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## **THE CHINESE FOOTWEAR INDUSTRY AND ITS INFLUENCE ON THE WORLD TRADE**

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\*This document has been prepared without formal editing.

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## LIST OF SYMBOLS AND ABBREVIATIONS

ACLE	All China Leather Exhibition (ACLE)
CAD	computer-aided design
CEC	CONFÉDÉRATION EUROPÉENNE DE L'INDUSTRIE DE LA CHAUSSURE
CIFF	China International Footwear Fair
China	People's Republic of China
CLFI	CHINA LEATHER AND FOOTWEAR INDUSTRY RESEARCH INSTITUTE
CLIA	CHINA LEATHER INDUSTRY ASSOCIATION
CNLIC	CHINA NATIONAL LIGHT INDUSTRY COUNCIL
CSR	corporate social responsibility
EU	European Union
EVA	ethyl-vinyl-acetate
GDP	gross domestic product
ISO	International Organization for Standardization
m <sup>2</sup>	square meter (= 10.76 square feet – sq. ft)
OSH	occupational safety and health
PVC	poly-vinyl-chloride
R&D	research and development
SARS	severe acute respiratory syndrome
STA	STATE TAX ADMINISTRATION
TPR	thermoplastic rubber
UK	United Kingdom
UN	United Nations [Organization]
UNIDO	UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
USA	United States of America
VAT	value added tax
WTO	WORLD TRADE ORGANIZATION
milliard	1,000 million = 1,000,000,000 (10 <sup>9</sup> ) = 1 billion in USA
RMB	Renminbi (or yuan) – the local currency of China
US\$	United States dollars

The official UN rate of exchange was US\$ 1.00 = RMB 8.11 on 2 September 2005.

*Mention of the names of firms and commercial products does not imply endorsement by UNIDO.*

## PREFACE

The survey is based on the work of *Mr. Anthony Clothier*, UNIDO Consultant, whereby UNIDO Leather Unit (especially *Mr. Ferenc Schmél*, Senior Industrial Development Officer) provided substantial support in making contacts and collecting information. The CHINA LEATHER INDUSTRY ASSOCIATION (CLIA) as an organization and specifically its two specialists (*Ms. Song Wen Xian* and *Mr. Su Chaoying*) were involved in compiling local statistics, reviewing the local footwear trade (see *Annex 1*) and making arrangements within China for factory visits. Information has been gathered from published and unpublished statistics, as well as from interviews with specialists (in most cases representatives of companies and organizations – including trade associations and research institutes) involved at all stages with the Chinese footwear industry that is to say manufacturers, wholesalers and retailers both in China and elsewhere in the World.

We are extremely grateful to all the people who have offered so much help in the preparation of this paper.<sup>1</sup> The statistics that we use are mostly non-attributable. The reason for this is that the Chinese footwear industry is developing so fast that it is difficult to paint a picture of exactly what is going on at any particular moment so there are few precise, reliable numbers. Our statistics should be considered as illustrative and represent a “best guess” of the situation.

The main body of the survey contains only short statistical tables to illustrate particular points. More full statistical data can be found in the *Annex 2*.

While we were collecting the information for this study the European Union (EU) instigated an antidumping investigation against the Chinese and other shoe industries. As a result we were not able to carry out the visiting programme we had originally planned. Therefore, we were unable to collect as much detailed information as we would have wished. Consequently some of our information and statistics may not be as reliable as we would have hoped.

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<sup>1</sup>For reasons of confidentiality we do not intend to acknowledge them by name.

## INTRODUCTION

The objective of this survey is to provide an independent and reliable review of the Chinese footwear industry and trade. This study

- assesses the scale of the industry and how it achieved its present size and status;
- describes the industry as it is today in all its various facets such as ownership, labour availability etc.;
- considers how much further the Chinese footwear industry is likely to grow and whether there is some equilibrium point it will reach and if so what that is likely to be and when this will happen.

Consensus figures give an actual output of the Chinese footwear industry of 5.252 milliard pairs of shoes in 1997. The estimate for production in 2005 is 7.65 milliard pairs and for 2009 is 8.908 milliard pairs.<sup>2</sup>

*Table 1* below shows the figures for the Chinese footwear industry together with the breakdown of production for the export and domestic market.

**Table 1: Comparison of the Chinese and the World shoe industries**

*Unit: million pair*

Year	Chinese production			World production	Share of China in the World production
	For the domestic market	Export	TOTAL		
1997 <i>Actual</i>	2,256	2,996	5,252	11,051	47.5%
2005 <i>Estimate</i>	3,060	4,590	7,650	13,000	58.8%
2009 <i>Estimate</i>	3,733	5,175	8,908	14,789	61.5%

The generally accepted view is that in 2004 China made approx 58% of the world's footwear. On the basis of the figures of the table above, it would appear that China will have 61% of the world's footwear production in the year 2009. Some people have suggested to us that the equilibrium point of the Chinese footwear production is at around 65% of total world production.

As we shall see later in the this survey, at first sight there seemed to be no restraint on the growth of the Chinese footwear industry but our studies have shown that there are restraints which will operate in a number of different ways and which are likely to bring to an end the head long expansion of the Chinese footwear industry. It must be admitted that up till now the growth of the Chinese footwear industry has always exceeded the various forecasts that have been made. Almost all growth forecasts have been overtaken by actual performance.

<sup>2</sup>The normal practice is to give the known figure for the "officially" recorded majority of the industry and then add a small amount for the small "unofficial" (or "informal") sector.

## THE PAST

It is worth remembering that the international trade in shoes is quite a recent development. Up till 1950 there had been an export trade between European countries and their former colonies but not much else. The 1950s saw the development of the Italian shoe industry that made Italy the first great shoe exporting country.

Something which is also easily forgotten is that in the 1960s the Japanese had become a considerable producer and exporter of shoes and it is worth recalling that in the early days the establishment of footwear manufacturing both Korea and Taiwan owed a great deal to the work of the Japanese trading houses who effectively set up off shore production to substitute for the output of Japan which had by then become too expensive. We should also note that up to this period Hong Kong had been a major centre for the manufacturer of canvas and rubber footwear products.

In the 1970s there was also a move to set up substantial shoe industries in Thailand and Indonesia. For reasons that have never been properly evaluated, similar attempts to set up a footwear industry in the Philippines were unsuccessful.

As has been said before, much of the footwear industry in South East Asia was set up with the assistance of the Japanese trading houses but the subsequent development of the industry has been largely the work of entrepreneurs from Korea, Hong Kong and Taiwan who rapidly acquired considerable shoe manufacturing and entrepreneurial skills. As is well known, the economies of South Korea and Taiwan developed very fast and in a short period labour costs were rising to uneconomic levels for low cost shoe making. In addition Hong Kong was developing into a major service industry centre with much higher wage levels and pressure on the labour supply.

So it was a piece of great luck for these manufacturers when in the 1980s the Chinese government opened up 14 coastal cities as manufacturing centres and allowed foreign investment. The basic reason why the Chinese footwear industry developed so rapidly is that the Hong Kong Chinese, the Taiwanese and the South Koreans transferred a totally ready made shoe industry to China. In those days this industry did not produce footwear of anything like the quality that is available in China today. Nevertheless it brought large lumps of well-established production using fully developed technology and with ready-made markets.

The actual transfer took place quite quickly. The Hong Kong Chinese started to move their manufacturing to Guangdong<sup>3</sup> Province in 1981 and within seven years the Taiwanese were doing the same somewhat further up the coast. We have been told that although the move did not take place at one moment the actual change took place quite rapidly. In the case of both the Taiwanese and the Hong Kong Chinese the initial moves were made by a few forward looking people/companies who were then able to offer such vastly lower costs to their customers that their competitors had very little choice to do anything other than follow the example as quickly as possible.

The businesses, which were transplanted to China, have grown very rapidly. The Chinese coastal area is in many ways an outstanding industrial location. It has excellent logistics and is

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<sup>3</sup>The earlier name of the province was Canton.

convenient for foreign buyers to visit. An enormous infrastructure has grown up making it almost totally self-sufficient in supplies with the exception of some leather. Labour availability was good to start with and once the local labour supply was exhausted there was the possibility of bringing in workers from the huge pool of unemployed elsewhere in China.

In addition to these historical advantages, China still has the following advantages:

- Continuing low wages, current hourly wages in China are about US\$ 0.59 whereas the total hourly cost in Italy is US\$ 7.80
- Continual migration of major brands to South East Asia away from Europe bringing large volumes of business and considerable product development and marketing skills.
- Good Industrial Estates, originally provided by local authorities but now increasingly by private investors. Local authorities in more remote areas of China remain keen to assist the establishment of shoe industry clusters as they see this as a first phase in industrialization.
- Good sources of low cost machinery from Taiwan and increasingly China itself. Very much cheaper than from Europe even if technically basic.
- Up till now good worker discipline but some unrest is becoming evident.

## THE PRESENT

In this section we briefly describe the Chinese shoe industry, as it exists today, where it is and how it works.

### The Chinese Economy

It is obvious that the shoe industry is growing very fast but so are a large number of other industries. These include relatively unsophisticated industries such as footwear and clothing industries and more advanced industries such as automobiles and electronics. There is no doubt that the gross domestic product (GDP) of China is increasing very rapidly as it is shown in the following *Table 2*:

**Table 2: Gross domestic product (GDP) of China**

Year	GDP	Actual increase	GDP per capita
	US\$ milliard <sup>4</sup>	%	US\$/capita
1995	713.1	10.5	592
1996	827.9	9.6	680
1997	908.1	8.8	738
1998	955.4	7.8	769
1999	1000.8	7.1	798
2000	1091.1	8.0	864
2001	1186.8	7.3	933
2002	1282.6	8.0	1,002
2003	1429.9	8.2	1,110
2004	1664.8	9.3	1,212

From the point of view of our study of the footwear industry, the rapid rise in Chinese consumer income means that people will be spending more on consumer goods and so domestic consumption of footwear is likely to rise rapidly. We were told that a Chinese worker may reasonably expect his income to double (mostly in real terms) within a three year period. On top of this there are significant areas of China where the demand for labour exceeds supply and therefore the Chinese worker can look forward to secure employment prospects and rising real wages. This is certain to create a market that will consume large quantities of footwear. It is the strength of consumer expenditure and the huge size of the domestic market that makes the Chinese footwear market stand apart from others in Asia. Only India has anything like the same prospect.

It is essential that this point is understood because it indicates that in the future even if the Chinese footwear industry increases its capacity very rapidly, much of that capacity will be taken up with supplying the domestic market. It is therefore conceivable that Chinese production for export might not increase much above current levels because:

- domestic demand is strong,
- prices are generally better in the domestic market,

<sup>4</sup>Milliard denotes one thousand million = 1,000,000,000 = 10<sup>9</sup>. This amount is referred to as *billion* in the USA.



- there are capacity limitations,
- production for the domestic market can take place in regions with less good logistics and lower labour cost.

### Location of the Industry

Local authorities selected and designated four regions for promoting leather-based industry related activities:

<b>Zhejiang/Wenzhou</b>	footwear production
<b>Zhejiang/Haining</b>	leather processing (tanning and finishing)
<b>Hebei/Xinji</b>	leather garment production
<b>Guangzhou/Huadu</b>	leather products manufacturing.

The likely output of the Chinese footwear industry in 2005 has been estimated to be 7.65 milliard pairs.



**Figure 1: Major footwear producing areas in China**

There are three provinces that are the major producers of footwear (*Figure 1*). In volume terms Guangdong Province is expected to produce 3.2 milliard pairs, Fujian Province 1.4 milliard pairs and Zhejiang Province 1.025 milliard pairs. The following table shows the split between

production and export and also gives an indication of the output in 2003 that was calculated on a slightly different basis. In 2003 it was calculated that these top three shoe making provinces produced around 80% of the output of the Chinese footwear industry. It is to be noted that all three provinces are coastal provinces with the high quality infrastructure and logistics that this implies.

**Table 3: Estimated output in leading Chinese provinces in 2005**

Region	Main city	For domestic sale	Export	Total	
		<i>million pair</i>			%
<b>Guangdong</b>	Guangzhou	600	2,600	3,200	41.81
<b>Zhejiang</b>	Wenzhou	900	125	1,025	24.78
<b>Fujian</b>	Fuzhou	300	1,100	1,400	17.98

Later on in this paper we will be considering the pressures which might make it necessary for the shoe industry to move some of its activities out of the coastal areas and it is interesting to note that there is already one other province, Sichuan Province in the north-west, which has shown considerable growth in its shoe industry in the last 10 years and is now the 4<sup>th</sup> largest shoemaking area in China with an annual output of 550 million pairs per year. Not surprisingly given the logistical problems this province concentrates on the domestic market and it is estimated that the export production is around only 1/10 of the total.

One of the great unknown factors is how far the Chinese footwear industry could successfully relocate to less popular industrial areas if there was real pressure on the wage levels and labour availability in the areas where it currently operates. We shall see that this is a very real possibility. The domestic market should not be too severe a problem, but for the export market things could be quite difficult. We are likely to see a substantial growth of the footwear industry away from the coastal region, but the main market for the production in these areas is likely to be China rather than the USA or Europe.

From the figures in the table above it is clear that Guangdong is by far the largest shoemaking area. It is also the most important export shoemaking area. There are said to be up to 10,000 companies working in the shoe and related industries. Within Guangdong there are some particularly powerful clusters of the industry, these include:

- Dongguan which is said to account for 30% of the total output of Guangdong Province and incidentally 10% of the world's footwear output.
- Huangbu to the east is another important concentration.

There is no doubt that the very easy access via Hong Kong and excellent seaports of the Pearl River Delta have been the key to making it the major export area for the Chinese shoe industry. Wenzhou situated in Zhejiang Province together with Fujian Province are important centres which were much used in the early years because of their proximity to Taiwan. Wenzhou in particular is a city with not only a substantial footwear industry, but also considerable activity in leather and leather goods. Zhejiang Province as a whole has a relatively low export percentage, among other things it is not popular with major foreign buyers because it is an area where much of the industry lives on non-original shoemaking.

