[116], first to Spain and Portugal, then to North Africa and, more recently, to China (although some companies maintained their contracts with North Africa). Most offshoring takes the form of outsourcing to third parties, rather than companies setting up their own plants. Offshoring to Eastern Europe is also an option for some companies, but this is mainly done by manufacturers in Italy and Germany.

While China does present a price advantage over other countries, this is reducing as Chinese wages rise. Similarly, many manufacturers have found Chinese contractors to have become less reliable recently, as they are focusing increasingly on their domestic market at the expense of their export clients. This is especially the case with luxury footwear manufacturers. As the production runs for luxury footwear are typically much smaller than mid- or lower- segment manufacturers (perhaps 200 pairs instead of 2000-3000), Chinese factories, whose key advantage is scale, are increasingly less interested in this market segment.

Offshoring to China also presents a range of difficulties linked to geographical distance as well as other factors (e.g. cultural, linguistic). The distance and time involved in getting products from Chinese factories to (mainly European) markets is proving problematic for an industry in which the norm is to produce increasing numbers of collections with ever more models. In this context, reducing the factory to market time requirement becomes crucial to remain competitive. For example, the sports shoe manufacturer's 2013 collection, comprising 30 models, needs to be ready for the sales team by April 2012, which is very tight.

For all these reasons, there is currently a trend away from offshoring production to China and towards bringing it back to Spain, Portugal or North Africa. However, the current political situation in North Africa means some companies may shift their supply from Morocco/Tunisia to, for example, Portugal or Romania. For example,

116 Anon (2001)

the sports shoe manufacturer we interviewed is considering such a move (see Box 7.3).

Box 7.3: Reasons for Considering Moving Production from China

A sports shoe manufacturer has outsourced its shoe manufacturing operations (including making prototypes) to a single factory in Dongguan, China. However, the company is currently considering relocating part or all of its production elsewhere, primarily North Africa, Eastern Europe or other East Asian countries. This is for several reasons including:

- communication problems due to both linguistic and cultural factors;
- Chinese price increases (and unpredictable price changes) making it less attractive;
- shifting priorities within China from export to domestic-led growth; and
- being one small client of a large factory means that they have less influence on production processes, technologies and quality control than their competitors with their own factories. Being a more important client of a smaller factory could go some way toward remedying that.

Source: Interview with company, October 2011

7.2.6 Closure

From the 1970s onwards, Rhône-Alpes has experienced a number of high profile closures. Two of the best-known names in the industry, Charles Jourdan and Stephane Kelian, were affected (although the brands were later bought by the Royer Group – see section 7.2.7). As noted in Section 7.1.2, the number of footwear manufacturers in the region has reduced from 12 in 2006 to seven in 2010.

A number of footwear companies in the region had become high quality producers for fashion labels; their dependence on these labels resulted in their closure when the labels moved their production to other regions. They were joined by the closures of small family firms whose owners had reached retirement age and could not find a buyer. These closures continued into the last decade; as it became more difficult to maintain the competitiveness of manufacturing, even traditional manufacturing companies were threatened.

7.2.7 Mergers and Acquisitions

Companies in Rhône-Alpes have been the subject of a number of acquisitions, focusing on companies with well-known brands that had been unable to maintain their competitiveness. Box 7.4 provides and example of this.

Box 7.4: Acquisition of a Major Brand in Rhone Alpes
The company produces three brands of footwear; a women's luxury brand, a men's luxury brand and a mid- high-end range. The company was acquired in 2011 by the private investment arm of a Hong Kong-based family, with the aim of preparing 'Made in France' collections specifically for the Chinese market over the next two years. The acquiring family also controls the Li & Fung group, which designs, develops and sources consumer products for retailers worldwide, it operates extensive logistics and distribution networks serving major brands globally. The group owns 400 luxury menswear units in China, where the collections will be sold. The acquisition was part of a wider investment in European luxury brands in order to build a leading luxury fashion position in China's expanding domestic market.
Source: Interview with company, October 2011

Similarly, two other companies based in Rhône-Alpes amongst the best-known names in the industry, Charles Jourdan and Stephane Kelian went into liquidation in the mid to late 2000s. The two shoes brands were reopened when they were bought up by the Royer Group, which also owns a range of other brands. Both brands were revived with new collections. Production of ladies luxury fashion shoes continues to be based in Romans, encouraging the production of Made in France footwear[117].

7.2.8 Best Practices in Restructuring

The best practices in restructuring for Rhone-Alpes relate to the way in which companies have taken advantage of market conditions to develop and sell new product ranges. For example, the sports footwear company was able to take advantage of subcontracting production to China, at low cost, to develop a business selling 500,000 pairs of shoes per year with just three full-time employees.

For the company that had been acquired by a Hong Kong based company, the acquisition had made possible a new strategy of aggressive expansion into the Chinese market. This should mean that the company should have fewer competitors to contend with in the future, as it will have a strong starting position in the new market.

7.3 Drivers for Restructuring

7.3.1 Main Reasons for Restructuring

The key drivers for restructuring were the need to maintain the competitiveness of companies in the face of market changes. For example, the aim of a safety footwear manufacturer was to remain cost competitive while maintaining its base in France.

[117] Anon (2010)

7.3.2 International Competition

Trade policies have had a mixed impact on companies in the region. Competition from low-priced imports has clearly been a factor in the closure of companies that were unable to compete with low prices, and in the relocation of manufacturing to cheaper locations outside the country. However, the 'Made in France' brand retains considerable cachet, as illustrated by the acquisition of a luxury shoe manufacturer by a Chinese company, with the express purpose of designing a range for sale to the Chinese domestic market.

CTC similarly recognises that the industry's expectations on trade policy are not uniform across the industry. While larger companies that focus on retail tend to favour policies that encourage lower prices and more open markets, smaller companies that focus on design and manufacture tend to favour the opposite.

7.3.3 Availability of Funding and Other Assistance

Availability of funding was not mentioned as a significant driver of restructuring by any of the organisations that we interviewed.

For example, a sports shoe manufacturer was aware of the Crédit Impôt Recherche offered by the French government, but had not made use of it. The company has not received any form of state support. Similarly, a luxury footwear company noted that the *de minimis* level of €200,000, below which funding is not subject to EU state aid rules is not sufficient to be meaningful to a company like itself (with a turnover of over €20 million). The company had therefore not sought such assistance.

However, the safety footwear manufacturer had received some assistance with investment in innovation from the regional authority, as well as funding from an EU programme on eco-innovation for leather.

In addition, the funding for CTC's research programme comes from a parafiscal tax on each m^2 of leather produced and each pair of shoes sold in France. This tax is collected by the Ministry of Industry then provided to CTC; CTC reports back to the Ministry on how the funding has been used. The Ministry will also provide support for individual research programmes, provided these involve at least two or three industry partners and are innovative. CTC is also supported by the Rhône-Alpes regional authority.

7.3.4 Assistance from Regional Associations

Assistance from regional associations was not a driver for restructuring. However, CTC has assisted a number of companies by undertaking audits at the company sites to ensure that production is organised in the most efficient manner. This may cover the whole production process or only particular parts, such as stocks or injection processes.

7.4 Impacts of Restructuring

7.4.1 Negative Impacts

The most significant negative effect of restructuring has been that many companies were not able to adapt successfully, resulting in a significant reduction in the size of the footwear industry in Rhône-Alpes. This has had a major effect on employment in the Rhône-Alpes region; from 1968 to 2000, footwear companies lost 3 300 jobs[118]. The numbers employed in the industry have continues to reduce, falling by more than half, from 843 to 408 between in 2006 and 2010. The new business models adopted by companies in the region require much lower numbers of staff (see Box 7.5).

