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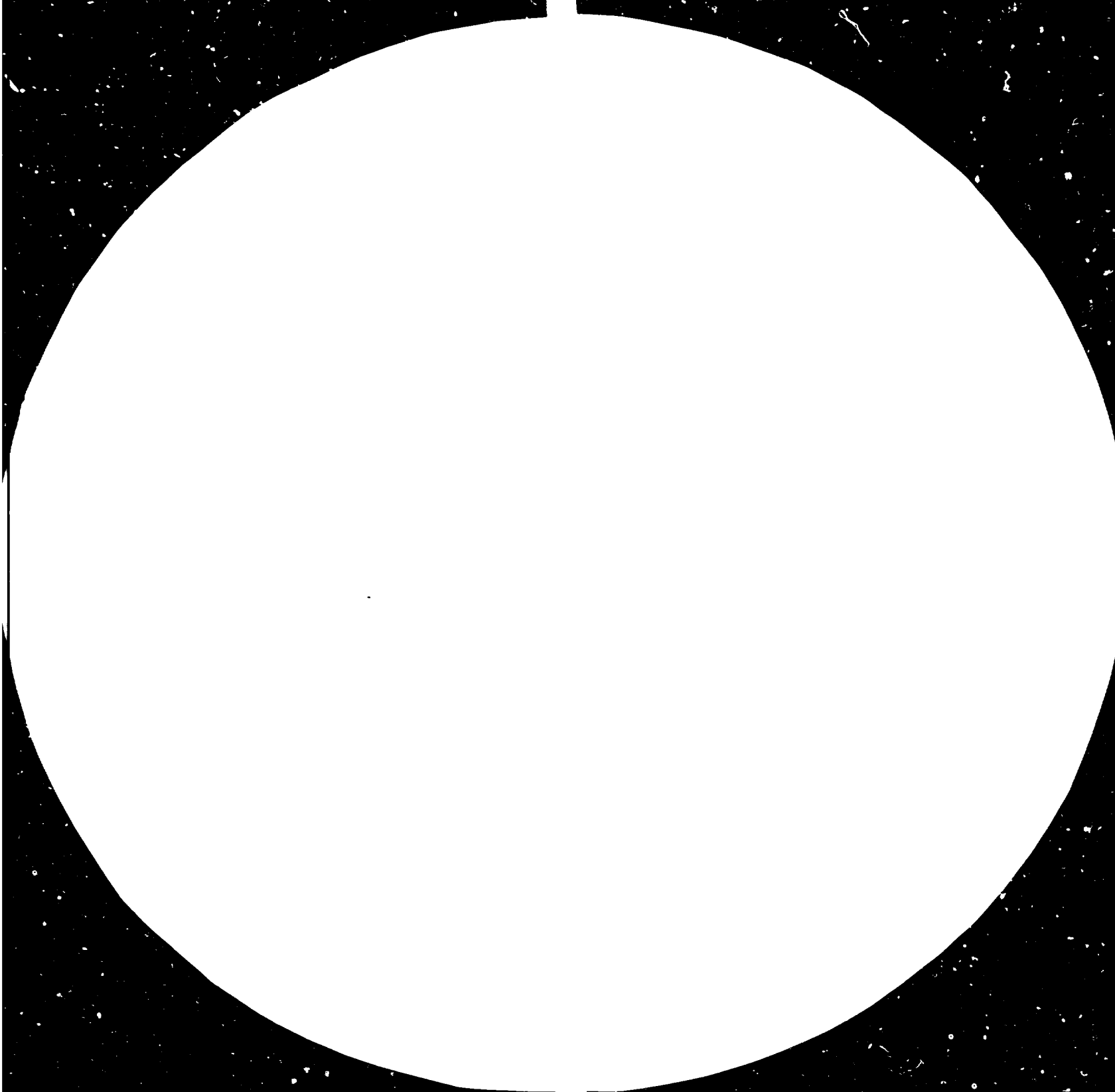
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Third Consultation on the Leather and
Leather Products Industry