Chengdu in the northwest of the country in Sichuan Province is developing rapidly as a centre of production mainly for the domestic market.

## Ownership of the Industry

The vast majority of the Chinese footwear industry is in private hands with only around 3% of the capacity still having any state involvement. There are a further 7% where there is some collective ownership and beyond this 45% foreign owned and 45% locally, privately owned. Foreign ownership mostly relates to three categories of people: the Taiwanese, the Koreans and the Hong Kong Chinese. Calculations have been made which show that out of an output of 7.65 milliard pairs, 4.6 milliard pairs (60%) are made by companies where the Taiwanese have a strong influence and a further 940 million pairs made by companies where Koreans have an involvement.

We believe that in the medium term the influence of the Taiwanese will decline and the influence of the native Chinese will increase. This is due to a number of reasons:

- The rapid growth in the entrepreneurial skills of the native Chinese.
- Any movement inland is likely to be by the Chinese rather than the Taiwanese.
- The ageing of the Taiwanese entrepreneurs.

The last point concerning the ageing of the Taiwanese entrepreneurs would seem to be a very significant factor in the future development of the Chinese footwear industry. What is happening is very similar to what has happened in the Italian and Portuguese footwear industries. This is the difficulty of footwear businesses that have been run by single entrepreneurs – securing adequate management succession once the original founder of the business reaches retirement age.

In Europe it is always being said that the problem facing the first generation owner of a business was that when the time came for him to hand over his business his children were either too clever and wanted to become doctors or lawyers or alternatively too stupid to run a business. In the case of the Taiwanese there are two additional problems. The first of these is that the Taiwanese younger generation does not particularly want to live in China and the second is that the skills that will be required in the future are less entrepreneurial and more related to scientific management.

By contrast the average age of the Chinese company owners and managers is quite low and so they have many years ahead of them, but as we shall see the management skills required for the future are not necessarily widely spread even among these younger owners.

## Labour availability and Cost

One of the main attractions of China as a manufacturing centre for a labour intensive industry like the shoe industry has been the large supply of low cost labour. In the early days there was obviously a substantial amount of local labour in the areas where the shoe industry was first established. It did not take very long for this surplus labour to disappear because industry in general, and not only the shoe industry, was growing so fast.

One of the key features of all the industry in the highly developed, coastal industrialized provinces has been the practice of bringing in labour from the more rural and agricultural regions of central and northern China. In fact a key feature of the shoe industry in the main shoemaking areas is the use of labour that has temporarily or more or less permanently migrated into the industrial provinces. The normal practice is to recruit people on a two to three-year contract to work in industrial companies. It is normal also for the shoe companies to provide dormitory accommodations for single people (often at no cost) and also to supply subsidized meals. More recently companies have started to provide accommodations for married couples. Also many migrants are now permanently settling in the industrial areas with their families in their own homes.

The workers normally return to their home areas for certain holidays especially the Chinese New Year. Historically it would appear that there has been a good rate of labour retention and people continue with the same employer for more than two years. The reason one can confirm this is that the percentage of workers that have to be trained each year appears to be in the region of 15-20%, which indicates a reasonable degree of labour turnover given the somewhat unusual working arrangements.

The extent of use of migrant workers is quite extraordinary. It is said that there are a total of approximately 90 million workers in Guangdong province and of these 25 million are migrants. We were even told a story, which may be slightly exaggerated, that in the city of Shenzhen which is just across the border from Hong Kong that there are only 1 million people left of a total of 9 million at the time of the Chinese New Year.

As a result of this movement of labour, we were told that it is no longer possible for there to be huge differences in pay levels throughout the whole of China because the concept of temporary migration to find better paid work is so prevalent.

In theory there are still a considerable number of people who are unemployed in China, but in practice this does not appear to be the case in some of the major shoemaking areas. It is said that in Guangdong province there are 2 million jobs vacant in industry as a whole and 150 thousand jobs vacant in the shoe industry. This has led to the situation where workers are able to move from one employer to another if they think they can obtain better pay or conditions. This in turn has led to companies offering pay above the normally agreed provincial rates and making sure that their accommodation and canteen arrangements are fully competitive. We were told that many companies pay well above regionally negotiated rates.

There is no doubt that there is substantial pressure on the labour supply and that this is going to be a key factor in deciding how and where the Chinese footwear industry will develop in the future. There are clear signs that the “unlimited supply” of labour in the most attractive industrial areas is drying up and there are clear signs that China may not remain a source of cheap labour in comparison to certain other countries. The key factors behind the pressure on the labour supply appear to be the following:

- (i) A very strong total demand with many new and more sophisticated industries moving into the coastal shoemaking areas.
- (ii) The Chinese government’s birth control policy is undoubtedly restricting the number of young people coming into the workforce.
- (iii) The workforce is becoming better educated and young people have aspirations to work in more sophisticated industries than the footwear and clothing industries.
- (iv) Many of the more advanced industries, including automobiles and electronics, provide better working conditions and pay better than the shoe industry.
- (v) The growth of the service sector. Under the former centrally planned economy system the service sector was very small but the new, more liberal economic conditions have allowed the rapid development of a service sector that is employing large numbers of people.
- (vi) The Government has become worried about rural depopulation in the areas where many of the migrant workers come from. It has also become concerned that there may not be enough people to work in the agricultural sector. So far the agricultural sector remains under-mechanized. The Government has, therefore, raised the prices for agricultural products and has tried to create other conditions, which make it attractive for workers to remain in rural areas.



- (vii) There is another reason that affects only those companies supplying the major international brands who impose a corporate social responsibility code of practice on their suppliers. It is usual for such companies to insist on a maximum working day of 10 hours and to insist that workers have one day free in seven. This has certainly restricted the output of some factories, which have historically worked extremely long hours.

In summary the present situation is that there is pressure on labour so that companies are forced to provide better conditions. It is also true that a number of companies have started to think about setting up satellite production areas away from their main coastal plants in areas where labour is more freely available. In this respect the Chinese industry is starting to follow the classical system of development that occurred European and American companies in the period after the Second World War.

### **The Cost of Labour**

In theory labour costs between companies should be relatively similar but it is clear that some companies in the same province pay significantly more and these are not always the largest companies. In fact the highest wages we were quoted was for a company employing 600 people; that is certainly not large by Chinese standards.

The wage rates we have been quoted are as follows:

- workers RMB 800-1,300/month depending on skill;
- workers up to RMB 3,600/month including bonuses and overtime in employment “hot spots”;
- production supervisors up to RMB 2,000/month (but may be lower);
- technical staff around RMB 4,000/month;
- design staff up to RMB 5,000/month.

In April 2005 the official shoe industry wage in Guangdong Province was raised by 28%. We understand that many companies increased their wages by 35%.

All these wages are based on free or heavily subsidized housing and subsidized meals.

A typical working day is 10 hours long for 6 days/week. Many companies not working for major international groups work significantly longer hours when there are tight delivery dates to meet. Over 10 hours/day usually attracts an overtime payment. Normally there are 3 holidays in every year of 7 days each.

### **Labour Discipline**

Many observers of the Chinese footwear industry over the past 15 years have commented on the high level of discipline that exists in the workforce compared with some other countries in the region and elsewhere. It was also said that some employers were imposing unreasonable conditions on their workforce.

While overall the Chinese workforce is well disciplined, the tightening labour supply situation in the main shoemaking areas means that workers will just walk away from unreasonable employers.

There are also signs that even major high-grade employers have run into semi-organised industrial action leading to quite long-lasting strikes.

## **Production**

In this section we cover all aspects of production including productivity, quality, delivery times etc.

The first thing that impresses one about the Chinese footwear industry is the very large scale of some of its factories. It is said that the largest shoe manufacturing group employs 90,000 people in total which is similar to the number employed by BATA in Czechoslovakia in 1938. Because the industry is of quite recent origin, in general it does not have the large amount of artisan production that exists in other countries though there are a large number of smaller shoemakers in Chengdu. In the Chinese classification of shoe factory size, small is up to 400,000 to 500,000 pairs/year, medium is over 2-3 million pairs/year and large is above 4-5 million pairs/year. Some of the largest plants are divided into separate units with each unit being allocated to a major foreign buyer.

It is not surprising that a number of factory owners and managers are finding their factories are too big and are unmanageable. This has led one major group to reduce the size of its workforce from 8,500 to 6,000. It is also leading companies to consider whether they should operate with one central plant serviced by several satellites. Not only does this practice make operation more manageable, but it also allows the company to take work to the workers in their original rural area homes. An advantage of this for the company is that it no longer has to be concerned with providing accommodation and food. We have been told that one of the advantages of the Vietnamese shoe industry is that it does not rely on migrant labour and factories tend to be sited close to where the workforce lives.

So although the Chinese shoe industry is currently based on the idea of large plants this is likely to change somewhat in the future.

### **Production Methods and Productivity**

In general Chinese factories use either Chinese or Taiwanese built machinery. It is rare to see Western European machinery. The machinery is generally basic with very little use of guides, automatic thread cutters, computer memories and so on. The basic stitching machine is a copy of the standard PFAFF post machine of 30 years ago. Lasting conveyors are extremely long, slow moving belts with a multitude of drying and activating tunnels.

The quality of work produced by Chinese shoe factories can be of a very high order and there is no doubt that the Chinese shoe industry is capable of producing very high quality work if it is required. In particular the quality of stitching can be excellent.

A number of companies have installed formal quality control procedures based on ISO 9000 and in some cases customers have assisted in this. There also seem to be independent finished product inspection services in addition to the customers' own inspection services.

In productivity terms the situation overall is very poor although stitching workers generally work at a reasonable pace but have not been well taught in terms of using minimal hand movements.

Cutting is usually by some form of press often wide beam presses for leather as opposed to the normal swing arm presses, but each cutter works with an assistant who puts work together and handles knives and so on. Assembly lines are extremely unproductive and we calculate that the output of many assembly lines is below 10% of optimum and probably only 20% of what could be achieved using the low level of mechanization that exists in China.

As we shall indicate in the short section on supervision, the quality of factory management is not good and the general reaction to any sort of problem in the Chinese shoe factory is to throw more people at the problem and not to try and solve the original problem. This practice is probably the biggest long-term threat to the Chinese shoe industry and requires a solution. Chinese wages are very low at present at about RMB 1,000/month (= US\$ 123/month) but everyone agrees that wages are likely to rise quickly and it is thought possible that in 6 years time real wages could have increased to RMB 3,000/month. If productivity is only 10-20% of normal best practice this wage can become effectively the

equivalent of RMB 15,000/month (US\$ 1,850/month), which is not really competitive with some countries where basic labour costs are higher but productivity is better.

Some major buyers have already encountered trouble in this area. Many of them insist on a maximum 10 hour working day and some of their suppliers say that they cannot make money on this basis and therefore do not want the business. A more appropriate response might be to say that they could do away with 10% of the people on the line and make the required saving.

The overall impression one has of the assembly lines is of a substantial number of people doing nothing and a further group doing operations that do not need to be done.

We have been told that some companies are now employing people called “lean manufacturing managers”. It seems that this function is more like the industrial engineering or work study function that would be found in a Western plant and does not have much to do with lean manufacturing but it is a recognition that a problem exists.

The end result is that many of the companies we spoke to made it clear that they had to work hard to hold together a well-trained workforce. They also understand that constant training is a costly business.

There are a considerable number of organizations providing training for the Chinese footwear industry. In fact there are said to be almost 20 institutions, which provide a bachelor degree in footwear engineering with an annual output of 2000 students. It also seems that considerable efforts have been made to provide courses for designers and pattern engineers.

Outside these areas there seems to be very little provision of formal training. There do not appear to be external courses for production supervision and our impression is that business owners and even the graduates of the bachelor level courses do not have much knowledge or interest in organizing efficient manufacturing. This attitude has also led to a lack of effective in-factory training of supervisors in productivity matters.

Therefore, it is not surprising that the job of a supervisor is not highly regarded. We were told by one person who knows a large number of Chinese companies well that the task of a supervisor was a thankless one and was not well rewarded. Consequently turnover among supervisors was high.

Although many of the stitchers were skilled we did not come across much evidence of scientifically planned vocational training. In other countries this might be organized either outside the factory, partly in and partly out, or wholly inside the factory.

Because of this general lack of interest in plant organization, it does not seem that many factories have any formal method of training their supervisors and the status of supervisors is not highly regarded. We were told by one person who is reasonably expert in the organization of a large number of Chinese companies that the task of a supervisor was a thankless one, they were not well rewarded and that consequently turnover among supervisors was very high.

We have already said that manufacturing proficiency is not good and that this will be dealt with more fully later but what is certainly true is that the ability exists in Chinese factories to produce shoes to a high quality standard and for us the problem is to know how one part of the management supervisory function appears to be well carried out whereas on the efficiency side so much is lacking.

Long term an improvement in supervisory quality and in managements’ understanding of the importance of manufacturing efficiency will be one of the keys to the ongoing success of the Chinese Shoe Industry.

### **Product Development**

Most Chinese manufacturers of any size have large product development sections and these seem to be staffed with people who have reasonable shoe engineering skills. Many of the

companies also have some form of computer-aided design (CAD) systems. In this section of the business there has also been considerable knowledge transfer both from foreign buyers and from the buying offices of the foreign buyers who often have strong technical sections.

Chinese factories are able to develop new models fast and they are able mostly to develop very large numbers of new models.

Some customers, mainly the Americans, tend to order in very large volumes per model. Many European customers order in much smaller quantities. It would appear that a Chinese company sets its prices on the basis of the likely number of models that its particular type of customer requires. So a company, which has a very full design service, might charge US\$ 5/pair for labour overhead and profit whereas a company with minimal support might only charge half that amount.

### **Logistics**

Historically the Far East has had a reputation for being a good place to source large numbers of shoes on relatively few models with long lead times. This implied that customers could not expect much of a quick repeat service.

As we understand it the current practice is to deliver orders on shoes, which are already developed, within six weeks and the preparation of a new model is said to take around 2 weeks although we have heard it happening in a much shorter time. It seems likely that delivery from China to Europe or the West Coast of America probably takes between 2½ to 4 weeks from leaving the factory. The big suppliers used by major international brands are slower than the ones used by wholesale trading companies, with ex factory delivery of 45 days.