Box 7.5: Reduced Employment Requirements of New Business Models
A sports equipment company moved into the shoe sector in 2003 and now produces 500,000 pairs per year across 30 models, under contract at a factory in Dongguan, China. The company has only three employees dedicated to its footwear business; an engineer, a designer and a marketing person. All other activities (such as production of shoes) are outsourced.
Source: Interview with company, October 2011

The companies we interviewed did not highlight particular problems with the restructuring process. The main drawback, for companies that have outsourced production to China, has been communication difficulties due to geographical, linguistic and cultural differences.

7.4.2 Positive Impacts

The main overall benefit of restructuring for companies is that it has enabled them to remain in business. Restructuring has resulted in a number of different business gains for the footwear companies that are still in business. This includes:

- new markets, such as the luxury footwear company's potential new markets in China;
- reduced costs and business efficiency from offshoring production (for example, the sports shoe company is able to operate a business producing 500,000 pairs per year with three staff by subcontracting all production to a factory in China); and
- faster time to market and a larger number of collections per year.

Restructuring has also encouraged manufacturers in Rhône-Alpes to regularly update their products in line with market requirements and to introduce new design elements. For example:

- the safety shoe company had made innovations in terms of design and protection of the foot; and

[118] Anon (2001)

- the sports shoe company had developed products specific to particular surfaces and is developing a celebrity-endorsed shoe.

However, most of these changes are evolutionary in nature. Indeed, for the luxury footwear producer, traditional approaches were seen as an important marketing factor.

7.4.3 Changes in Business Partnerships and the Supply Chain

Some companies have developed close relationships with suppliers and other experts as part of their product restructuring (see Box 7.6)

Box 7.6: Development of Partnerships with Suppliers

A company manufacturing sports shoes has particularly close links with its supplier of rubber for the shoe soles. It has worked with the supplier in order to improve the outsole, tread, rubber formulation according to the tennis court surface. The company has also worked with a podiatrist in order to improve shoe design so that, for example, they provide greater ankle support.

The company's range carries the rubber-supplier's branding on the soles and they receive assistance from the supplier to develop the vulcanised rubber formulations and the structure and design aspects. The branding is seen as an important promotional feature as it is an established name which the consumer knows and trusts.

Source: Interview with company, October 2011

The CTC considers that a key factor in its success has been the close working relationships it has established with companies in the sector. Companies that we interviewed considered that Romans is one of the traditional shoe-making areas of France. This has a positive impact on the reputation of shoe-makers in the town.
Footwear companies in Rhône-Alpes continue to use a range of distribution channels for their footwear. Two of the companies we interviewed were placing particular emphasis on exports. One company plans to use the retail stores controlled by its new parent company, based in China, to provide access to the Chinese domestic market for the first time.

According to CTC, one of the key trends of recent years has been a marked increase in both the frequency of collections and the number of models per collection required by retailers (see Table 7.7). This trend puts increasing pressure on the whole design-manufacturing-sales process, necessitating greater overall efficiency and closer integration of design and manufacturing operations.

Table 7.7: Trends in Collections and Models

Timescale	No. collections per year	No. models per collection
1990s	2	few
2000s	2	several
2011	4	many

For example, the luxury footwear brand now produces four collections per year. This is more than has been the case historically, which makes production challenging. The safety footwear manufacturer indicated that time to market is reducing, which has required the adoption of software tools for design and fast prototyping. However, the costs of such tools can be a problem, particularly for SMEs.

The significant reduction in footwear manufacturing in France has also impacted the supply chain. There are now few equipment suppliers in France, for example.

7.5 Effects of the Economic Crisis

The companies that we spoke to had not been significantly affected by the economic crisis. For example, the sports shoe manufacturer was as a new company in the market, but with a strong pre-existing tennis racket brand, and had grown significantly in recent years. For this reason, the economic crisis has not had a discernible impact on their shoe business.

However, the luxury footwear company indicated that the economic crisis had made emerging markets more attractive relative to mature ones. This was a decisive factor in the company's acquisition by Hong Kong based group and subsequent strategy of designing luxury collections specifically for the Chinese market.

7.6 Future Trends in Restructuring

7.6.1 Expectations of the Industry

In terms of future trends, the safety footwear manufacturer considered that the focus would be on:

- further reductions in time to market, through the use of new software and reorganisation of the supply chain;
- new materials and manufacturing methods to meet the requirement for sustainable development;
- more partnership in research, between industry, the CTC, the industry association, universities and experts in specific fields; and
- more and more skills will be required to be successful.

Two years ago, CTC anticipated that the focus of research would be less on technical aspects and more on new products and new markets. However, this has not happened. It is apparent that French manufacturers want to remain as manufacturers and continue to focus on research to improve productivity and equipment. Products continue to be important, of course, focusing on new properties and meeting the needs of changing markets (e.g. for older people). Going forward, innovation may be focussed more towards sustainable development.

7.6.2 Barriers to Restructuring and How to Overcome Them

According to CTC, the French footwear industry as a whole suffers from skills shortages, particularly at the luxury end of the market. The luxury footwear company that we interviewed indicated that skilled shoe-makers are increasingly hard to find, especially people capable of producing "luxury" items.

Therefore, the qualified workers currently in Romans are particularly valuable to the company (see Box 7.7).

Box 7.7: Problems of Skill Shortages

A luxury footwear producer wants to maintain the high quality of its products, as this is intrinsic to their market value. However, there is an acute shortage of skilled staff in the industry.

For example, the company only has two people capable of producing a Goodyear welt[119]. The company estimates that there are no more than seven people in France able to do this. The company is therefore trying to train people in some of its key activities, but this is a lengthy (seven months) and costly process.

Source: Interview with company, October 2011

7.7 Summary

The footwear industry in Rhône-Alpes has seen significant changes in recent years, with a 40% reduction in the number of companies and a 52% reduction in the number of people employed in the sector. There is a long-term downward trend in production and, although exports have increased over the past 5-10 years, the balance of trade remains significantly negative. The key driver for restructuring in the Rhône-Alpes region was the need to maintain the competitiveness of companies in the face of market changes.

The main types of restructuring carried out by footwear companies are product restructuring to meet the changing needs of the market, locational restructuring through outsourcing and offshoring of production to North Africa, Portugal and China and reorganisation of sales channels to focus on growing markets, including the Chinese domestic market. Mergers and acquisitions, and closures of plants, have also been important.

Trade policies have had a mixed impact on companies in the region. Competition from low-priced imports has clearly been a factor in the closure of companies that were unable to compete with low prices, and in the relocation of manufacturing to cheaper locations outside the country. However, the 'Made in France' brand retains

[119] Goodyear welting is a traditional form of shoe construction used mainly for mens' quality products. The upper is lasted in the usual way, but secured to a rib on the underside of the insole. A welt (a strip of leather) is then sewn onto this rib and flanged out so that a sole can be attached to the rib using a lockstitch. The key point is that the shoe can be repaired regularly by unpicking the welt sewing and replacing the sole and restitching. It produces a more substantial (and expensive) product, hence the emphasis on quality.

considerable cachet, as illustrated by the acquisition of a luxury shoe manufacturer by a Chinese company, with the express purpose of designing a range for sale to the Chinese domestic market.