A number of people told us that the Chinese already delivered faster than the Italians particularly where Italian companies were sourcing from Eastern Europe.

### **Electricity and Water Supply**

China does not have sufficient electrical power available in many of the industrial areas. This leads to days when power is cut off for industry (often two days in five). Many companies have installed generators to deal with this problem but this is an added cost. It is likely that China will be able to solve this problem in the longer term.

There is also a problem with water supply. There is insufficient water in general and many sources are polluted. This does not affect the shoe industry too much, but it is a brake on the expansion of the tanning industry.

Most of the major export producing areas of China is situated near to a wide variety of container ports so there is an excellent ability to secure rapid shipment of goods outwards and inwards. When we talk about the supply chain, we shall note that the main shoemaking areas have a very wide selection of suppliers, which allows almost all raw materials to be acquired locally. However, we should note that where certain crucial supplies have to be brought in, customs clearance procedures are extremely important. Delays in customs for incoming supplies can be a major problem. Customs clearance is available either at the port of entry or at the customers' premises. In general the major ports have good customs services though the national customs laws do allow a lot of scope for local interpretation. Trying to run customs clearance from one of the ports for a company in Chengdu, which is 1,500 km away, could be quite difficult.

A new phenomenon is the development of specialist logistics companies who manage, on behalf of the buyers, all the specialized labeling and pre-packing needed if production from various sources is to be sent to individual retail stores in the buyer's country. These companies have developed from their original business of freight handling and transport.



Increasingly they are carrying out the function of the buying agent, i.e. progress chasing and so on.

## Marketing and Sales

Originally (prior to 1980) the Chinese shoe industry was mainly concerned with the domestic market. With the arrival of foreign investors in the 1980s and 1990s, exports became more important. In recent years domestic demand has increased rapidly. It is possible to envisage a situation in the future where China produces more shoes for the domestic market than for export and yet remains by far the biggest shoe exporter in the world.

Large companies generally sell direct to major international buyers and major international buyers prefer this as it gives them direct access to their supplier and that allows better control. Equally, large companies sell direct to their domestic market either using their own brand or through owned chains of shops.

For the majority of the industry both in the domestic and export markets, the wholesaler/trading house plays an important part: in many shoemaking centres and in other major cities there are shoe wholesale markets. These are buildings where a number of wholesalers have their showrooms. These markets may be mainly export or domestic.

A wholesaler will probably have the exclusive right to sell the products of a factory in either export or domestic markets or in specified regions.

An export wholesaler will probably provide a design service so that a buyer can just visit the showroom and place an order and need not visit the factory. The wholesaler operates in the same way as the buying agents did in European shoe centres. Getting the order, possibly arranging finance, ensuring shipment on time and to the correct quality standard. The wholesaler will also arrange a second source of supply if the order is too big for one factory or if the original factory is running late.

Within the domestic market wholesalers have a vital part to play. China is a very big market and arranging an adequate selling organization even in one region of the country is something that a small or medium-size producer cannot afford.

China exports shoes all over the world. The following *Table 3* (see next page) gives the actual figures for 2003 for *all* types of footwear.

In conversation it became clear that Russia was an increasingly important market at prices significantly above average.

China already supplies such a high proportion of the shoes sold in the USA that it is hard to see much increase there. On the other hand its penetration of the European market is much lower allowing the possibility of considerable growth.

Historically, China's key business has been with very large volume products for the United States based international brands. Certain companies are now adapting successfully to deal with customers (typically non USA-based) who want shorter runs.

Over the last twenty years China has not only increased its shoe export volume it has also moved progressively up-market.

**Table 4: Major export target regions of the Chinese shoe industry 2003**

	Target market	Export		Percentage proportion		Compared with 2002 +Increase/-Decrease	
		Amount	Value	Amount	Value	Amount	Value
		Million pair	Million US\$	%	%	%	%
	<b>Total</b>	<b>5025</b>	<b>12,490</b>	<b>100.0</b>	<b>100.0</b>	<b>17.0</b>	<b>17.0</b>
1.	United States	1,550	5,285	31	42	3.1	5.3
2.	European Union	744	1,980	14.8	15.8	23.0	27.0
3.	Japan	422	984	8.4	7.8	4.5	8.7
4.	Hong Kong	510	621	10	4.9	44.0	32.0
5.	Russia	126	522	2.5	4.1	-3.0	10.0
6.	Kazakhstan	102	358	2.0	2.9		
7.	Canada	66	209	1.3	1.7	10.0	7.7
8.	United Arab Emirates	103	204	2.0	1.6	47.0	46.0
9.	South Korea	52	168	1.0	1.3	26.0	45.0
10.	South Africa	77	164	1.5	1.3	57.0	67.0
	<i>Subtotal of the top ten</i>	<i>3,753</i>	<i>10,495</i>	<i>74.5</i>	<i>83.4</i>		

*Remark:* The high export figure for Hong Kong undoubtedly includes many shoes that are re-exported.

Delivery times from major producers are still not short enough to allow for repeat ordering from retailers. We were told that major Vietnamese plants could be quicker. However:

- The wholesalers can usually get shoes from their suppliers in 4 weeks.
- Higher-value, more fashionable products can justify the cost of airfreight.
- Some European retailers find that a fast repeat service in the middle of the season justifies the cost of airfreight.
- It is already clear that well organized Chinese suppliers provide a faster service than less well organized Italian companies.

It seems that in the Chinese shoe industry there is no particular bias in favor of the domestic or export markets. We met different people who were planning to increase their activity in both directions. There does seem to be a general move:

- To become more involved with owning retail shops. This is a very old story and has occurred in many countries. Shoemakers always believe that shoe retailers make more money than they do; therefore, they expand into retail. There is also the entrepreneurial excitement of owning shops. It can be seen as a development phase that may be a success for a few companies but which is generally a disaster for the majority!
- To try and develop their own brands. Some companies have tied up in joint ventures etc. with foreign brand owners, but a number of others are developing their own brands. It is not certain how well the key requirements of brand creation are understood, i.e. brands cannot be created simply by advertising or other promotion.

### **Pricing and Profitability**

There seemed to be a general view that currently prices in the domestic market were somewhat (not a large amount) better than in the export market. Exchange rate movements could increase this difference. We cannot have total confidence in the figures that we have on profitability (as is normal). However our impression is that the domestic market produces around 2% more on

sales than export sales. Other factors such as quick and secure payment go some way to compensate for this.

However, what we have been told by a number of people is that in the early days of export shoemaking in China the foreign investors made very large margins. The reason was quite simple, foreign buyers were so delighted to be able to get a shoe from China for a dollar less than they had bought it in Hong Kong or Taiwan that they failed to ask whether they should have been getting it for three dollars less. The factory owner kept quiet and pocketed the difference.

The situation now is that major buyers are imposing conditions on hours of work etc., which together with the rise in labour costs is squeezing export margins quite hard for some producers. This is starting to produce some pressure to economize on labour, which as we have already noticed is a skill that most Chinese factories are short of.

Apart from inefficient use of labour, the biggest managerial problem in Chinese shoe companies is their primitive or non-existent costing systems.

A typical costing system consists of a calculation of the material used plus a fixed sum for labour, overhead and profit. The fixed sum will vary according to the quality of the company and the service it provides. A company which is prepared and organized to take small orders for a large number of models will charge more, while a company with a more basic organisation will charge less.

We were given the following examples:

- company with large development section US\$ 5/pair for labour, overhead and profit;
- less prestigious and flexible but competent Taiwanese company US\$ 3.5/pair;
- local Chinese company US\$ 2.5/pair.

To anyone who has been involved in shoe manufacturing, the results of fixed price overheads, the following consequences are well known

- those with high work content which stop the factory are underpriced;
- shoes with low work content which flow smoothly are overpriced;
- buyers notice value and buy more of the difficult shoes and less of the easy shoes;
- incidentally this could be an easy way to be accused of dumping without really knowing it had been done.

## The Supply Chain

The main shoemaking areas have a superb infrastructure of firms supplying all kinds of components and materials to the shoe industry. Only Italy has had a similar structure in the past and this is now breaking down. It is an advantage not possessed by China's rivals such as Vietnam, which is still dependent on Taiwan for certain supplies. The Chinese work well together to achieve common goals and this has accelerated its development of a closely linked industrial structure.

This situation applies to all non-leather supplies to the shoe industry. It does not apply to the same extent to leather where China is not always able to produce leather to the requirements of some of its major export customers. However since the major international tanners are happy to supply and since there are no difficulties placed in the way of importing leather, this does not cause problems.

It is important to note that not only are a very wide selection of shoe components available locally, but they are low priced not only because they are made with low cost labour, but also because the price of many freely available local chemicals and fibres are very low. There are a few internationally traded materials able to maintain international price levels, but these are in the minority.

The component industry came with the Taiwanese shoemakers and is closely linked to them. In addition while most of the shoe industry moved from Taiwan, a substantial component and shoe supply industry remains on the island.

China has a large leather producing industry using both domestic and imported skins. One should not forget that China is a very large producer of other leather goods and, in fact, the Chinese shoe industry only uses 50% of the output of the tanning industry.

As has already been noted China has a serious water supply problem, both in terms of amount and quality. It is recognized that tanning has contributed to the water quality problems. As a result Chinese government policy is leaning towards the development of leather finishing plants (wet blue onwards) rather than full vertical tanning operations.

The quality of China's shoe industry's infrastructure is a major contributor to the success of the industry, so a very key question is whether the infrastructure can move in the event of the shoe industry being forced to move inland by reason of the cost or supply of labour. The general answer is that the supply industry will move. It is not difficult to envisage companies in the supply industry setting up satellite plants in newly developing shoemaking areas. It has been done before elsewhere.

## Retailing

Shoe retailing is developing rapidly in China to meet the needs of a powerful manufacturing sector and a population that is increasingly able to afford more and better shoes. The property sector is extremely active and this has resulted in the building of many new shopping centres and the upgrading of existing shopping areas.

It is worth commenting on two types of shopping areas:

- The prestige shopping malls, which are sometimes referred to as “department stores”, though in fact they are a hybrid.
- The shopping streets and lower priced malls where the main part of the population does its shopping.

The prestige malls are often multi-storey, open atrium in design with separated shop units on each floor. They are called department stores but they look more like closed off “shops within shops”. Apparently the proprietor takes a rent of 25% of turnover. It was unclear what the proprietor provided in addition to serviced space.

In the more prestigious malls there were many shops selling luxury international brands such as VUITTON, RALPH LAUREN etc. There were not many luxury price shoe shops but a good mix of second line international brands like BASS, MEPHISTO, 9 WEST. Products were either original or locally licensed production. Prices were higher probably than in the original markets (e.g. RMB 1,000 for 9 WEST).

There were also many nice looking modern shops selling pretty shoes at prices around RMB 350-500/pair; there were few shops selling “street” fashions. In these prestige malls there were only a moderate number of customers.

In the popular malls and main shopping streets the situation was different; there were large numbers of customers. Service systems were assisted, self-service and prices were considerably lower. Quite attractive shoes were available for as little as RMB 60/pair but the top price seemed to be around RMB 300/pair. It seems that the retail multiple in the domestic market is normally around three times the ex factory price.

Although the shops are bright and clean most of them look the same as each other and there seemed to be little attempt at differentiation. There were some Chinese branded shops that tried to present a more distinct image. Not surprisingly this was more successful where the shop was selling more casual shoes.

Although the shop staff is mostly bright and enthusiastic, they were breaking many of the rules that would be set by an experienced American or European retailer. There is a big training job to be done.

The Chinese entrepreneur is enjoying the freedom to invest as he wants in retailing. Many new retail operations are opening. It is likely that as rent and other costs increase, a large number will be found to be non-viable and will close. It is unlikely that this will have long-term, adverse effects on the local shoemaking industry though in the short term retail bankruptcy may have a domino effect on some shoemakers.

## Social, Ethical and Safety Issues

In this section we will try to cover a number of the issues that people bring up in discussions about the Chinese shoe industry. It is rather normal when a particular industry or particular country is doing very well to accuse it of unjust labour practices, pollution, illegal subsidies etc. A large number of accusations have been made against the Chinese industry; we shall try to present a balanced view where we have been able to obtain information. In certain areas it is not easy to obtain information and we cannot really comment on these.

### **Working Hours**

Normal working hours are longer in China than in many countries. For example it is usual to work 6 days per week. It is quite common for the working week to be 60 hours, although Government rules may specify no more than 52 hours/week without special permission. There have also been stories of 7 days working with considerably longer hours particularly in companies where export deadlines had to be met.

It is certainly true that many export customers put huge pressure on delivery dates and that factory management accepts business knowing that excessive hours may be needed. However, the following points need to be noted:

- (i) If a workforce consists mainly of single migrants working away from home in order to make more money than they would if they stayed at home, the people will be happy to work long hours particularly if overtime rates of pay because they do not have much else to do. This will change if more of the workforce becomes resident near the factory, as workers will want to go home to their wives and families.
- (ii) More companies are becoming aware of the fact that excessive overtime produces diminishing results.
- (iii) There is a lot of pressure (which is obeyed) on companies working for the big brands to work only 10 hour/days as a maximum and to have one day off in every week.
- (iv) The high demand for labour, particularly trained labour means that workers will just go elsewhere if they think the hours of work are unreasonable.

### **Other Working Conditions**

Bigger companies with clearly stated corporate social responsibility (CSR) policies watch out for various other abuses which include such things as unreasonable and unexplained deductions from pay and contracts which lock the worker into a job for an unreasonable length of time on unreasonable conditions.

Workers who were well established in the industry would not be susceptible to this and could always walk away from a company that indulged in such practices (or even go on strike). It is possible that less sophisticated workers from rural areas could be disadvantaged and this probably does occur.

- *Occupational Safety and Health (OSH)*

The majority of Chinese shoe factories in the main shoemaking areas are in new purpose-built factories. Large buyers, their technical teams and foreign investors have set high standards. Most factories are well lit, clean and fitted with adequate ventilation in areas where fumes are present. In some ways it is odd that a pay premium should be given to workers thought to be exposed to fumes.