Companies in the region anticipate that competitive pressures will continue in future, with an emphasis on further reductions in time to market. Products will also need to be further developed to meet consumer needs, including customised ranges and new, more eco-friendly materials and production methods. This factor has encouraged some companies to consider switching production back from China to locations nearer to France. One potential barrier to further restructuring is from skills shortages, particularly at the luxury end of the market.

8. KEY FACTORS AFFECTING THE SUCCESS OF RESTRUCTURING AND MODERNISATION

8.1 Introduction

The European footwear industry has been subject to an elongated period of transition since the early 1990s, following increasing competition from countries with lower production costs. The EU footwear industry has changed from a near equilibrium in international footwear trade to a trade deficit in 2010 of €5.5 billion[120]. A key reason for this change is the full integration of China into world trade. During the period 2001 to 2010, imports from China into the EU increased from 420 million pairs per year to almost 1.9 billion. A major factor in such high import penetration is the low price of Chinese footwear, an average of €4 per pair (wholesale); this is less than a quarter of the price of intra-EU imports and is considerably lower than imports from other Asian countries.

In response to these market pressures, the EU footwear industry has undergone a period of substantial restructuring, resulting in significant changes in output and numbers of companies. EU manufacturers have sought to maintain their competitiveness using two main business models, although in practice there is overlap between them and a single company may adopt different models for different product ranges. These include:

- a 'low road' model, with offshoring/outsourcing of all or part of the production process to countries in Asia or eastern European with cheaper labour, as well as introducing cost cutting measures, which have resulted in a reduction in employment within the sector; or
- a 'high road' model, seeking to develop into niche markets through innovation and quality.

The rate of reduction in EU production has now started to slow down, as the restructuring process has enabled the industry to adapt more effectively to the new global trading environment

8.2 The Process of Restructuring

8.2.1 Overall Strategies

In section 2 we noted that the literature in social sciences has differentiated between a 'low-road' approach to restructuring based on a strategy of cost leadership, offshoring production to low wage countries and/or outsourcing, both near and far, and a 'high-road' trajectory of restructuring. The latter is based on strategies of diversification and innovation through internal restructuring, business extension and offshoring/outsourcing. 'High road' trajectories of restructuring are also based on

[120] APICCAPS (2011a)

regional and national institutions fostering, for example, collaboration in education and training and R&D with non-profit institutions. However, these are ideal-type strategies. Our research has shown that, in practice, restructuring involves a host of hybrids in different regions (and even within individual firms).

The case studies covered regions in five EU countries, two from southern European (Portugal-and Italy) two from the Northern European industrial core (France and Germany) and one new Member State (Poland). Each country has followed a different trajectory in restructuring.

Footwear companies in **Rheinland-Pfalz** have combined aspects of the 'low road' approach, addressing competitive pressures through offhsoring the high-cost aspects of production to China and eastern Europe (see Box 8.1) with 'high road' aspects of retaining their technical competence and innovation in products.

Box 8.1: Stages of Restructuring in the Rheinland-Pfalz Region

The Rheinland-Pfalz region previously hosted an integrated footwear cluster, of equipment manufacturers, suppliers and footwear assemblers. During the 1980s and 1990s German footwear companies separated production into different steps and outsourced certain steps, such as upper production to Portugal and eastern Europe and mass production to Asia. The main driver was lower wages in these countries, which reduced costs. This also was the phase of operational restructuring in process technologies.

From the 2000s onwards, the focus was on product quality, design and improvement of own brands and the search for market niches. The drivers were increasing international competition and the decline of the middle range segment in traditional markets.

Currently, restructuring is even more focused on investment in design and product quality, maintaining market niches and increased efforts to ensure access to sales channels. Part of this strategy is to improve production technologies for efficiency in small batch production and fast access to the market. This has resulted in a trend of relocation of production back to Europe (but not Germany) from East Asia.

Source: Interviews with companies and associations in Rheinland-Pfalz, November 2011

The main strength of the German footwear industry appears to rely on technical competence in product design. After unsuccessful experiences with targeting market niches, such as ecological and orthopaedic shoes in the early 2000s (with even a recently-founded firm going bankrupt after five years), companies have focused on strengthen their competencies in design, branding and, finally, in investment in their own sales channels (takeover of retail chains, internet retailing). More recently, the survival of small brand owners has been put into question as sales channels seem to have become extremely difficult for them. As a result, there has been consolidation through mergers and acquisitions, where family owners acquire groups of brands to target different market sectors.

The development of the footwear industry in **Norte** from a small-scale, domestically focused sector began in the 1980s when it became an outsourcing location for major brands, in particular from the UK and Germany, adopting a 'low road' approach, because of its low labour costs. When these companies subsequently moved their production to even cheaper locations, the industry went through a second phase of

restructuring (see Box 8.2). The focus of the industry has always been on exports, because of the small size of the domestic market. It is now focused on a 'high road' approach of developing brands and improving the quality of products, together with improving marketing and sales skills, to access high-value markets in northern Europe and elsewhere.

Box 8.2: Stages of Restructuring in Norte

During the 1980s, foreign-owned footwear companies moved into Norte to take advantage of lower labour costs. This contributed to a rapid growth in footwear exports and required local companies to adopt more modern, large scale production methods.

However, the increased ease of importing into the EU in the 2000s saw many of these foreign-owned firms move their production to countries outside the EU with lower costs, particularly China and India. This resulted in the closure of foreign-owned factories and a reduction of output and employment amongst Norte companies that relied on the foreign-owned firms for sub-contracts. The average size of firms reduced. Portugal's footwear exports fell significantly during this period and imports of cheaper shoes grew.

Since 2005, the footwear sector in Norte has adapted to the new market conditions through a strategy focused on innovation, increased development and promotion of own brands based on fashion and quality rather than subcontracting, and the use of technology to improve flexibility. The customer base has widened, with a continuing emphasis on exports. This restructuring has enabled the sector to remain relatively resilient through the economic crisis.

A key factor is that, during the period of subcontracting, Norte companies often produced the full shoe, with limited disaggregation of assembly and upper production. This allowed the companies to continue with integrated production of the full shoe and enabled them to focus their efforts on new functions such as distribution, branding and logistics

Source: Interviews with companies and associations in Norte, October 2011

Southern Poland has followed a similar trajectory to Portugal in moving from mass production to a more flexible approach. However, unlike Portugal, the shift from mass product subcontracting to brand ownership ('low road' to 'high road') is still ongoing. Until the end of the 1980s, the Polish footwear industry mainly produced low-cost exports, to both Russia and the EU. The first stage of restructuring was the privatisation of large, formerly state-owned footwear companies. The second stage of restructuring arose when the large companies found it impossible to compete in a market system and many of them went bankrupt and were broken up. Most footwear production in the country is now undertaken by private firms, mainly SMEs. These smaller companies combine some subcontracting for major European brands with development of their own brands. Unlike Portugal, Polish companies have followed the strategy of fragmenting production (which enables them to relocate production to Romania or even Tunisia). Furthermore, as the domestic market is still growing, some companies have focused on the local market through establishing brands and improving sales channels.

Rhône-Alpes appears to represent a region with a traditional footwear industry that has been squeezed out of the market due to high costs and unsuccessful strategies by companies to develop their brands and access the market. Some of the footwear companies in the region became high-quality contract producers for fashion brands and were forced to close when the brands moved their production to other regions,

similarly to Portugal. This has resulted in a gradual decline over the years to the point where very few footwear companies remain in the region. The few remaining firms have mainly adopted a 'high road' approach, focused on design and pattern production, with some finishing for the luxury end of the market and niche areas. The market focus is on exports, including exports to China. However, one sports footwear company in the region has adopted the opposite, 'low road' approach, with total offshoring of production to China.