Chinese factories are not highly mechanized so there are less potentially dangerous and/or damaging machines than usual. However, cutting presses appear to have two-switch operation that is a basic safety requirement.

We understand that in inland areas, which work mainly for the domestic market working conditions, are less good and that in particular fume extraction is poor. In general smaller scale Chinese industry has a poor safety record.

- *An Overall Comment on Compliance*

Quite a number of people said to us that adherence to rules on working conditions etc. were not part of the Chinese business culture and that things were only done correctly when an inspection was being made. This makes international companies who have the reputation of very big brands at stake rather nervous. There is certainly some feeling that a lot of effort goes into diverting the attention of visiting buyers, technicians etc.

- *Local Authority Incentives*

There is no doubt that local Government authorities have done a lot and provided considerable assistance towards the setting up of shoemaking companies in their area. We were told that local Government bodies away from the coastal region were often keen to try and encourage the establishment of a shoe or clothing cluster in their area as they saw it as a way of getting on the first step of the ladder of industrialization.

This appears to be little different from the incentives that have been offered by provincial governments in Brazil and which have led to the relocation of a substantial part of the Brazilian shoe industry. It does not appear to amount to an unreasonable long-term subsidy to the industry.



## Taxes

A detailed description of the Chinese business tax system is to be found in *Annex 2* but it is worth making a few general points about the less controversial and simpler taxes.

- The Chinese Government has seen rapid growth of the footwear, clothing and similar industries, which are labour intensive, as a means of bringing down the unemployment level. It has, therefore, entirely logically created fiscal conditions that have helped ensure early profitability for investments in these industries. It has also levied lower rates of income tax on companies where foreign capital investment is involved. These tax breaks are given for a finite number of years after the first profits are made.
- All businesses pay a business tax of 3-5% of sales. This is the main source of income for local Government.
- Value added tax (VAT) is the main source of income for the Chinese Government; for the shoe industry it is levied at 17%.
- Customs duties are levied on import goods and materials. The normal rate of duty has now dropped to around 10%.

The area, which we have found most complicated to understand, is what is sometimes referred to as export subsidy. In the past this was at the rate of 17% (the same as the VAT rate), today it is 13% and the government has promised the WTO that this will be progressively reduced to 11% then 8% then 5%.

If this were truly an export subsidy then obviously it is something that would cause problems in international trading circles, on the other hand if it was just a refund of VAT then it would be a perfectly normal trading practice. We were told that this refund was not paid to shoe factories that sell through export trading houses but that it was paid to the export trading company. This would be totally consistent with a normal VAT system where the shoemaker would charge VAT to the export wholesaler.

If in the future a shoemaker pays 17% on all his supplies and is only allowed a 5% export subsidy, then he will be paying a substantial extra tax that is not very logical. Equally part of the subsidy could in part be a repayment of customs duty on raw materials (covered by duty draw back arrangements in other countries) or a repayment of business taxes.<sup>5</sup>

### Corruption

There is a lot of talk about corruption in China. We do not know what it refers to, i.e. who is being bribed to do what. What we do know is that it is a problem that worries many foreign business people who trade with China and that it is something that makes them want to do business in areas where corruption is less of a problem.

## Institutional Background

In this, the final section, we will look at three areas of institutional support for the shoe industry.

- trade associations
- training organizations
- research (R&D) institutions.

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<sup>5</sup>Unfortunately we have been unable to obtain an authoritative explanation of this.

### Trade Associations

The umbrella organization for the industry is the CHINA LEATHER INDUSTRY ASSOCIATION (CLIA), which that was established in 1988 and covers all parts of the leather and leather products industries and their suppliers together with the research and training institutions that support the industry. CLAI has today 1,300 members.

“As a role of a bridge and tie between the government and enterprises, CLIA has to accomplish the work entrusted by the government, implement government policies and decrees, as well as promote the development of the leather industry. (...) To facilitate exploitation of the international market the exhibitions of All China Leather Exhibition (ACLE), China International Footwear Fair (CIFF) and Moda Shanghai are established and held in Shanghai annually which became the most attraction international fairs.”<sup>6</sup>

CLIA has – beside its secretariat – nine commissions for tanning, fur, leather and sports shoes, leather garment, leather goods, leather chemicals, machinery, science and technology, management respectively. The Association operates the *Genuine Leather Mark (GLM)* scheme established in 1994 and is awarded to leather products if they are (i) made of genuine leather, (ii) of high or medium quality and (iii) feature after sale service. The *GLM Eco-leather (fur) mark* introduced in 2003 is given if products – beside the previously mentioned three criteria – are manufactured in environmentally friendly conditions.

There are also regional associations. For example there is the GUANGDONG ASSOCIATION, which represents 10,000 members who are active in all parts of the industry. It would seem that both the more influential members and we understand the Government do not think that this is a particularly effective body as more local groups are being set up, for example the ASSOCIATION OF GUANGZHOU SHOE TRADES (100 members) and the SHANWEI ASSOCIATION OF SHOE TRADES (400 members). It appears that membership (RMB 1,000/year) of these groups is more selective and thus the association does not have to represent the rather embarrassing activities of some members. The main activities of the new associations are:

- export and marketing promotion,
- technology support,
- warning members of new risks and new policies in China and in the export market, but they do not deal with pay issues.

The CHINA NATIONAL LIGHT INDUSTRY COUNCIL (CNLIC) is – partially – the successor organization of the former Chinese MINISTRY OF LIGHT INDUSTRY, but without controlling functions. Representatives of the *Department of International Cooperation* of CNLIC explained that this new organization is a channel between the Government (normally not dealing with sector-specific issues) and the private industry in some 40 sectors. (The light industry<sup>7</sup> produces 30% of the Chinese export, of which 2/3 is footwear and other leather products.)

### Training

Medium and large-scale shoe manufacturing companies claim to provide 1-3 month training to their newly employed labour, some reported even 1-3 months probationary period for newcomers. Technical, design, managerial and support (e.g. marketing, finance) staff is either from Taiwan or from Wenzhou-based plants getting experienced by working with foreign (predominantly Taiwanese and Korean) specialists.

There is a national secondary school named BEIJING LEATHER AND FOOTWEAR TECHNICAL SCHOOL providing training in footwear design and technology. Furthermore, there are some

<sup>6</sup>Extracted from the CLIA bilingual (Chinese and English) leaflet.

<sup>7</sup> The term “light industry” in China does not include textile and its derived products, but it covers light engineering, pottery, household appliances, furniture etc. Practically all economic activities, including production are privatized in this sector as opposed to mines, energy suppliers and metallurgy where state-ownership is dominant.



local training schools imparting such kind of training, those schools are located in Guangzhou, Wenzhou and Shanghai provinces respectively and carry out short terms (1-1.5 months) training courses in different footwear production bases each year. About 2,500-3,000 students and technicians received training each year.

According to local sources nearly 20 higher educational institutes have faculties dealing with footwear engineering producing about 2,000 graduates annually (*Annex 1*). In fact factory visits did not reveal presence of such specialists in the practical work.

### **Research and Development**

The CHINA LEATHER AND FOOTWEAR INDUSTRY RESEARCH INSTITUTE (CLFI) located in Beijing was founded in 1959. It is a state-owned enterprise and employs 120 researchers and assistants. The INSTITUTE concentrates on research, technology development, quality assurance (testing), standardization and environmental protection related to leather processing, footwear and other leather goods (including fur products) manufacturing. Operational costs are covered from incomes generated through implementation of projects ordered by the Government<sup>8</sup> (1/3) and local companies (2/3).

The physical and chemical testing laboratories of CLFI are far from being well equipped: existing testing equipment do not cover all relevant test used worldwide, at the same time some locally manufactured (not standard) machines are installed in large numbers. CLFI, including the satellite laboratory in Guangzhou, undertakes 3,000 test jobs annually.

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<sup>8</sup> MINISTRY OF SCIENCE.

## THE FUTURE

In the previous section we described the Chinese shoe industry as it is today. We showed that the situation of the industry is not at a standstill. The industry is growing fast and it is already beginning to show some problems (such as labour cost and availability), which might restrain its growth in the future. We now come to the most interesting but least certain part of this report, “what will happen to the Chinese shoe industry in the future?” In order to try and find an answer to this, we shall look at the growth potential of the Chinese shoe industry, which will probably be balanced by a number of constraints such as

- internal constraints;
- external competitor countries;
- customer concerns;
- trade restrictions and pressures.

We will then try to come to an overall conclusion together with some recommendations on what the Chinese shoe industry might do to avoid some of its potential difficulties.

### The Growth Potential of the Chinese Shoe Industry

The Government – in cooperation with CLIA – designated the following towns/cities and provinces as prosperous, special areas for further development (*Table 5*). It should be noted that with the exception of Chongqing, Henan and Sichuan all other provinces are located on the coast, whereas Fujian, Guangdong and Zhejiang provinces have already quite extensive leather-product manufacturing clusters.

**Table 5: Prosperous special areas**

Industry	Town	Province
Footwear	Junjiang	Fujian
	Chengdu Wuhou	Sichuan
	Bishan	Chongqing
	Huidong	Guangdong
Fur	Tongxiang	Zhejiang
	Tonggepru	Liaoning
	Sangpro	Henan
	Daying	Hebei
	Suning	Hebei
Leather Goods	Baigou	Hebei

The first thing to be said is that after only 20 years of development of the industry there are now no technical or logistical constraints on what the Chinese footwear industry can do. In the past it was said that China was a good place to do business provided you were prepared to order and take delivery at one time of say 20,000 pairs of a single style as long as the order was placed six months in advance and as long as the order was for quite simple footwear.

All that has changed:

- The Chinese shoe industry is capable of making shoes of high quality.
- It is capable of making shoes efficiently in small volumes.
- Many factories have very fast product development procedures.
- Repeat delivery times are dropping down from 45 days.
- In any case high value, high fashion shoes can support the extra cost of airfreight.

China has a population infinitely larger than other countries with the exception of India. This large population presents the Chinese shoe industry with two great advantages:

- a huge and growing domestic market;
- a large potential workforce.

It has been estimated that in 2005 Chinese shoe production for the domestic market will be just over 3 milliard pairs and that this will rise towards 4 milliard pairs by 2010. This will still give a per capita consumption well below that of many Western countries. There is ample scope for further long-term growth. Any national improvements in wages and living standards will increase the ability of the domestic market to absorb more shoes.

On the labour supply side although there is a tight labour supply situation in the prime coastal industrial areas, for all the reasons indicated in the previous section the shoe industry can move inland towards the areas where there is considerable labour still freely available, so taking the work to the worker. Long term this is probably a more satisfactory situation and will produce a more stable and skilled work force.

It is likely that in the future around 50% of the total Chinese shoe output will be for the domestic market and for this the logistic changes brought about by a move of production from the coast to the interior of the country are not serious.

We have already noted that the Chinese shoe industry uses labour very wastefully. This means that large increases in output could be achieved by better organization and pressure to make these changes already exists in the coastal areas.

Equally Chinese agriculture is still largely non-mechanized. It is certain that this situation will change and less people will be required to produce the same amount of food crops. This will produce surplus labour that can then be employed in industry.

The other factor that will drive the Chinese footwear industry forward is the fact that it includes a rapidly increasing number of dynamic young native Chinese entrepreneurs who are highly motivated and ambitious. If the industry was to depend for its future on Taiwanese or Korean owned companies, the situation would be less optimistic because these foreign owned companies have the management succession problems that we described earlier.

There is no doubt that some of the earlier entrants to the industry may find it harder to compete in the future because in a large country like China with a dynamic industry there is always someone prepared to make things cheaper (but not always better). So the industry will grow overall but may leave a train of failed companies behind.

However, there are several constraints that will probably have an impact on the future growth of the Chinese footwear trade.

## Internal Constraints

The most obvious constraint is the availability of labour at current wage rates in the main shoemaking areas. Wage rates will be driven up by:

- An overall increase in wage rates as living standards improve in China.
- Tough competition for labour in areas with the best logistical support in China. The areas where the shoe industry is currently concentrated are areas where industries that are even more dependant on good communications are likely to concentrate. Among these are automobiles and electronics.

As we have already noted higher living standards imply not only higher wages, which increases production costs, but a much larger market for shoes.

Higher labour costs make it more difficult to export (if there is real world competition) but on the other hand increases the size and probably the profitability of the domestic market. All things being equal, it is likely that the proportion of Chinese output going to the domestic market will increase and this proportion will increase by more than the simple expansion of the domestic market implies as the domestic market becomes more attractive.

The key problem facing the Chinese shoe industry is poor productivity, which is the result of lack of management and supervisory skills. In the best departments (closing, stitching) Chinese productivity is only 40-50% of normal benchmark standards, in final assembly it may be below 10% of standard. There has been little investment in training supervisors. It seems that most foreign investors are entrepreneurs who do not have the detailed production management skills required and we have the impression that the new Chinese managers and owners do not regard it as a high priority.

Long term there is a serious problem of market expectation. As a result of the extremely low costs which Chinese shoe producers have been able to offer shoe buyers, the buyers and Western consumers have become used to prices much lower than used to be the case. If labour costs rise rapidly and if the currency appreciates somewhat, it may be very difficult to pass price increases on to buyers. Profitability may be squeezed very hard (possibly fatally for some firms). Unless companies can improve efficiency (and this may mean investment in better machinery) buyers will tend to move to someone who can do the job cheaper although this may well still be in China.

The current view is that moving production to areas where wage rates are low can solve this question of price pressure. The question is whether such a move would produce logistical problems that would outweigh the labour cost savings.

The current situation is that although the coastal areas are congested and, in spite of heavy investment in roads, there are huge traffic problems. Nonetheless, it is a very good place to do business. There is an unparalleled concentration of the shoe industry and all its supporting supply and service industries, which means fast reaction times. In addition there are a number of major container ports. These are not feeder ports but mainstream ports used by the “trunk” route container ships. This provides a wide choice of fast delivery services.

From the point of view of visiting buyers, there are direct international air services into a number of major cities such as Guangzhou and Hong Kong that have direct connections throughout the Pearl River Delta; then there are Shanghai and Beijing.

Customs clearance inward and outward is quite simple. It seems that if the industry was forced for labour cost reasons to move a long way inland, then the supply and component industry would move with it to a large extent. The real difficulty would lie in the transport system. Neither road nor rail transport in the more rural provinces are particularly good and at present it seems there are old “command economy” restrictions on the free development of road haulage services which prevent the development of efficient “all China” trucking companies. Customs clearance will also clearly be a problem.

Many of these difficulties are less important for customers operating in the domestic market, but at present exporting from Sichuan Province would be hard work. However one must assume that something will be done about roads and road haulage and there is no reason why Chengdu should not become a well-serviced international airport.

It is also true that something will have to be done on the question of water and electricity supply. While it is possible for factories to get around the problems, in the end difficulties with basic service industries do not make a good impression with buyers.

## External Competition

The Chinese shoe industry is so big that there is no single shoe producing country that can present a threat. Any threat would have to be from a general dissatisfaction and turning away to a number of different alternative sources.

- **Brazil.** Produces around 600 million pairs/year with exports around 25% of the total. The industry has well-located, modern plants. It has a good reputation for fast service to the USA and Europe and is appreciated for other reasons we shall deal with later. Not particularly low cost, but could expand.
- **Vietnam.** For some buyers it is the real alternative to China. Production is thought to be around 400 million pairs/year with an installed capacity of 550 million pair/year. There appears to be agreement that Vietnam, with a population of 80 million, could only support an industry producing 1 milliard pairs/year. At present the ownership of many plants is Taiwanese and in fact many components come from Taiwan but the industry is likely to become rapidly more independent and there is a view among outside observers that the Vietnamese will do some things better than the Chinese.
- **Thailand.** The industry here is exporting less than it did in the past, but is still a viable production source.
- **India.** Has the same large population as China and is also enjoying an improved standard of living. India has excellent raw material resources and a huge tanning industry with some world-class plants. Although in the past India produced large quantities of uppers, which were finished in the USA and Europe, it has failed to develop an export shoe industry. Partly this is due to managerial attitudes and relationships between companies. This could change and the catalyst might be a major feeling of dissatisfaction with China resulting in technically competent buyers putting real pressure on Indian companies to get organized. Indian stitching standards are similar to China.

- **Pakistan.** Has good material resources but has never managed to become active in the leather shoe upper exporting business in the way that India did. This was possibly due to the fact that persistent security problems in Pakistan made it a less attractive place to do business.
- **Italy.** During our investigations it has become clear that the Italian shoe industry is undergoing a major reduction in capacity and that this reduction in capacity is also destroying much of the comprehensive infrastructure network that was an important ingredient for the success of the Italian shoe industry.  
For many years the capacity of the Italian shoe industry was around 480 million pairs/year. Over the last seven years this has come down to around 350 million pairs/year. There is a strong and widely held view that this will collapse further and quickly to around just over 200 million. In recent years Italian companies have sourced a lot of production in Eastern Europe. We have been told that the decline in the Italian shoe trade has been due to the industry not concentrating on what it should concentrate on, which is providing quality fashionable shoes on short delivery dates. In fact it appears that with poorly managed Eastern European resourcing, quality has become unreliable and delivery slower than from Asia.  
The important point is that some Italian shoemakers are still the best and if there was a major upgrading of management in the wider industry, then the Italians could regain a market share in the future.
- **Turkey.** In the shoe industry Turkey is, up till now, one of the great “might have beens” like the Philippines; unlike in textiles and leather clothing where it is a world-class, low cost producer with quick delivery to Western Europe. Could it do this in shoes?
- **Other countries.** There are quite a number of other places where modest amounts of shoemaking capacity could be created but none are very large.

## Customer Concerns

By customer concerns we mean the factors which influence the decisions made by buyers as to what mix they want in their supplying countries and companies. This covers a whole range of topics from macro economic issues such as the political relationship of the USA and China to micro irritations where a buyer goes against a country because he/she always gets some kind of food poisoning. The following issues deserve special attention.

### **Intellectual Property and Design Exclusivity**

In general China has a bad reputation in this area. Certain shoemaking centres have a particularly bad name and are avoided by major international groups. Steps are being taken to tighten down on the worst abuses but even so there is a feeling that it is hard to get an individual “handwriting” on a collection made in one of the major shoemaking centres. This is one of the reasons why companies like to do business in Brazil, which is perceived as being much better in this respect.

### **Corruption and Transparency**

The existence of extensive corruption in any country is likely to make the management of major customers nervous. They are only too well aware of how a serious attempt to corrupt their staff by suppliers can put the whole business at risk. Working in an atmosphere, which seems to be corrupt makes them uncomfortable.

We have already talked a certain amount about the steps that companies take to ensure that their suppliers do nothing which could make them the subject of a consumer boycott or



serious public relations problems. Major companies like to feel that their suppliers genuinely agree with them that these issues are important and do not just comply to win a particular order because they are forced to. There is no doubt that at present many Chinese shoemakers are not seen as being deeply committed to some of their supplier's policies.

### **Trade Policy [Risks]**

Buyers like to feel that their trading relationships are not likely to be suddenly upset by quotas, extra duties etc. This was a major reason why some companies went to Vietnam rather than China because they felt (wrongly as it has turned out) that they were less at risk of anti-dumping etc. actions.

The way that the Chinese shoe industry has grown and the way that it has been organized without strong control by industry associations means that it is not surprising that it has provoked quite strong counter reactions in some of its potential markets. There is little sign of political sensitivity at present.

### **Major Political Risks**

It could be that large American buyers who are particularly dependant on China might worry about the risk of trade disruption as a result of a dispute between the USA and China over the future of Taiwan. We did not find much evidence of this.

### **Health**

The severe acute respiratory syndrome (SARS) was an awkward moment that caused no long lasting problems. It does not seem to have altered trade patterns for more than a few months. Avian 'Flu remains a risk.

### **Buyer Prejudices**

We were told that in the clothing industry a buyer might well decide not to transfer all his business from Mauritius to China because Mauritius was a nice place to visit from time to time. Keeping buyers happy does matter and it is not just a matter of "special treatment".

## **Trade Restraints and Pressures**

These are very much in the news at present. In fact Chinese exports have only been seriously constrained over the years to the EU and to some parts of Central and South America. There have been virtually no constraints on exports to the USA where China already supplies around 80% of the market. Since the USA footwear industry has already effectively ceased to exist, there is unlikely to be any of the kind of lobbying that has been exerted on behalf of the clothing and textile industries. Equally, growth potential is limited by China's already high market share.

The reality is that the shoe industry in most Northern European countries is in the same state as that of the USA. Their industries were destroyed by much earlier competition from within the EU such as Italy, Portugal and Spain, to some extent Brazil and in a specialized way by South Korea and Taiwan. The current pressure to reduce or control imports from China into the EU arises because of the pressure on the shoe industries of Southern Europe.

In the short term a successful anti-dumping action by the EU would cause considerable disruption to established supply lines to the European footwear market. It might provide temporary respite to the Italian, Spanish and Portuguese industries; however, European buyers - both wholesale and retail - are not moving away from Italy only on price grounds and a more likely

beneficiary would be South East Europe. In the longer term China would increase its share of the European market.

The EUROPEAN SHOE FEDERATION (CEC)<sup>9</sup> has argued for many years that its key objective was world shoe trading without subsidy and free access to markets like China for its European production, which would benefit the medium to high priced European shoe makers. Total and transparent opening of the Chinese and neighboring markets might solve a lot of problems.

Another issue is the need for the Chinese industry to be seen to be operating in an environmentally and socially responsible way, as not doing so can quickly make the industry vulnerable to boycotts by consumer groups. This is always a problem but the industry needs to have pro-active trade associations who are constantly on the lookout for threats. Local trade associations should not try to defend the practices of irresponsible companies; if necessary they should be shut down to avoid ruining the reputation of the rest of the industry.

It is obvious that anything that smells of any kind of export subsidy or special tax treatment is likely to provoke very strong reactions.

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<sup>9</sup>The abbreviation comes from the French name of the European confederation: CONFÉDÉRATION EUROPÉENNE DE L'INDUSTRIE DE LA CHAUSSURE.



## CONCLUSIONS

### Conclusions

The Chinese Shoe Industry has huge growth prospects in its domestic market. It may well be that higher labour costs which are not compensated by increased productivity, less good logistics caused by the need to move away from the coast etc. may make China over the years a less attractive place for export shoe business. Therefore, future growth in internationally traded shoes could come from quite a wide spread of other countries and it may be that China can grow its exports only by a further 500-1,000 million pairs/year.

At the same time it is hard to see other countries taking away large amounts of shoes made for export by the Chinese shoe industry. Other countries do not have either the workers or the sheer scale of industrial capacity. Even though we can expect major buyers to put pressure on to diversify their sources.

Production in China is likely to be around 7.75 milliard pairs/year of shoes this year of which perhaps 4.65 milliard/year will be exported. A guess might put production at around 9 milliard pairs/year with exports making up half that amount. At 9.5 milliard pairs/year production China would be at that 65% equilibrium point. Is that where it is going?

What is reasonably sure is that China will not go on expanding shoe output quite as fast as it has done in the past.

### Recommendations for the Chinese Footwear Industry

Although the purpose of this survey is to inform members of the UNIDO Leather and Leather Products Industry Panel about the Chinese shoe industry, as the team has spent considerable time on research it might be helpful if we set out what are the recommendations we would make if this was a “consultancy” type of report.

The Chinese footwear industry’s poor productivity, its weak costing systems, its lack of good production management skills at all levels and the apparent lack of interest in the subject by senior management are serious problems.

They are likely to lead to severe price pressures for the reasons we have shown. In turn this is likely to lead to severe financial problems for weaker companies, many of which may fail although lower cost operators may well take their place.

We, therefore, recommend that the industry and its supporting organizations should develop training schemes to

- improve serious management understanding of productivity and proper product costing;
- improve the level of supervisory skills by systematic training.

## Recommendations for the Rest of the World

The shoe industry of the rest of the world is faced with a situation where China already supplies around 60% of the world's shoes, and we agree that this proportion could rise to 65%. In theory there is no particular reason why it could not go higher still. The task of the shoe industry in the rest of the world is to ensure that it has a permanent position in the shoe market that allows it to make sustainable profit, for without profit it has no future.

Actions required are most easily identified by looking at consumer attitudes. Low cost production in China and the surrounding areas has allowed the world's population to equip itself with basic and much not so basic footwear at a cost much lower than was thinkable some years ago.

Governments in Eastern European countries were forced to open their markets to low cost imports from China simply to provide for the needs of their poorer citizens even if it meant sacrificing their own country's shoe industries.

The population of the world, including many reasonably well off people in developed countries, has become accustomed to spending a lower proportion of their income on footwear than they would have believed possible in the past.

This situation has arisen for a number of reasons, but among them:

- Consumers appear to have been prepared to accept less stylish footwear than they did in the past or perhaps shoemakers did not produce sufficiently exciting new products.
- The shoe industry of China (and countries like Vietnam) have become more flexible in production demands and more able to produce smaller series of more complicated footwear.

So, taking into account these realities of the market the following recommendations are offered for rest of the World:

1. It may be possible for some countries still to maintain **protective duties and quotas** to a certain level, but in developing countries one needs to be aware of the following:
  - Severe duties and quotas almost inevitably lead to large scale smuggling in one form or another.
  - It is difficult for a poorer country to insist that its people buy shoes at say four times the world market price.
  - Over-protected industries are usually inefficient and do not supply consumer needs as well as they should. They are unable to seize export opportunities even when they exist.
2. **Anti dumping duties and trade management systems** currently being investigated by the EU for the footwear and textile industries do not provide long term protection for the industry and encourage shoemakers to put off much needed reforms.
3. **Service.** Providing excellent service to local retailers or retailers in nearby countries is probably the best way of surviving. Retailing is all about stock turn and being able to get more of the models that are selling well quickly. Many of the Italian shoemakers who are having problems now have not concentrated on this aspect of their business enough. The ability to provide a reliable repeat service within four weeks is a key commercial advantage. It applies to Mexican shoe companies supplying a USA East Coast retailer as it does to an Italian shoemaker supplying a Belgian retailer.

4. **Product differentiation.** There is a lot of talk about niche products and undoubtedly producing highly specialized footwear can provide secure markets. But there is also a lot of benefit in just producing products that are not niche, extremely well. For example men's street fashion is not really a tight niche but providing a very up-to-date collection for this market is something that not everyone can do.
5. **Design integrity.** China has a reputation for being a difficult place to produce collections with a unique handwriting. Other countries have done much better.
6. There is nothing to stop highly efficient shoe plants being set up in a whole number of countries. If the plant is truly efficient (in the way that most Chinese factories are not), then there is nothing to stop it being highly competitive even if the wage levels are not as low as those in China. This will be a route chosen by many entrepreneurs and encouraged by their international buyers.
7. **Export.** A company that is a successful exporter almost never has problems in defending its home market. In the smaller niches strong exports make a company viable. The ability to export is the real certificate of competence for a shoe company.

These are a few ideas, they could be elaborated further and of course there are many other strategies.

## The Chinese Footwear Industry as Reported from China

### General Characteristics

The footwear sector is a significant segment of the leather industry in China. After fifty years of development the footwear industry of China has formed its integral system from research, production, marketing and education and is one of the biggest footwear producer in the world.

When China joined WTO in 2001, the footwear industry showed a trend of even more rapid development. Annual footwear production in China amounts to some 6.5 milliard pairs, covering about 60% of the world's total output (including an annual output of some 2.6 milliard pairs of leather shoes) reached US\$18 milliard and contributed a 55% share of its total export of leather and leather products of China.

China's access to the WTO opened new opportunities for the local footwear industry, namely:

- As the import tariff declines, local manufacturers can equally procure the shoe material, components and machinery it needs. It helps to improve product quality and lower the operation costs, so as to sharpen their competitiveness to meet the challenge.
- The export value has dramatically increased from the benefits of enjoying the favorable treatment granted by the US Government to the Chinese economy, which is a consequence of China entering the WTO agreement.