The footwear industry in **Veneto** has traditionally been focused in clusters of SMEs, based on decentralised production and flexible specialisation. In the last decade, this model has been put under significant pressure by increased competition in international markets. Within the Veneto region, different clusters have adopted different approaches to restructuring (see Box 8.3).

Box 8.3: Varying Restructuring Strategies in Veneto

Montebelluna is dominant in technologies for the production of ski boots and other sports footwear. Companies in the cluster have focused on developing and promoting their own brands, offshoring production to lower labour cost locations whilst responsibility for design, R&D, marketing and sales remains in Montebelluna. As a consequence, the cluster has lost the more standardised end of the manufacturing process but has retained the highest value-added and creative activities. Restructuring has enabled companies to expand their output and turnover rapidly in a cost efficient way.

Companies in Brenta, mainly SMEs**,** produce medium and high price fashion footwear. They have restructured by subcontracting for major fashion label companies that entered the luxury footwear market in the mid-1990s. This process contributed to increased competition among local firms, accelerating closure of the less competitive. Many firms have merged and small Italian multinationals have been created. For the firms remaining in business, subcontracting for fashion labels has provided stability and growth, allowing them to remain in the market without having to relocate production to remain cost-competitive. However, their independence has been compromised. They depend on orders from major brands and are finding it difficult to enter the market with their own product.

Source: Interviews with companies in Veneto, October 2011

Competitive pressure has led firms in Montebelluna to grow in size, through mergers and acquisitions, and cut costs through subcontracting labour-intensive operations to countries with lower costs 'low road' approach. There is a along history of offshoring production, starting with sports brands in the 1960s and extending to all types of production in the 1990s.

Companies in Brenta, by contrast, are at a similar stage to those in Norte in the 1980s, as they are highly dependent on sub-contracting. In contrast to Norte, however, this subcontracting is for luxury fashion brands and is more driven by quality than price. However, companies in Brenta are seeking to adopt a similar approach to those in Norte, with an increasing focus on developing and marketing their own brands ('high road' approach).

8.2.2 Types of Restructuring

The different strategies have implications for the types of restructuring undertaken. However, this is also influenced by the resources available to companies and their historical development. One common feature is that it is not a single type of restructuring that is the norm, but a combination of approaches.

The process of **operational restructuring** is very dependent on the strategy adopted, as strategies involving large-scale production of footwear require very different technology from a focus on small-scale, niche production. In Norte, for example, subcontracting for foreign brands led some companies to invest in large, mechanised production lines. This equipment was unsuitable for the move to smaller-scale niche production which followed the loss of subcontracts, and some companies have now mothballed or disposed of the equipment.

The current focus on niche markets and more fashionable footwear relies on smaller batches and faster response times. This requires innovation in equipment to enable greater flexibility as well as organisation of factories and more effective production management. In Norte and Southern Poland, this has involved the introduction of water jet and laser cutting equipment, while in Rheinland-Pfalz oscillating knife cutters are seen as providing higher quality. IT advances such as CAD/CAM systems have been critical to companies in all of the case study regions in delivering the increased emphasis on design and more frequent changes in collections, or both small and large companies.

For some niche markets, particularly high end fashion footwear, a lack of technology can be seen as an advantage, with brands trading on the fact that footwear is hand made. For example, doing things 'the old way', which is increasingly valued by customers, is an important part of the brand profile for some manufacturers in Norte.

Different approaches have also been adopted to **product restructuring**. For companies that continue to manufacture in the EU, primarily SMEs, the focus has been on developing products for niche markets, where price is less of a consideration. Innovative design is a key factor, including rapid response to fashion trends and a greater range of styles and colours. EU manufacturers are also targeting niche markets, such as safety footwear with design and fashion elements, specialist work footwear for hospital staff and shoes for people with foot problems. We also found examples, in Norte and Southern Poland, of sole manufacturers moving into designing and manufacturing their own ranges of footwear.

Quality and design are also important factors for larger companies. Brands are vital to the sector, although the closure of companies in Rhône-Alpes has shown that possessing an established brand is not sufficient in itself. The approach to product restructuring varies by country and by market segment. For example, shoe producers in Germany have a tradition of comfort in shoes, but are now aiming to supplement this by being more fashionable. Italy still has the highest reputation in fashion terms and aims to retain this through rapid changes to collections. For sports footwear

manufacturers, footwear technology and new materials are the focus of product development.

Approaches to **reorganising sales channels** also vary according to the overall restructuring strategy and the way the retail market operates in different countries. The key elements are developing new sales channels and new markets. In Norte, companies that had previously focused on subcontracting needed to develop new competencies in marketing when they moved to producing their own brands. This is a problem faced by companies in Brenta that mainly produce under contract for fashion labels but wish to develop their own brands. Southern Polish companies have a similar problem, compounded by the relative lack of development of footwear retailing in the country.

Footwear companies have adopted different approaches to marketing. Some companies, both large and small, have decided to open their own stores as a way of developing sales channels, either mono-brand stores or in cooperation with other manufacturers. For small companies, in Southern Poland for example, this can be a single store; for larger companies it may involve setting up or purchasing retail chains. One problem for companies that have their own stores is that of competition with their established retail customers. Companies in Norte, for example, were reluctant to set up their own stores because of concern that this could reduce sales elsewhere. Another issue is the level of investment required to establish a retail presence.

Although some companies in all the case study countries are embracing internet retailing, others are more reluctant. One reason for this is concern about competing with retail customers. Some companies instead use their web sites to inform consumers about the stores where their footwear is available. Others, such as a company in Poland, have used IT to facilitate selling by traditional salesmen; the salesmen use an integrated online ordering system to process sales made to retailers in real time. Another concern is the practicality of internet retailing for footwear, given differences in sizing and the attitudes of consumers. One company in Germany noted that the level of returns on shoes sold via the internet is very high; only a few specialist firms have return rates below 50%. Customers tend to order several pairs at once, intended only to buy one pair, as a substitute for trying on several pairs in a shop. However, online retailing does allow companies to be closer to consumers and to understand what the market wants. One way round the practical problems for shoe manufacturers is to sell via an established online retailer.

At the same time as some manufacturers are moving into retailing, some traders are moving into footwear production. For example, traders in Belgium and the Netherlands import cheap footwear then re-export it with a higher margin. They have responsibility for financing, design, branding, sales and promotion and distribution. Indeed, Belgium has a higher positive export balance in footwear than Portugal, despite having no production. Retailers in Germany, Italy and Spain are also following this route.

Another important focus of reorganising sales channels is a focus on exporting, particularly for manufacturers in countries where the home market is dominated by cheap imports. For example, one of the key features of the restructuring strategy in Portugal is exporting, primarily to other EU countries but increasingly outside the EU. Italy has also focused on exports, and remains one of the largest exporters of footwear in the world. Nevertheless, the majority of exports by EU manufacturers are still to other markets within the EU; exports to third countries tend to be niche-based and often related to past ties (for example Portuguese exports to Mozambique and Angola).

Locational restructuring has been a feature of all of the case study countries. In the case of Norte (initially) and Brenta, this involved inward relocation, with local companies acting as sub-contractors to major brands. In other cases-study areas (and Norte in the second phase of restructuring) it involved relocation of production to lower cost areas outside the country.