At present there are approximately 30,000 leather and leather products manufacturing enterprises operating in China with over 2 million employees – 55% of them work in footwear companies.

In 2004 the annual output of the entire leather processing industry was 4,000 million m<sup>2</sup> of finished leather and over 6 milliard pairs of footwear.

### Location

Along with 15 years of rapid development in the Chinese leather and footwear industry, a larger footwear production base was formed. In this base, the footwear industry has become the mainstay industry with specialized social divisions of labor and special features promoting the development of the local economy and has laid the basis for stable and steady development of the whole leather and footwear industry of China.

The largest footwear production areas – in order of production volumes – are Guangdong, Fujian, Zhejiang and Sichuan provinces.

#### **Guangzhou in Guangdong Province**

In the Pearl River Delta Guangzhou was the first shoe manufacturing centre with foreign investments made by Taiwanese entrepreneurs, promoting the development of the shoe material market, technical service center and the work of research and development.

The footwear industry in Guangdong province has become one of the largest bases for production and export of footwear in the world. Dongguan is the heart of footwear production in Guangdong, with thousands of production lines in more than 3,000 shoe factories, covering one third of the total footwear output of Guangdong or 10% of world's footwear output. The town of Houjie is the most important place in Dongguan area for its hundreds of shoe factories equipped with hundreds of production lines producing over 300 million pairs of shoes annually. Also, in such a small town nearly all the world-famous shoe machinery producers and traders from Italy, Taiwan, Hong Kong, as well as 2,000-3,000 shoe material suppliers have gathered there and the town has become one of the most important bases for manufacturing and trading shoes, shoe machinery and material in China. A town called Huangbu is located on the coast of Guangdong province, formerly a coastal goods distributing center between Huidong and Haifeng counties. It now has become the "shoe city of the world". There are 668 shoe factories and 135 shoe material producers with 199 production lines in that small town. For the year of 1998, the total footwear output of the town amounted to 42 million pairs with a value of US\$ 100 million, covering 92% of the total industrial and rural production values of the town and 98% of the industrial production value. Leather shoes, sandals, sports and children's shoes produced here sell well to all parts of the World (some 30 countries and regions including Japan, the USA, Russia and Hong Kong). The average income of people of the town has surpassed that of any other town in the same county. At present the Huangbu "shoe city" is striving for the target of group control of combined organization of factory premises, mechanization of manufacture, brand promotion of products, web site utilization for sales and development for more foreign trade.

### **Fuzhou in Fujian Province**

The second largest footwear base after Guangdong is Fuzhou being the prosperous footwear industry with key products of jogging and sports shoes together with allied industries of shoe material and shoe machinery. There are about 4,000 footwear producing units and allied trade enterprises around the area of Fujian province with more than 500,000 people working for shoes with an annual production value of US\$ 2.5 milliard. The factories are equipped with hundreds of complete production lines sourced from Italy, Japan and Taiwan and thousands of injection moulding machines and other specialized shoe-making equipment for the manufacture of various kinds of men's and ladies' fashion shoes, boots, outdoor casual shoes, sports shoes, safety footwear, sneakers, beach flip-flops, sandals, various types of children's shoes and traditional embroidered shoes with fine workmanship. Some other factories produce shoe materials including PVC, TPR and rubber. The shoe-making base of Fujian has formed a complete chain of industries and trades with superiority of groups and clusters on the basis of sports shoes and jogging shoes as main products integrated with allied trades of shoe material and shoe machinery. Now all allied products used on shoes such as metal accessories, shoe lasts, soles, heels, shoe lining materials, adhesives and packing boxes are produced in this industrial area. Shoe factories are mainly located in the areas of Fujian urban districts, Shishi, Jinjiang, Hui'an and Nanan. In these areas, various shoe-making bases of different special product features have formed, such as the production base around the area of Fuzhou urban district, towns like Chendai, Xinbin and Qidian (they belong to Jinjiang city) mainly producing jogging/sports shoes as well as allied products of metal accessories and shoe material. The cluster located around Shishi mainly produces leather shoes, fashion and casual shoes. The Honglai cluster, consisting of Jiudu town of Nanan county produces children's shoes as well as the slipper production base at Neikeng town of Jinjiang. Now a market of shoe material, shoe machinery and shoe technology in the Fujian area has formed, with annual requirement of these products and data from all over China with a total value of RMB 10 milliard. In the Fujian area, large

amounts of jogging shoes and sports shoes are produced, accounting for one fourth of shoes produced in all of China and nearly one fifth of those of the world.

### **Wenzhou in Zhejiang Province**

Wenzhou is located in the southeast part of Zhejiang province – adjacent to Fujian – and is one of 14 coastal cities first open for foreign investments during the 1980s. The formation of shoe-making industrial clusters on the basis of development of leather shoes in conjunction with the advancement of allied trades such as shoe material, shoe machinery, specialized markets, technical training and product inspection as integral parts of the whole shoe-making industry in the Wenzhou area has shown its brilliance in the development of the economy of Wenzhou. For the year 2003 the total output value of the leather and footwear industry amounts to US\$ 4.2 milliard, accounting for 25% of the total industrial production value of Wenzhou, and for 1/3 of the total export value of the city. The leather and footwear industry is a traditional industry in the Wenzhou area with a long history and has now formed an integral industrial system of three main production operations of leather, leather shoes, leather goods and leather garment, together with allied trades of leather chemicals, leather machinery, metal accessories and shoe material. Therefore, Wenzhou has become an important base for production and export of leather products in China. According to incomplete data information, at the end of the year 1999, there were some 350,000 people involved in the leather and footwear industry in the Wenzhou area and there are about 4,000 shoe-making enterprises (mostly private invested).

### **Chengdu in Sichuan Province**

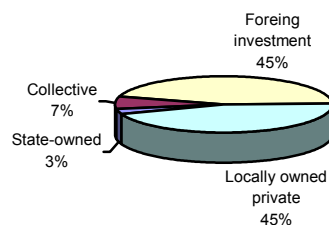
Chengdu city in Sichuan Province is one of the larger shoe-making bases on mainland China. More than 3,000 footwear enterprises have been set up there including 10% of medium and large-scale production units. There are more than one thousand shoe-making units and allied enterprises concentrated in the Wuhou district of Chengdu with more than 80,000 employees. Shoes produced in the Chengdu area sell well to cover the market of the western part of China, including Sichuan, Guizhou, Yunnan and Tibet and is competitive on the market of other parts of China such as Shanghai, Jiangsu, Zhejiang as well as the northern and central part of China. Also, the gradual increase in the amount of exported shoes produced in the Chengdu area shows that these shoes have covered a certain portion on the foreign market for Russia, the European Union and countries of South East Asia.

As the areas of special features as described above have shown their benefits to the industrial chain of clusters formed by integration of main industry and its allied trades with a specialized division of labor, the government of Sichuan province has decided to put the development of the leather and footwear industry as an important project with government support to solve the problems of funding and land requisition to speed up the progress of the construction of “west shoe capital”.

In the vicinity of Sichuan province, the Bishan county of Chongqing municipality has rapidly developed its shoe-making industry. In recent years, the county government has exerted great efforts to develop shoe making as its main industry in the county and thus an industrial cluster for footwear production has formed. There are now some 1,800 shoe factories in the county with over 50,000 skilled workers producing more than 50 million pairs/year with value of about RMB 2 milliard/year.

## Production and product structure

The 7,200 large-scale shoe factories employ more than 2 million people in China. The ownership structure is shown in the following figure:



*Figure 1.1: Structure of the Chinese shoe industry*

### **Guangdong Area**

In the sequence of amount of the output of different kinds of footwear in all China, leather and plastic shoes of the province get are in first place and rubber shoes second, with cloth shoes in fourth place. With regard to leather shoes there are all kinds and types of shoes including men's and ladies' dress, casual, jogging shoes and safety boots. As to the scale of production, some Taiwan-invested jogging shoe factories are quite large, but most leather shoe factories are very small. The three most concentrated areas for leather shoe production in the province are Guangzhou, Dongguan and Shenzhen.

### **Wenzhou Area**

In the sequence of amount of the output of different kinds of footwear in all of China, rubber shoes of the province are in first place in China with plastic shoes in third place. The output of leather shoes is only less than that of Guangdong province and is in second place in China. The most concentrated area of footwear production in the province is Wenzhou, with men's shoes as main products together with a certain output of ladies' shoes and children's footwear. As the whole leather shoes industry of Wenzhou has the awareness of brands with a strong capability of market expansion and trends of rapid development and also in view of the development of whole leather industry there, Wenzhou has had the honors of being awarded the name of the "Leather Capital" of China.

### **Fujian Province**

The output of plastic shoes is in second place in China with leather shoes in third place. The most concentrated area of footwear factories in the province is Guangzhou, with jogging and casual shoes as main products.

### **Henan Province**

The main product is textile shoes whose output is in first place in China.

### **Jiangsu Area**

The output of cloth shoes is in second place in China. Most footwear factories are scattered in different areas of the province with a relatively small number of enterprises in each area. However, several larger scale enterprises in the province enjoy a certain degree of prestige on the Chinese market.



### Shandong Province

The output of rubber shoes is in third place in China. Most production enterprises are located in the areas of Qingdao and Weihai of a relatively small-scale.

### Chongqing City

The city is one of the four municipalities in China. Although the output of enterprises with an annual sales revenue of about US\$ 1 million ranks only 10<sup>th</sup> place in China, the city is actually one of the important leather shoe processing bases in the country. The leather shoes are mostly men's shoes, manually produced in many small factories. In Bishan county of the municipality, many leather shoe factories have gathered, mostly of relatively small scale, processing shoes with orders on their own brands, mostly of medium and low grades. There are also several medium-scale leather shoe manufacturers in the municipality with their own brands.

### Sichuan Area

Although the output of enterprises in the province with an annual sales revenue of above RMB 5 million ranks only 14<sup>th</sup> place in China, the province is actually one of the important leather shoe processing bases in China. Most leather shoe enterprises have gathered in Wuhou district and Cuqiao township of Chengdu city, mostly of relatively small scale with mostly manual operations. Their ladies' leather shoes are a special feature, with most products of a medium and lower grade level.

## Production Volumes

Table 1.1: Typical sizes of shoe production

Scale of operation	million pairs/year	pairs/day
Small	0.4-0.5	700
Medium	2.0-3.0	1,000
Large	4.0-5.0	10,000

## Export

Table 1.2: Production of various types of footwear

Main products	2003		2002		Change in %	
	million pairs	million US\$	million pairs	million US\$	Volume	Value
Leather shoes	1,153	6,317	1037	5,355	11	18
Rubber/plastic shoes	3,306	5,708	2724	4,790	21	10
Textile shoes	932	1,858	818	1,595	14	17
Others	493	741	444	748	11	-1
<b>Total</b>	<b>5,884</b>	<b>14,624</b>	<b>5,023</b>	<b>12,488</b>	<b>17</b>	<b>17</b>

For the export of rubber/plastic shoes in 2003, the shoes with material not clearly stated as components of sole and upper cover 58% of the total export amount and, therefore, rank at the top. Shoes with rubber or plastic soles with upper straps bolted or inserted to the sole cover 24.9% of the



total and thus rank second; the shoes in third place are other sports shoes with rubber/plastic soles and uppers, covering 13.5%.

For the export of leather upper shoes in 2003 the largest category is shoes or boots with leather uppers and soles made of plastic, rubber or regenerated leather board, covering 68.5% of the total. The next category is other kinds of sports shoes or boots with leather uppers and soles made of plastic, rubber or regenerated leather board, covering 22.6% of the total.

For the export of textile upper shoes or boots in 2003, the largest category is shoes or boots with textile uppers and plastic/rubber soles, covering 85.7% of the total. The next category is other kinds of sports shoes or boots with textile uppers and plastic/rubber soles, covering 14.3% of the total.

For the export of other kinds of shoes in 2002, the largest category is shoes or boots with other kinds of textile fabric uppers, covering 72.6% of the total. The next category is shoes with material of components not clearly stated, covering 24.6% of the total.

### Unit Prices

Most exported footwear is of a lower grade with relatively lower export unit price. For the year 2003, the average footwear export unit price is only US\$ 2.77/pair including leather upper shoes with an average unit price of US\$ 5.28/pair, plastic/rubber shoes US\$ 1.77/pair, textile upper shoes US\$ 1.7/pair and other kinds of shoes US\$ 1.35/pair.