There are different models of locational restructuring, and individual companies may adopt a range of models at the same time. The models vary in terms of:

- the countries to which production is offhsored. This is affected by geographical proximity (e.g. Veneto producers offshoring to Romania and Tunisia, German companies to Hungary and Slovakia, Rhône-Alpes and Norte companies to North Africa) and type of production (mass production to China and India, higher quality fashion and component production to eastern Europe);

- whether the offshoring producer establishes its own factories or outsources via subcontracts. This again can be a feature of geography, with relatively few companies establishing their own plants in China, and also of the financial resources of the producing company. Outsourcing allows for greater flexibility whilst owned factories allow for greater control (which is likely to be more important at the higher-priced end of the market);

- whether the subcontractor works solely for one producer or for several. A number of smaller EU producers noted that being only one of several of a subcontractors' customers could cause problems in delivery and quality, if priority was given to other customers;

- whether only component manufacturer is offshored or entire shoe making. A number of companies that have offhsored most of their production still assemble or finish footwear in their own countries, partly to control quality and partly to be able to use 'made in' labels; and

- the extent of control that the producer has over design and quality. While the general model is for design and quality control to be retained in the manufacturer's home country, some companies (especially retailers) buy 'ready made' shoes from producers, particularly those in China. We were also told that some retailers ask their subcontractors to copy models produced by European brands.

One interesting development in locational restructuring is the trend by certain companies to move at least some of their production back from China. in particular to the lower cost areas of Europe. The main reasons for this are the rising costs in China and the awareness that relocation to other (low-cost) countries in Asia, such as Indonesia, means high learning costs at the beginning. At the same time, proximity to the market is increasingly required due to the need for product quality, flexibility, and speed to market and due to changing retail structures.

Closure of footwear companies has been a feature of all of the case study countries, and the number of footwear companies within the EU has contracted significantly during this century. There was a continuous reduction in the number of footwear firms in the EU between 1999 and 2007. Eurostat data[121] indicates that the number of firms in the footwear industry fell by 10% between 2004 and 2007 alone. Figure 2.1 (in Section 2) illustrates that the numbers of footwear firms in Europe fell from from over 33 000 in 1999 to around 26 000 in 2007.

Mergers and acquisitions have also been important in several case study countries. These include mergers of footwear companies within a region (this has been a particular feature in Veneto where multinational companies have acquired a number of historic local brands and local companies have also acquired foreign brands), acquisition of bankrupt firms which own important brands, including by purchasers from outside the EU, and acquisition of retail chains by footwear manufacturers.

8.3 Drivers for Restructuring

8.3.1 Types of Drivers

We noted in Section 2 that differentiation between endogenous and exogenous drivers or between push factors (in the sense of traditional migration theory: pushing the footwear sector out of Europe) and pull factors (attracting footwear companies to a location abroad) seems somewhat arbitrary in the case of the EU footwear industry.

This has been demonstrated by our case studies. For example, the entry of China into the WTO and the subsequent reduction in import tariffs to the EU was an exogenous driver. However, the higher costs of production in the EU could be considered partly endogenous, in that they were linked to failure to invest in more efficient production. Similarly, the ability to manufacture cheaply in China, without facing high import duties, created a 'pull' factor for companies to relocate production there. However, the fact that cheap imports were then able to enter the EU market created a 'push' factor for the companies that had retained their manufacturing in the EU. For some companies, this resulted in the need for a rapid decision on whether to move production (see Box 8.4, over page).

[121] Eurostat (2011):

Box 8.4: Complexity of Drivers for Restructuring

A UK company, which produces a major brand of boots, shoes, sandals and safety footwear offshored almost all of its production to China over a period of six months. While the shoes' leather uppers had been made in China, Vietnam and Romania for some time before restructuring, most of the product manufacturing had stayed in Britain. Two of the suppliers of uppers were the first subcontractors for offshoring.

The company moved its machinery to these subcontractors and trained their staff in its use.

The restructuring was driven totally by cost. The company was facing financial disaster; it lost about £20m in 2001. Its gross margin in the UK had fallen from the mid-40s% to the low20s% and it could not increase the price further as the market would not accept it. This margin was insufficient for investment in marketing or capital equipment, which meant the company would no longer be able to compete as a brand. All of the company's competitors had already offshored their production.

Since offshoring, the company has developed its own retail presence in Asia (previously it only had UK and US stores, it now has 22 in Asia). It also has a growing e-commerce business. Offshoring of production enabled the company to substantially reduce its costs and remain in business. The company believes there is no viable alternative to this business model; the source countries and suppliers might change, but offshore production will continue to be the model. Offshoring effectively saved the company and it is now profitable and growing.

Source: Interview with UK company, October 2011

8.3.2 International Competition

The key driver for restructuring in every cases-study country was **increased competition**, particularly from low-cost producers in Asia (with China being the largest threat). Not only has imported footwear taken an increasing share of the EU market, it has also lowered customers' expectations in terms of price. Although few companies mentioned trade policy specifically as a major driver, this clearly underlies the increase in competitive pressure that they are facing.

Large volume EU producers had already begun the process of relocating production from higher-cost EU countries, such as Germany, the UK and Italy, to lower cost regions such as Portugal, Romania and Hungary in the 1980s and 1990s. Changes in EU trade policy made it easier for these companies to transfer production to even lower-cost locations outside Europe. Large volume had to follow this route or risk becoming uncompetitive and closing (see Box 8.4 above). Other EU footwear manufacturers responded by changing their business models away from ('low road') competition with low cost countries, focusing instead on innovative products, style and service which cannot be matched so easily by competitors outside the EU (the 'high road' model).

8.3.3 Competition Within the EU

A further aspect of competition that has driven restructuring is the trend towards fast fashion, leading to more frequent collections and a wider range of styles and colours. This has required a more flexible approach to production, marketing and logistics.

Competition in sales channels has also been a driver, particularly for companies in Germany. Here, concern about losing future access to customers has been a driver

behind certain companies opening their own stores and even acquiring retail chains threatened with insolvency.

8.3.4 Availability of Funding

None of the companies and other organisations we interviewed, in any of the case study countries, considered the availability of funding to be a driver of restructuring in itself. However, the availability of EU, national and regional funding has facilitated the restructuring process for some companies. This has been more successful in some case study areas than others. For example, Norte companies have made use of funding for training (from the European Social Fund) and for trade promotion (from the European Regional Development Fund). Indeed, the footwear sector has made more use of trade promotion funding, to help finance attendance at trade fairs, than other sectors of the economy in Portugal.

By contrast, companies in the other case study regions appear to have made little use of such funds. A number of companies in Veneto and Southern Poland had applied for EU funding but had been unsuccessful, even in the case of a Southern Polish footwear firm that had hired a consultant specifically to help with its application. Authorities in the Rheinland-Pfalz area recognised that they had not been successful in general in accessing EU funds and were planning further training of officers on this issue. Several companies indicated that the administrative requirements of the application process were too demanding.

Companies in several of the case study countries have also made use of EU 7th Framework Programme funding for technology development; however, some companies expressed concern that EU-funded projects tend to be some distance away from their practical needs.

8.3.5 Assistance from Regional Associations

The extent of assistance available from regional (and national) industry associations varied considerably between the case study regions. In Norte, APICCAPS has taken a leading role in driving restructuring and innovation in the footwear sector in this later phase. It has developed a Strategic Plan for the sector, covering the period 2007-2013, which was agreed by all members and is being implemented by the companies.

Regional and national associations have not played a similarly proactive role in the other case study areas, although associations in Italy have supported their members through restructuring, including providing assistance with training and marketing.

8.3.6 Effects of the Economic Crisis

The overall view from the companies and organisations that we interviewed was that restructuring has enabled the footwear sector to remain relatively resilient through the recession so far. Although most companies we interviewed had lost sales initially, they were poised to take advantage of market upturns and in many countries sales had increased in 2010 and 2011. An increased focus on exports had also enabled

companies to take advantage of better market conditions in certain countries. In addition, the luxury market was less affected by the recession than other segments, so the general trend of moving to higher price brackets had helped insulate many companies. One company in Rheinland-Pfalz indicated that seasonal fluctuations had been a more significant influence than the economic crisis on short-term profitability.

The footwear industry in Europe remains heavily dependent on the EU market, however, and the state of the EU economy remains a major concern for the companies we interviewed. One company noted that the economic crisis had led to significant reductions in sales in some markets (its sales to Ireland fell by 50%), although some markets are now recovering. Customers are also more risk averse; one manufacturer noted that distributors immediately reduced stocks and many now purchase more frequently in smaller batches, which requires an efficient logistics system.

Access to credit remains an issue for some companies, particularly SMEs in the countries most affected by the recession, such as Portugal. As a consequence, most restructuring activities have been financed by companies' internal resources. Nevertheless, cash flow remains a critical issue for the sector, especially for smaller firms and, as with SMEs in other sectors, there is a risk that even companies with full order books could fail because of a lack of short-term credit.

The economic crisis has also affected footwear retailers, causing them to be more risk-averse and ordering smaller batches and less expensive models. One German footwear manufacturer had responded by offering better customer service and more rapid restock; orders used to be around 80% up-front and 20% restock, but were now only 40% to 50% up front. This increases risks for the manufacturer, as it now has to produce for stock.

8.4 Key Success Factors

Despite the turmoil of recent years in the footwear sector, and the difficult economic outlook, the overall view of most companies and organisations that we interviewed was quite positive. A number of different factors had contributed to this success.

A key reason for the success of the Norte footwear industry in restructuring has been the **close partnerships** that exist within the industry and with the Government. The footwear industry association, APICCAPS, has played a very active role in developing an overall strategy for the sector and assisting companies to implement that strategy. Together with its research institute, CTCP, it has helped to bring researchers, equipment suppliers and manufacturers together to address the challenges of the new market conditions. It has also helped companies to access EU and national funding, for research and for marketing.

A similar situation is found in Italy, with the cluster system still operating despite the effects of restructuring and strong national and regional associations helping companies to address the challenges they face. The regional industry association considers that the secrets of Montebelluna's success are the high level of integration

of the production cycle, along with the presence of a highly specialised supply chain. The presence of education and training facilities in the region is also an advantage. In both Veneto and Norte, there is still a considerable amount of local outsourcing, taking advantage of the proximity of subcontractors to enhance flexibility.

This level of cooperation does not appear to exist in the other case study regions. In Rheinland-Pfalz the local association noted that companies have only recently begun to cooperate rather than compete, probably a consequence of the drastic reduction in the numbers of firms. However, there are strong relationships with the local research and training institutes. In Southern Poland, too, cooperation appears to be emerging between larger companies, but SMEs continue to be suspicious of their competitors, with only a few examples of companies joining together (for bulk buying of supplies). In Rhone-Alpes, the small number of manufacturers remaining in the area makes cooperation between them difficult, but the industry appears to retain close ties with the research institute in the area and the shoemaking tradition of the area is still seen as having a positive impact on the reputation of shoe manufacturers in the region.

These differences demonstrate that proximity of different actors in the footwear industry is not sufficient in itself to ensure success of a region. Instead, it needs active cooperation amongst stakeholders. In Norte and Veneto, the role of industry associations appears to have been critical in promoting such an approach.

The level of support to the sector from the **National and Regional** Governments also appears to be a factor. The Portuguese Government has been very supportive of the footwear industry and has helped it to access EU funds. The sector has a good reputation with the Government because of its record in exports and has received assistance in the form of export credit guarantees, which have been very important, as well as small grants for SMEs to work with consultants/advisors and assistance to APICCAPS in developing the strategy for the sector. By contrast, a company in Rheinland-Pfalz noted that the shoe industry has always been a small part of the German economy, so is not influential at Federal Government level. There is more interest at regional and local level, but this has not necessarily resulted in effective support. The French government supports research in footwear through a parafiscal tax on shoes and leather products, but this has not halted the decline of the sector in Rhône-Alpes.

Another key factor in successful restructuring has been **flexibility** in the face of changing market conditions. The manufacturing companies that have remained in business and been successful are those that were best able to adapt to the new requirements. In Norte, many of the remaining SMEs are family firms, where younger generations entering the business were able to change the focus of their companies from production to design and quality. Companies were also able to develop skills in marketing and distribution to adapt to the move from single subcontracting customers to dealing with large numbers of retailers. For larger companies, the ability to remain competitive has been linked to the flexibility provided by outsourcing production. This has led to a very adaptable system, where production can be closely geared to market requirements. This flexibility is one

reason why footwear companies appear to have been relatively resilient through the recession.

The ability to **differentiate their products** has been an important factor in allowing EU footwear manufacturers to remain in business. Focusing on factors such as fashion, comfort and safety has enabled them to avoid direct competition with low-cost competitors. The basis for differentiation varies between the case study regions, although fashion is an important aspect for most markets. For example, a Portuguese manufacturer of safety footwear has differentiated through designing safety footwear specifically for women, with a fashionable style, and for men with designs resembling football boots. Emphasising their national origins, particularly for Italian firms, has also been a way to differentiate products.

Differentiating in terms of **sales channels and branding** has also been key. Finding new ways of accessing the market has been particularly important for footwear manufacturers. In Rheinland-Pfalz, firms initially focused on developing strong brands and sold through traditional specialist retailers. Now they are faced with competition for stores by large retailers producing and selling their own brands and by international firms opening mono-brand stores. In response, manufacturers have taken steps to ensure access to sales channels through acquisitions, opening their own retail stores (as mono-brands or with complementary brands) and develop e-commerce initiatives. Similarly, when moving away from subcontracting, Norte companies needed not only to develop their own brands but also to develop ways of selling. For most companies, this involved setting up systems of salesmen and agents, with specialist footwear stores as the main sales channel. A similar problem is being faced by companies in Brenta that are currently subcontracting for fashion brands.

8.5 Barriers to Effective Restructuring

The companies and organizations that we interviewed identified a number of barriers to effective restructuring.

One remaining barrier identified by companies focusing on exports is the **lack of openness of non-EU markets** to EU footwear exports. Most exports by EU footwear companies are still to other EU countries, and exports outside the EU are limited. There is greater potential for growth in other markets; China in particular and to a lesser extent in the other BRICS countries, in future. Lack of access to these markets could constrain future growth. Although some companies and organisations still call for tariff barriers against imports, most organisations recognise that competition is now a fact of life.

Another barrier, identified by many of the companies we interviewed, was increasing **difficulty in recruiting younger people** to replace ageing workforces. This was identified as an issue in Norte, Veneto, Rhône-Alpes and Rheinland-Pfalz. There are two aspects to this problem. Firstly, there is a lack of people with specific skills, such as lasters and finishers, particularly at the luxury end of the market. For example, one company in France estimates that there are only seven people in the country capable

of producing one particular type of welt. The average age of staff with these skills is high, so this could become a significant problem in future. Secondly, it is difficult to recruit young people to production roles in the industry because of its poor reputation; young people do not consider that footwear manufacturing has a future. An example of this issue in Rheinland-Pfalz is given in Box 8.5.