### Main Foreign Markets

Table 1.3: Export of all kinds of shoes

	Target market	Export in 2003		Proportion		Compared with 2002	
		Amount	Value	Amount	Value	Amount	Value
		<i>million pair</i>	<i>million US\$</i>	%	%	%	%
	<b>Total</b>	<b>5,025</b>	<b>12,490</b>	<b>100.0</b>	<b>100.0</b>	<b>17.0</b>	<b>17.0</b>
1.	USA	1,550	5,285	31	42.0	3.1	5.3
2.	European Union	744	1,980	14.8	15.8	23.0	27.0
3.	Japan	422	984	8.4	7.8	4.5	8.7
4.	Hong Kong	510	621	10	4.9	44.0	32.0
5.	Russia	126	522	2.5	4.1	-3.0	10.0
6.	Kazakhstan	102	358	2.0	2.9		
7.	Canada	66	209	1.3	1.7	10.0	7.7
8.	United Arab Emirates	103	204	2.0	1.6	47.0	46.0
9.	South Korea	52	168	1.0	1.3	26.0	45.0
10.	South Africa	77	164	1.5	1.3	57.0	67.0
	<i>Subtotal of the top ten</i>	<i>3,753</i>	<i>10,495</i>	<i>74.5</i>	<i>83.4</i>		

Table 1.4: Export of footwear with genuine leather upper

	Target market	Export in 2003		Proportion		Compared with 2002	
		Amount	Value	Amount	Value	Amount	Value
		<i>million pair</i>	<i>million US\$</i>	%	%	%	%
	<b>Total</b>	<b>957</b>	<b>4,816</b>	<b>100.0</b>	<b>100.0</b>	<b>10</b>	<b>11</b>
1.	USA	579	2,991	60.5	62.1	4	6
2.	Japan	54	339	5.6	7.0	16	27
3.	Hong Kong	68	222	7.1	4.6	110	61
4.	United Arab Emirates	44	209	4.6	4.3	6	1
5.	Panama	18	100	1.8	2.1	13	5
6.	Russia	14	86	1.5	1.8	16	20
7.	Spain	15	63	1.6	1.3	23	23
8.	Italy	8	58	0.8	1.2	16	26
9.	United Kingdom	8	55	0.8	1.1	-19	-11
10.	Poland	8	55	0.8	1.1	5	4
	<i>Subtotal of the top ten</i>	<i>816</i>	<i>4,178</i>	<i>85.2</i>	<i>86.7</i>	<i>10</i>	<i>10</i>

Table 1.5: Export of footwear with textile/canvas upper

	Target market	Export in 2003		Proportion		Compared with 2002	
		Amount	Value	Amount	Value	Amount	Value
		<i>million pair</i>	<i>million US\$</i>	%	%	%	%
	<b>Total</b>	<b>727</b>	<b>1,406</b>	<b>100.0</b>	<b>100.0</b>	<b>0</b>	<b>12</b>
1.	USA	223	582	30.7	41.4	-1	-2
2.	Japan	117	215	16.1	15.3	-23	-10
3.	Belgium	12	71	1.7	5.0	14	17
4.	Netherlands	12	50	1.7	3.5	42	67
5.	Hong Kong	47	43	6.4	3.1	100	14
6.	United Kingdom	17	40	2.3	2.9	19	30
7.	France	21	32	2.8	2.3	8	14
8.	Canada	14	29	2.0	2.1	6	8
9.	Italy	18	23	2.4	1.6	0	2
10.	Australia	10	22	1.3	1.5	8	19
	<i>Subtotal of the top ten</i>	<i>491</i>	<i>1,107</i>	<i>67.4</i>	<i>78.8</i>	<i>-1</i>	<i>2</i>

Table 1.6: Distribution of production [%]

Footwear	Volume	Value
Leather	20	43
Plastic/rubber	56	39
Textile/canvas	16	13
Others	8	5

## Manpower

### Direct Labour (Operators)

The footwear industry is a traditional, labor intensive manufacturing industry. The industry's main labor source is mainly from rural areas such as Jiangxi, Chongqing, Anhui, Guizhou, Guangxi, Hubei, Hunan and Sichuan Provinces where 200 million surplus laborers are available. In the shoe factories in Guangdong provinces, the employees from the above areas cover 85% of the total labor force. However, in recent years the cheap labor from Hunan, Sichuan and Chongqing Provinces has decreased. According to demographic statistics from 2003, about 35 million of the Guangdong Province's population of 95 million were migrants from rural areas. The estimated shortage of labour is 150,000 in Dongguang city. Guangdong claimed that 2 million jobs are vacant in plants making toys, shoes, furniture and electronics. The new generation of migrant workers is more educated. They do not want to work for jobs with low salaries. Many shoe factory owners are prepared to raise salaries and wages by 10-15% to keep their workers loyal. Even more important is the fact that some investors are now planning to shift their shoe production to more attractive and cheaper areas like Vietnam.

### Technical and Managerial Staff

There are three kinds of personnel for technical and managerial manpower:

- those trained by the enterprises themselves for many years;
- those employed through channel from market recruitment;
- graduates of specialty colleges or schools with the education background.

For age structure of technical personnel the statistics show that in Guangdong area the average age is about 25-28 years, in Wenzhou about 30 years and in Fujian Province 30-35 years. The proportion of technical personnel in companies of different scales of operation is as follows:

small	5%
medium	10%
large	10-15%

### Recruitment Pattern

Recruitment through channels of qualified manpower departments and labor markets has become the main contacts of recruiting rural workers. A survey shows that 80% of the enterprises recruit rural workers through the channel of manpower department, 10% of the enterprises tend to make open recruitment through the media and about 10% recruitment in the form of introduction by familiar people. Some larger scale enterprises like to recruit graduates from specialty colleges or schools at the campus or at job fairs.

The job *requirements* of footwear enterprises are educational background, technical knowledge and skills. 80% of the positions require educational background of junior middle school, 15% middle or high school and 5 % of working experience plus college degree.

### Wages and Welfare

Average monthly wage of footwear enterprises varies with the scale of production of production units, generally piece rate wage system is adapted in small-scale factories, the average wage of workers is RMB 800-1,000/month. Average monthly salary of technical development and designing personnel it varies with area difference. In Zhejiang Province it is US\$ 250-300/month, in Fujian Province US\$ 200-250/month, in Guangdong Province US\$ 300-500/month. Some senior designing personnel even can get monthly pay of US\$ 600-1,000/month.

Most footwear manufacturing companies provide accommodations for their employees. Employees can dine in canteens with own payment on enterpriser's subsidy and can live in the dormitory built next to the factories at monthly rates of US\$ 10-20. Some enterprises with favorable conditions provide family-type dormitories for those couples working in the same enterprise.

Some employees working in processes with their body exposed to poisonous or hazardous substances such as cementing process, can get a monthly health subsidy of US\$ 15-25. Some enterprises in developed coastal areas like Guangdong province with favorable operating conditions give annual medical check-ups to their employees; however, most of the medium or small-scale enterprises have no such favorable conditions or do not like to do this.

The common employment contract that enterprises signed with the employees is for 1-2 years, for managerial personnel for 3-5 years. 50% of the above-scale enterprises give social insurance to their managerial personnel. According to stipulations of the Government through the *Labor Law*, employees enjoy holidays and some traditional festival holidays. Annual vacations for employees will be arranged each month in turn.

The situation of shortage of labor force which has become a serious problem and has forced the owners to increase the salary plus the basic medical care and social security in some areas such as Guangdong and Wenzhou.

### **Recent Trends in Employment**

In some provinces and regions where the electronic industry has developed, there is a trend of moving labor resources from the footwear industry to such new and prosperous industries, which is especially visible in areas like Jiangsu Province as generally the wages of electronics industry are double or even triple that of the footwear industry with much more favorable working conditions than the footwear industry. Therefore, such movement trends is one of the reasons for the shortage of labor resources of the footwear industry.

The more important reason for accelerating this movement is the Government's new policy of reduction or exemption of tax on agricultural products. Income in the rural and agricultural areas has increased greatly, even higher than those working in cities or other provinces. Moreover, with cost of living increases in coastal regions of China, some farmers have the idea of abandoning their original intention of doing work there. All these have become one of the reasons for the shortage of labor resources for the footwear industry.

In view of this, many footwear factories have taken measures to improve working conditions, increase wages, visiting their home in order to keep their employees.

### **Professional Education**

During the 20-year development, the Chinese footwear industry is well supported by institutional infrastructure through the following schools. Nearly twenty colleges or schools have set up the bachelor degree in footwear engineering:

- Beijing Leather Industry School
- Resources and Environment College
- Shanxi Science & Technology University
- Sichuan University
- Yangzhou University
- Xingtai Military College
- Wenzhou University
- Fuzhou University
- Tianjin Light Industry

- Liaoning Industrial Art College
- Nei Monggol Industrial Art Designing College
- Henan province Light Industry college
- Fujian Second Light Industry School
- Guangzhou Bai Yun Technology College
- Shanghai Technical Secondary School
- Chengdu Leather Shoe Technology School.

About 2,000 students graduated each year from the above schools.

The colleges and schools have specialty courses of footwear design with a larger force of teaching and education sources. Most of them have many years of practical experience in the designing work of the enterprises. They can associate the practices of the enterprises and current fashion with the theory of shoe designing and are aware of the requirements of the enterprises and the market. As they actively take part in the reform and construction of specialty of the faculty, they have improved their ability and have become mainstay. Most colleges and schools coordinate with the shoe enterprises to invite managerial personnel and technical personnel to do concurrent work on-site.

The MINISTRY OF EDUCATION gives great support to the education reform. In 1999 the Ministry approved that footwear be a major special course for key projects to improve and develop the Chinese footwear industry and put courses in footwear designing on the list of important courses guided by the Ministry in 2000.

In the 1980s, the MINISTRY OF LIGHT INDUSTRY set up a commission for guiding the construction of the courses of shoe making and designing, which has made great achievements in the compilation of teaching material. For a long time in the past, teaching material for shoe designing and shoe-making processes has been non-existent and with great effort by the commission, compilation and publication of special footwear teaching material took place, of which many textbooks are the first teaching materials in China. In addition specialized teachers have utilized advanced technologies and cameras to make audio and video teaching material of many kinds for publication as other ways of teaching, which is not only a “must” for college or school students, but also teaching material for personnel training in footwear enterprises.

At present, the colleges and schools also utilized the Internet as a means of web site education for footwear designing specialty, that is, to use remote education as an advanced means or way of professional education or training. These colleges and schools actively take part in various exhibitions or designing competition organized by leather associations. These activities have had good results educating students as they can intensify students' impressions of better understanding of the footwear industry. After graduation they can utilize what they have learned and can soon become key members of technical or managerial teams and contribute their knowledge to the enterprise successfully.

## Company Management

### Management Structure

The chain of command in different size enterprises is as follows:

- *Large-scale companies*: board of directors → general manager or managing director → deputy general manager → department manager → production manager → department directors;

- *Medium-scale enterprises*: general manager, deputy general manager → managers of various functional departments → workshop directors;
- *Small-scale operations*: owner → family member.

### **Managerial Staff Profile**

Generally, managerial personnel in footwear factories can be classified according to the products and scope of work responsibility into several kinds, such as technical management, production management, financial management, logistics (transportation) management and administration. They can also be classified into several kinds according to work backgrounds, such as those trained by the factory, graduates of specialized colleges or schools and those recruited in job markets from allied trades or industries. Most factory management or administration personnel are from local areas. During the 1990s, when Taiwanese factories for the footwear industry were shifted to China mainland, some technical personnel and managerial personnel came from Taiwan. They have brought their experience of technology and management of Taiwan footwear industry to China mainland, which has a good effect on the development of the Chinese mainland footwear industry.

### **Export Order Handling**

Generally, there are two procedures for work arrangement for orders from foreign clients, one is: the factory makes a sample according to the one given by the client and returns it for recognition, then the client will place the order for the factory to produce, inspect and make delivery of the goods. The another is: the factory makes its own designed samples for choice by the client who will select a sample or some samples for recognition and then place an order or orders for the factory to produce, inspect and make delivery of the goods.

### **Standardization**

The Chinese footwear enterprises have paid much attention to the work of certification of ISO9000 quality management system and ISO 14000 environmental system. In most export-oriented enterprises, according to requirements by the foreign clients, a standard for safety and social responsibility similar to SA 8000 has been established and the stipulations for labor protection, insurance, subsidy for extra shifts and weekly working hours have been clearly defined. However, in places like Sichuan province in West China, such stipulations have not been defined by the shoe factories. The results are insufficient ventilation devices and less day light in workshops as well as an insufficient system for labor insurance. The most serious situation is that in some medium and small-scale enterprises, the environmental conditions for workers have grown worse.

### **Operations of Enterprises**

- *Investment structure*  
There are more than 7,200 enterprises operating on a relatively larger scale in the Chinese footwear industry, with employees of more than 1.5 million. The system of ownership and operation of these enterprises is state-owned covering only 3%, collective enterprises 10%, foreign-invested enterprises 42% and private enterprise 45%. These different components of ownership make the different contributions to the Chinese footwear industry.
- *Selection of Plant Location*  
The location selection of these enterprises is generally based on the factor of whether the factory will be convenient for traveling to Taiwan and Hong Kong considered by most investors from Taiwan and Hong Kong. Therefore, Guangdong is their ideal site to move their business to China. Most enterprises like to concentrate themselves in the area near the shoe-making market for procurement of shoe material, components,



machinery etc. like Guangdong, Wenzhou and Sichuan. Some new factories like to place themselves in a new industrial development zone for the enjoyment of preferential treatment.

### Sale Pattern

- *Full export*: mostly doing processing of world-famous brands. A few powerful enterprises can produce their brands for export with products manufactured in China and sold abroad. For instance, CONEY products are welcomed in Russia and Europe. Several exclusive distribution stores opened recently in Europe. Most of the enterprises for making shoes for 100% export are located in the areas of Guangdong.
- *Partial export*: these enterprises make shoes both for domestic and foreign markets and are mostly located in the Fujian, Wenzhou and Sichuan area.
- *Full domestic sale*: predominantly in case of medium and low quality footwear, which is what most of the Chinese footwear enterprises are doing at the present time. As compared with products for the domestic market, the total products are of larger amount with prices between RMB 200-250/pair.

### Production Costs

The cost of leather shoe products mainly consists of manufacturing cost (material and manufacturing expenses), administrative, sales and financial expenses. At present the average ex-factory price of a pair of medium grade leather upper shoes is RMB 60-80/pair with a retail price of about RMB 200-300/pair.

Table 1.7: Ladies' leather shoe production cost structure [US\$/pair]

Component	Low quality	Medium and high quality
<b>Material</b>		
Upper leather	2.70	3.00
Lining	0.80	0.80
Sock	0.50	0.60
Sole	0.25	0.35
Heel	0.32	0.75
Counter	0.07	0.07
Toe-puff	0.04	0.04
Welt	0.12	0.12
Rib tape	0.09	0.09
Insole	0.10	0.12
Shank	0.05	0.06
EVA/rubber sheet	0.06	0.06
Needle/thread	0.06	0.07
Cement	0.20	0.20
Tack	0.02	0.02
Trade mark	0.03	0.03
Shoe box	0.25	0.65
Packing paper	0.01	0.01
Auxiliary material	0.01	0.12
<i>Subtotal</i>	<i>5.68</i>	<i>7.16</i>
<b>Labor</b>		



Component	Low quality	Medium and high quality
Cutting	0.10	0.10
Upper closing	0.35	0.35
Lasting	0.26	0.26
Sole cementing	0.14	0.14
Sole/heel assembly	0.15	0.15
Finishing	0.10	0.10
Development	0.10	0.10
<i>Subtotal</i>	<i>1.20</i>	<i>1.20</i>
Overheads		
Management expense		
Vehicle expense		
House rent		
Power/water supply		
Administration expense		
<i>Subtotal</i>		
<b>TOTAL</b>		
<b><i>Profit (approximate)</i></b>	<b><i>5%</i></b>	<b><i>5%</i></b>

Use of genuine leather:

Shoes:	50%
Garments:	15%
Leather goods:	10%
Upholstery:	20%
Miscellaneous:	3%
Automotive:	2%

Accessories mainly come from larger Chinese leather and footwear wholesale markets. There are several large and important wholesale shoe material markets with are attractive to all parts of China formed in places like Guangzhou and Wenzhou (e.g. Xinhaopan is one of the most important such markets in Guangzhou).

Rising shoe manufacturing costs cause pressure on the footwear industry. At present such pressure has become more serious, mainly in the following three aspects:

- **Shortage of power supply.** Since 2004 a continuous shortage of the power supply in the main footwear production provinces and areas has caused increased production costs of the footwear industry. In provinces like Guangdong and Zhejiang a method was adopted for the shortage of electricity during summer peak hours, a power supply was open for two days and stopped for three days. That is, for power supply for five work days each week, only two days supply of electricity of the network of the state and three days cut in supply. In provinces like Guangdong the price of power supply had an increase of about 30% in 2004 as compared with that of the previous year, and it is expected that in 2005 the price will stay at this level or may be slightly increased. To solve the problem of supply shortage, some enterprises have adopted some measure of using their own power generator; however, at a cost 25-30% higher than that using electricity from the state power network supply.
- **Increase in wages of employees.** It affects areas where the footwear industry is prosperous: e.g. 2004, average wages of footwear industry employees of Guangdong area had an increase of some 20%.

- **Increasing petrol prices.** During the years of 2004 to 2005 the increase in price of petroleum has resulted in a rise in prices of shoe material of about 8-10%.

## Marketing

Ways of marketing footwear industry products vary according to the scale of production of enterprises. There are four ways to market footwear:

1. Products of larger enterprises with their own relatively famous brands are usually sold in cities of first and second level. They have set up specialized footwear counters for themselves in department stores of these metropolitan cities or larger cities. They include companies like SHENDA, BAILI, RED DRAGONFLY and WEALTHY BIRD.
2. Some enterprises with relatively famous brands tend to adopt the way of setting up their exclusive distribution stores in some prosperous sectors of larger and medium size cities. They include companies like SHENDA, BAILI, CONEY and RED DRAGONFLY.
3. Large and medium-scale enterprises usually have their central agency for distribution in main districts or regions of China, such as the north part of China, the central and south part of China and the east part of China under such central agencies, there are secondary agents and many distributors.
4. The ways of marketing in the forms of shopping malls or wholesale markets. At present, there are many larger wholesale markets in China.
  - a) CHINA SHOE CITY of Shenyang, for wholesale of leather shoes and jogging shoes to the three provinces of the northeast part of China and Nei Monggo (Inner Mongolia).
  - b) DAKANG SHOE CITY of Beijing, for wholesale of leather shoes, casual shoes and jogging shoes to the northeast part, north part and northwest part of China.
  - c) ZHENGZHOU FOOTWEAR MARKET of Henan Province, for wholesale of leather shoes to the region of central plains around provinces of Henan, Hebei and Shandong and the central part of China.
  - d) WUHAN FOOTWEAR WHOLESAL MARKET of Hubei Province for the wholesale of leather shoes to the central part and south part of China.
  - e) CHENGDU FOOTWEAR MARKET of Sichuan Province for the wholesale of various types and kinds of shoes to the area around Chengdu and Chongqing as well as the southwest part of China.
  - f) Several large footwear wholesale markets of Guangzhou in Guangdong Province including the GUANGZHOU XIN HAO PAN footwear wholesale market mainly for sales of ladies' shoes. As shoes of current fashion and newer type gather on these markets, distributors from all parts of China will come to these places for procurement.
  - g) WENZHOU FOOTWEAR WHOLESAL MARKET of Zhejiang Province for wholesale of mainly men's shoes to all parts of China.

## Technology

At present the production technologies employed in most Chinese footwear factories are cementing process, plastic injection moulding process and machine-sewn construction. Some individual enterprises also adopt the technologies of moulded construction and vulcanization process according to requirements of the clients. In some coastal areas where prosperous footwear industries exist, some shoe factories utilize the technology of CAD for designing.

## Trade Associations

CHINA LEATHER INDUSTRY ASSOCIATION (CLIA) was established in 1988. It is a national trade organization of the leather industry of trans-regional and trans-ministerial nature covering different kinds of ownership and acting as a social economic body consisting of manufacturers, institutions, research institutes and people, based on the leather industry production system of leather, fur, footwear, leather products, leather chemicals, leather machinery, leather metal accessories and shoe material, with over 1,300 associated members.

## OVERVIEW OF THE CHINESE TAX SYSTEM

Under the current Chinese tax system there are about six basic taxes for which the enterprises are liable.

### Value added tax (VAT)

VAT is administered by the STATE TAX ADMINISTRATION (STA) and shared between the central and local governments.

VAT is the major source of fiscal revenue for the Government of China. According to the statistics in 2003 the total revenue collected was approximately US\$ 100 milliard, accounting for 40% of the state total tax revenue, which is the highest tax collected by the Chinese Government.

There are three VAT rates:

- 0% for exported goods such as gold, silver, metal, oil wood etc.;
- 13% mainly for agricultural products such as grains, vegetables, sugar, animal skins etc.;
- 17% for goods other than those mentioned above.

### Business Tax

Business tax is administered respectively by the STA and local tax bureaus and the revenue from it is shared between the central government and the local government. Business tax is the main tax source for the local government. In 2003 the revenue collected from business tax was approximately US\$ 32 billion, accounting for 13% of the total revenue.

Applicable business tax rates are as follows:

- 3% for communication, transportation, construction and manufacturing (including engineering work);
- 5% for service industry.

### Enterprise Income Tax

There are three rates under the income tax rates:

- enterprises with foreign investment: 11%
- local companies: 22%
- state-owned enterprises: 30%

The Government has introduced new policies to encourage foreign investment in inputs of either new technology or capital funds. Most favorable terms are provided for foreign investors.

The income tax on enterprises with foreign investments established in Special Economic Zones, foreign enterprises which have establishments or places in Special Economic Zones engaged in production or business operations and on enterprises with foreign investments of a production

nature in Economic and Technological Development Zones shall be levied at the reduced rate of 15%.

The income tax on enterprises with foreign investments of a production nature established in coastal economic open zones or in the old urban districts of cities where the Special Economic Zones or the Economic and Technological Development Zones are located shall be levied at the reduced rate of 24%.

The income tax on enterprises with foreign investments in coastal economic open zones, in the old urban districts of cities where the Special Economic Zones or the Economic and Technological Development Zones are located or in other regions defined by the STATE COUNCIL, within the scope of energy, communications, harbor, wharf or other projects encouraged by the State, may be levied at the reduced rate of 15%.

Any enterprise with foreign investments of a production nature scheduled to operate for a period of not less than ten years shall, from the year they begin to make a profit, be exempted from income tax in the first and second years and allowed a 50% reduction in the third to fifth years. However, the exemption from or reduction of income tax on enterprises with foreign investments engaged in the exploitation of resources such as petroleum, natural gas, rare metals and precious metals.

Any enterprise with foreign investments engaged in agriculture, forestry or animal husbandry and any other enterprise with foreign investments established in remote, underdeveloped areas may, upon approval by the competent department for tax affairs under the STATE COUNCIL of an application filed by the enterprise, be allowed a 15-30% percent reduction of the amount of income tax payable for a period of another ten years.

Any foreign investor of an enterprise with foreign investments which reinvests its share of profit obtained from the enterprise directly into that enterprise by increasing its registered capital, or uses the profit as capital investment to establish other enterprises with foreign investment to operate for a period of not less than five years shall, upon approval by the tax authorities of an application filed by the investor, be refunded 40% of the income tax already paid on the reinvested amount. Where regulations of the STATE COUNCIL provide otherwise, in respect of preferential treatment, such provisions shall apply. If the investor withdraws its reinvestment before the expiration of a period of five years, it shall repay the refunded tax.

Losses incurred in a tax year by any enterprise with foreign investments and by an establishment or a place set up in China by a foreign enterprise to engage in production or business operations may be made up by the income of the following tax year. Should the income of the following tax year be insufficient to make up for the said losses, the balance may be made up by its income of the further subsequent year, and so on, over a period not exceeding five years.

Any foreign enterprise which has no establishment or place in China but derives profit, interest, rental, royalty and other income from sources in China, or though it has an establishment or a place in China, the said income is not effectively connected with such establishment or place shall pay an income tax of 20% on such income.

Income tax shall be exempted or reduced on the following income:

- (i) The profit derived by a foreign investor from an enterprise with foreign investment shall be exempted from income tax;

### III

- (ii) Income from interest on loans made to the Chinese Government or Chinese State banks by international financial organizations shall be exempted from income tax;
- (iii) Income from interest on loans made at a preferential interest rate to Chinese State banks by foreign banks shall be exempted from income tax;
- (iv) Income tax of the royalty received for the supply of technical know-how in scientific research, exploitation of energy resources, development of the communications industries, agricultural, forestry and animal husbandry production and the development of important technologies may, upon approval by the competent department for tax affairs, be levied at the reduced rate of 10%.

The revenue from foreign enterprises' income tax is approximately US\$ 10 milliard accounting for 4% of the total tax revenue in 2003.

#### Stamp Tax

The taxpayers of stamp tax include all state-owned enterprises, private enterprises, enterprises with foreign investments, foreign enterprises etc. There are 13 rates ranging from 0.03% to 0.05%. In 2003 the revenue from stamp tax was US\$ 2.7 milliard accounting for about 1% of the total tax revenue.

#### Customs Duties

The customs duties are collected and administered by the Government CUSTOMS DEPARTMENT. The revenue duties were approximately US\$ 10 milliard accounting for about 4% of the total tax revenue in 2003.

In recent years, to quickly merge China with the world economic system, China has made efforts to reduce customs duties as demonstrated by the following table:

*Table 2.1: Decrease of custom duties*

Year	Custom duty [%]
1992	43.2
1994	35.0
1996	17.0
1997	16.4
2000	15.0
2002	12.0
2004	10.4
2005	10.0

Having entered the WTO the Chinese Government has to continue to carry out its promise of reducing the customs duties step by step.



## Resource Tax

Aimed at protection and improvement of the reasonable development, the resource tax is levied in China with the purpose of adopting energy saving application. In 2003 the revenue from resource tax was US\$ 1.2 milliard accounting for about 0.4% of total tax revenue.

## Export Subsidy

As a member of WTO the Chinese Government has promised to reduce the export subsidy from 17% to 13% in 2004, then gradually to 11%, 8% and 5%.

## STATISTICS

### World leading footwear traders

Rank	1995			2001		
	Country	million pairs	%	Country	million pairs	%
<b>PRODUCTION</b>						
1.	China	4,270	42.7	China	6,628	54.0
2.	Brazil	500	5.0	India	740	6.0
3.	Italy	476	4.8	Brazil	610	5.0
4.	India	462	4.6	Indonesia	488	4.0
5.	Thailand	410	4.1	Italy	375	3.1
6.	Indonesia	371	3.7	Vietnam	320	2.6
7.	USA	227	2.3	Thailand	273	2.2
8.	Japan	204	2.0	Pakistan	242	2.0
9.	Spain	187	1.9	Mexico	217	1.8
10.	South Korea	185	1.9	Turkey	211	1.7
	<i>Rest of the World</i>	<i>2,701</i>	<i>27.0</i>	<i>Rest of the World</i>	<i>2,165</i>	<i>17.6</i>
	<b>WORLD TOTAL</b>	<b>9,993</b>	<b>100.0</b>	<b>WORLD TOTAL</b>	<b>12,269</b>	<b>100.0</b>
<b>EXPORT</b>						
1.	China	2,540	40.4	China	3,961	49.1
2.	Hong Kong*	1,447	23.0	Hong Kong*	1,667	20.7
3.	Italy	427	6.8	Italy	354	4.4
4.	Thailand	287	4.6	Vietnam	292	3.6
5.	Indonesia	211	3.4	Indonesia	193	2.4
6.	Spain	132	2.1	Spain	171	2.1
7.	Brazil	130	2.1	Brazil	142	1.8
8.	India	125	2.0	Thailand	138	1.7
9.	South Korea	95	1.5	Portugal	91	1.1
10.	Portugal	82	1.3	Netherlands*	73	0.9
	<i>Rest of the World</i>	<i>805</i>	<i>12.8</i>	<i>Rest of the World</i>	<i>989</i>	<i>12.3</i>
	<b>WORLD TOTAL</b>	<b>6,281</b>	<b>100.0</b>	<b>WORLD TOTAL</b>	<b>8,071</b>	<b>100.0</b>

Remark: \* Re-exporters

		1995		2001		
Rank	Country	<i>million pairs</i>	%	Country	<i>million pairs</i>	%
<b>IMPORT</b>						
1.	Hong Kong*	1,474	27.5	USA	1,784	20.5
2.	USA	1,409	26.3	Hong Kong*	1,718	19.7
3.	Japan	386	7.2	Japan	467	5.4
4.	Germany	337	6.3	Germany	339	3.9
5.	France	249	4.6	UK	300	3.4
6.	UK	213	4.0	France	278	3.2
7.	Italy	140	2.6	Italy	203	2.3
8.	Netherlands*	99	1.8	Russia	146	1.7
9.	Canada	88	1.6	Poland	119	1.4
10.	Belgium*	77	1.4	Netherlands*	117	1.3
	<i>Rest of the World</i>	888	16.6	<i>Rest of the World</i>	3,230	37.1
	<b>WORLD TOTAL</b>	<b>5,360</b>	<b>100.0</b>	<b>WORLD TOTAL</b>	<b>8,701</b>	<b>100.0</b>

Remark: \*Re-exporters