Box 8.5: The Problem of Recruiting Young People

The Federal Employment Agency carried out a review of the current workforce in the footwear sector in the region as part of a national initiative, which mapped the characteristics of the labour force and provided an analysis of future trends both in relation to skills demand and supply. Previously it had not focused on the shoe sector because it was not offering jobs.

The study found that 41% of production staff in the sector are in the 50-65 age group; most of these will leave in the next 5-10 years. It has been difficult to recruit young people into the sector because of the adverse effect of previous job losses; shoe making is seen as an industry with no future. However, companies in the region indicated that there was a need to recruit, even in production jobs.

Source: Interview with Federal Employment Agency, November 2011

Access to credit is a concern for some footwear firms in some countries, particularly smaller companies in the countries most affected by the recession, such as Portugal. As a consequence, most restructuring activities have been financed by companies' internal resources. Nevertheless, cash flow remains a critical issue for the sector, especially for smaller firms and, as with SMEs in other sectors, there is a risk that even companies with full order books could fail because of a lack of short-term credit.

Several companies and organisations also raised concerns about the difficulties of **protecting designs.** A company in Rheinland-Pfalz identified copying of designs by retailers selling their own brand products as a particular concern. The retailers know what will sell, from their closeness to the consumer, and need high margins to afford their city-centre locations. They therefore have cheaper copies of brand designs made in China for their own label, but sell them for only a little less than the brands (around 10% cheaper). The quality of the copies is poor, which could be damaging to the brand as customers may perceive them to be the same.

Many of the companies we spoke to had not taken action to protect designs, because they considered that the current process for protection is not really effective. Companies considered that patenting innovations is costly and takes too long; simply registering a brand can take two years. Companies need expertise to obtain patents and protection inside the EU is not enough. For worldwide protection, though, patents need to be taken out country-by-country. Simpler procedures for obtaining a patent and assistance with worldwide registration would assist with this problem.

Even when a design is protected, enforcement may be difficult. One company in Rheinland-Pfalz had taken a retailer to court twice for copying one of its products which had very distinctive features, which made the case easier to prove. However, although the company has won twice in the courts, the retailer is delaying action by appeals, which means it continues to gain the benefits from selling the copy.

Other barriers identified during the case studies included:

- the continuing decline of traditional specialist shoe shops, which could have a significant impact on companies that reply on these sales channels;

- increases in the prices of raw materials, particularly leather. As it will be difficult to pass these costs on to customers, especially in the current economic crisis, this could lead to pressure on profit margins. Alternatively, increasing prices could reduce sales, as fewer customers will be able to afford the higher prices; and

- the future of family firms. These still tend to seek new managers within the company, which requires the younger generation to be engaged and not want to sell up. This appears to have happened successfully in Norte, and for some firms in and Rheinland-Pfalz, but to be a problem in Veneto, Rhône-Alpes. There is no obvious reason for this difference, other than perhaps the relative lack of other opportunities in Norte. It appears to be related as much to individual family dynamics as to external factors. It is rare for a company or entrepreneur with no footwear experience to enter the sector; companies in the apparel and related industries may move into footwear but they rely on the expertise of those with experience of the sector.

8.6 Future Trends in Restructuring

In general, the companies and organisations that we interviewed expected that restructuring in the industry would continue in future, but at a slower pace than in recent years.

The Norte footwear industry anticipates that the current trends will continue in future, with further improvements in efficiency, especially in the use of materials, increasing focus on quality and service and moves into additional export markets. Most of the footwear companies that we interviewed plan to continue with their current strategies of building and expanding their own brands of footwear. The next few years are seen as a period of consolidation after major changes and the shock of the economic crisis; companies do not envisage any dramatic changes over the next few years and plan to continue with their existing business relationships. Most companies do not plan to expand their production significantly, but instead aim to move further upmarket (through better design) to gain enhanced margins on their products.

Companies in both clusters in Veneto plan to continue with their current strategies in future. Work for major brands will continue to be the main strategy for companies in the Brenta region. The quantity of orders placed by the major brands is not expected to reduce. However, companies are also now aiming, as far as possible, to launch their own collections to enable further diversification. Companies in Montebelluna plan to continue with the promotion of their brands and the development of international markets. One potential barrier to this strategy is a growing shortage of skilled staff, which companies are trying to overcome both through developing their

own training programmes and attracting employees from other parts of Italy, where the footwear industry has been contracting.

The companies we interviewed in Southern Poland identified continuing competitive pressure as a key future challenge. They planned to respond to the challenge by further investment in equipment to increase efficiency, by improved product design and quality, and by effective marketing.

Although the majority of restructuring of the footwear sector in Rheinland-Pfalz is complete, the industry is now one of continual change. Most companies envisage only minor changes in the location of production in future. However, changes to sales channels are likely to continue. This will include both changes in stores in which their products are sold and a continuing focus on exports.

Companies in Rhône-Alpes anticipate that competitive pressures will continue in future, with an emphasis on further reductions in time to market. Products will also need to be further developed to meet consumer needs, including customised ranges and new, more eco-friendly materials and production methods. This factor has encouraged some companies to consider switching production back from China to locations nearer to France.

Thus current trends in restructuring of the footwear appear largely set to continue. Although the major period of restructuring in the industry is largely complete in most regions, the sector is now in a period of continuous change. Companies expect to face continues competitive pressure, primarily from imports into the EU from countries with lower production costs, particularly China. They will therefore have to keep working to control costs, differentiate their products and develop their sales channels to remain profitable.

9. CONCLUSIONS AND RECOMMENDATIONS

9.1 Conclusions

The aim of this Task of the study has been to assess past or ongoing restructuring and modernisation processes in footwear enterprises in five regions of the EU and to anticipate future modernisation and restructuring.

The key conclusions of the study are that:

- The process of restructuring in the footwear industry has taken place over a number of years. It has resulted in a major contraction of the industry, with reductions in numbers of companies, output and employment across many EU countries. It has followed different routes in different parts of Europe;

- Northern European countries (including France, Germany and the UK) began to face increased competitive pressures from the 1970s, which began the process of restructuring. Their industries mainly responded to the crisis by relocation of production to lower-wage economies, initially to Portugal and Spain (France, Germany, UK), secondly to North Africa (France). At this time, Italian and Spanish footwear producers were still competitive in their domestic markets;

- While Portuguese and Spanish companies may have benefitted from this process during the 1980s and 1990s, they came under increasing competitive pressure from low wage countries outside the EU (such as China) from the early 2000s. Similar pressures were felt by Italian companies. These countries adopted different responses to the pressures. Italian and Spanish companies began to offshore production themselves (to Romania and North Africa), while companies in Portugal focused on technological upgrading followed by product development and improved sales channels;

- The remaining companies in northern Europe have focused on upgrading in fashion, quality, speed to market and, hence, the price range of their products. This is often based on spatial division of labour, with design, marketing and logistics managed in their home country while production is offshored around the world, to factories they own or through outsourcing. There is evidence that companies are relocating some production back to eastern Europe from China, due to cost increases in China and the need to meet demands for fast fashion and increased quality; and

- Eastern European countries appear to have followed different strategies, according to the size of their domestic markets. Companies in countries with relatively small markets (such as Hungary, Bulgaria and Romania) have become subcontractors of companies from the major producers in western Europe (particularly Germany and Italy). Companies in countries with a larger domestic market (such as Poland) have remained competitive in their home market through restructuring.

It is clear from our case studies that international competition has been the key driver of restructuring in the EU. Despite Operational restructuring, footwear manufacture remains a highly labour-intensive activity so is always vulnerable to competition from low-wage economies. This process was accelerated by the removal of tariff barriers following the entry of China into the WTO.

The major stages of restructuring appear to be largely complete, and the level of output, the number of firms and employment appear to be stabilising. Most companies we interviewed see their focus in the next few years as consolidating their position in the market. This is one reason why the economic crisis appears to have had a limited effect on restructuring. Nevertheless, footwear companies recognise that restructuring is a continuous process and that they need to continually adapt to changes in the market in order to stay in business.

The EU footwear industry faces a number of challenges in the coming years. One major issue is a growing problem of skill shortages. The workforce in the industry has a high proportion of older workers and it is proving difficult to attract young people into the industry in all of the cases study countries. Innovative approaches will be needed to overcome the perception by young people that footwear is an industry with no future. If this is not successful, it could result in a further round of production relocation and the closure of small firms that are not able to undertake this step.

In the longer term, the industry in northern Europe (and Italy) appears reasonably stable. The model of offshored production, with high-added-value activities such as design and marketing within the EU, appears set to continue (although this could change if China develops its own capability in fashion and design). Small-scale production is likely to remain in Europe, focusing on niche markets such as luxury fashion, quality safety footwear and footwear designed for people with health problems. Eco-friendly footwear may provide another niche in future.

In Portugal, although good progress has been made in moving to the higher quality fashion end of the market, this process is still on-going. There is also potential for further improvements in productivity and upgrading of technology. In eastern Europe, the picture is more mixed. Progress is restructuring is more variable and some countries remain vulnerable to changes in outsourcing policies by northern European companies, as they have not yet developed the skills in marketing and design to become more independent of their customers.

9.2 Recommendations

Some of the organisations we interviewed made suggestions themselves on action that could be taken to support the restructuring of the sector. These are summarised in Box 9.1.

Box 9.1: Suggestions from Consultees for Action to Assist Restructuring
• Development of effective 'origin labelling' schemes, which are becoming increasingly important for customers; • Maintaining the temporary increase in the ceiling on state aid to companies to €500,000 every three years, rather than reducing it to €200,000; • Continuing to work to remove tariff and non-tariff barriers to EU footwear exports; • Support to training centres to help retain competence in shoe manufacture and a greater role for industry in setting training course curricula to make them more relevant and more attractive; • Support for other forms of training, such as e-learning; • Tax reductions or employment guarantees to encourage young people to take up training and enter the sector; and • Simplification of processes for accessing EU funding.
Source: Interviews in case study countries

The industry's policy expectations are not uniform. While larger companies that focus on sales and marketing tend to favour policies that encourage lower prices and more open markets, smaller companies that focus on design and manufacture tend to favour the opposite. It is notable that most of the companies we interviewed had not received any incentives for restructuring, but had completed the process through their own resources.

Based on the findings of this Task, we recommend that the following actions are considered by the **Commission**:

- In general, policy assistance should focus on ***upgrading*** *in* ***southern and eastern European locations***, as the industry in northern Europe has a more limited need for help (partly because companies have closed down, partly because they have managed to survive in a stable way). Upgrading should focus on better access to markets (fashion and high product quality, design, logistics, distribution) rather than on production technology. Access to skilled labour force may also become crucial; this is addressed in the recommendations of the Task 5 report;

- On trade policy, the sector recognises that it is not politically feasible to introduce anti-dumping measures against non-EU producers, even though it considers that footwear is still being sold on the EU market at below the true cost price. Instead, as an exporting sector, the focus should be on ***ensuring that non-EU footwear markets are as open*** to EU producers as the EU footwear market is to imports. Duties on EU footwear in key markets should be reduced to EU levels and eventually to zero;

- ***Simplification of access to, and a better industry focus on, EU incentives***. Funding under FP7 has encouraged and supported the development of innovative technologies and their implementation in the footwear industry. However, EU-funded projects tend to be further away from the practical needs of companies. The process of selecting projects for funding seems to involve academics, who are less in touch with the industry, rather than sector experts. This means that

academic proposals, which universities are good at writing, tend to be supported. Assistance with marketing, in the form of support to attend trade fairs under the Regional Development Fund, has been particularly valuable to smaller firms in developing their designs and in establishing contacts to assist with developing sales channels. However, firms are not always aware of these resources unless their industry associations have been active in promoting them (as in Veneto and Norte);

- the case studies indicate that there is a trend towards relocating production back from China in particular to lower-cost locations in eastern Europe. At the same time, manufacturing companies in eastern Europe are seeking work. However, our interviews indicate the two groups are not always aware of each other and that industry associations and the specialist press, the usual channels for assisting this process, are not working effectively. There may be scope for the Commission to work with industry associations to examine the potential to ***develop a more effective platform for producers and potential subcontractors to get into contact with each other*** to help address this problem; and

- there could also be a role for the Commission in encouraging ***exchange of experience in training and recruitment*** between countries and regions (see below). One factor identified as important in several countries was offering training to people from different countries, including countries to which EU manufacturers have outsourced production. There may be scope for the EU to facilitate this process; this is examined further in the Task 5 report.

There are also a number of potential actions that could be taken at **national/regional level**:

- companies in many of the case study regions mentioned concern about future shortages of skilled labour, due to an ageing workforce and difficulties in attracting young people to the industry. Addressing this issue will require a combination of ***upgrading training programmes, liaising closely with industry to ensure training is relevant and promotion of the industry to young people***. (Recommendations specific to training are included in the Task 5 report). One innovative approach that could be transferred to other regions is the Rheinland-Pfalz 'Step up Shoes' campaign, which has been developed by the local employment agency and industry representatives (see Box 6.18 in Section 6). This has proved successful and is now being transferred to other regions; and

- another issue for firms in many of the case study areas, but particularly Portugal, Italy and Poland, was the development of sales channels. National/regional action to assist with this problem could take a number of forms. One method would be to provide ***training in marketing and sales*** to companies. The ISC in Rheinland-Pfalz, for example, offers a range of training courses for marketing and sales staff. Another approach might be to offer unused local buildings for local manufacturers to sell their products; this is also being considered in Rheinland-Pfalz;

- finally, national/regional authorities could ***assist companies to access EU funding sources better***, through providing guidance on what incentives are available and how to access them.

The role of **industry organisations** in assisting companies with the process of restructuring has been noted as a key success factor. Some association, such as APICCAPS in Norte, appear to have taken a strong, proactive role. Others have been less successful. This is partly a function of the requirements of the industry; whilst companies in Norte and Veneto appear keen to work closely together, competition remains the norm in Southern Poland and, until recently, in Rheinland-Pfalz. Areas where industry associations could take action include:

- ***encouraging companies to work together***; this can be facilitated by identifying common problems to be addressed, such as recruitment in Rheinland-Pfalz;

- ***assisting with awareness of and access to incentives*** from national and regional governments and the EU; and

- ***participating in the development of training***; for example, the industry association in Germany was instrumental in setting up the ISC and ensuring that the training it offers is industry-focused (this is examined further in the Task 5 report);

- ***showcasing the industry's products and qualities***: for example, APICCAPS exhibits at trade fairs on behalf of the footwear industry in Norte as a whole. Associations could also consider setting up small stores showcasing products at key locations, such as airports or major tourist centres. This has happened through individual firms' initiatives in Hauenstein, Rheinland-Pfalz, where a combination of a discount shoe mall and a shoe museum has created a hub for 'shoe tourism'.

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