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**CHECKLIST FOR CONTRACTUAL AGREEMENTS
IN THE FOOTWEAR SECTOR
BETWEEN ENTERPRISES FROM
DEVELOPED AND DEVELOPING COUNTRIES ***

Background paper for issue no.1

prepared by
the UNIDO secretariat

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I. INTRODUCTION

1. The Second Consultation on the Leather and Leather Products Industry, held in Cologne, Federal Republic of Germany, 23-26 June 1980, concluded that ".... there is ambiguity as to what should be part of a contractual agreement between parties interested in international development in the (leather and leather products) sectors", and recommended that "the UNIDO Secretariat and its Leather Panel should undertake the research necessary to establish a check-list of clauses, conditions and variations thereof that could be included in contractual agreements".^{1/} The Consultation indicated the various types of enterprises from developed and developing countries who could form partners in international co-operation, and identified their respective objectives which should be taken into consideration in formulating the check-list.

2. In undertaking the work on the checklist, the UNIDO secretariat found it expeditious to develop separate checklists for the different subsectors of the industry, i.e. the tanning and footwear industries, since each of these subsectors poses unique problems in international co-operation. The present document covers potential forms of co-operation in the footwear industry.

3. The objective of the checklist is to achieve a comprehensive listing of the types of agreements and specification of the items for negotiation, rather than to draft legal clauses which could be included in contracts. This document has been prepared on the basis of three sources of information:

- (i) UNIDO's experience in its technical assistance projects in developing countries.

^{1/} See ID/255 - Report of the Second Consultation on the Leather and Leather Products Industry, Cologne, FRG, 23-26 June 1980, para. 7, pp.9-11.

(ii) Analysis of a few contracts in the footwear sector, dealing with co-operation between developed and developing country enterprises, which were provided confidentially to the UNIDO secretariat through its contacts with the industry.

(iii) The expert knowledge of specialists from the industry who were engaged by the UNIDO secretariat as consultants in formulating the checklist.

4. The emphasis here is on problems which are judged to be specific to co-operation in the footwear sector, and not on general commercial issues. ^{2/} It is hoped that managers and decision makers in developing country footwear enterprises will find, in this document, a useful tool for making optimum use of international co-operation in the development of their industry.

5. An earlier draft of this checklist was presented to the Fifth Session of the UNIDO Leather and Leather Products Industry, Vienna, Austria, 25-27 November 1981. The Panel approved the contents and format of this checklist, and proposed certain additions and textual modifications, which have been incorporated in the present document. This is now being submitted to the Third Consultation on the Leather and Leather Products Industry as a background paper to issue no. 1.

^{2/} For view of issues arising from general commercial aspects of international co-operation, see inter alia, ID/68 - Manual on the Establishment of Industrial Joint Venture Agreements in Developing Countries, UNIDC, Vienna 1971, which could be used in complementarity with this checklist.

II. BASIC CONSIDERATIONS IN INTERNATIONAL CO-OPERATION

The necessity to develop resources for world markets

6. The demand for footwear is increasing with the growth of world population and the improvement of its standards of living. At the same time, shoe manufacturing remains a semi-artisanal industry, therefore it is highly labour intensive. There is a scarcity of suitable labour in most of the developed countries, and in order to maintain an adequate supply of merchandise in the markets, it is necessary to develop new resources. A large part of these resources lies in the developing countries. One important element of the development of these resources could be found in international co-operation between enterprises from the developed and developing countries which could form a long-term stimulus to the growth of the leather industry.

The nature of resources required by the footwear industry

7. A "resource" is defined as potentially available raw material or labour or both. Each resource possesses unique characteristics.

8. The raw material for the footwear industry may be available in various stages in a given developing country, ranging from tanned hides to well perfected leather. The leather itself varies in quality, depending on the conditions within which the country's animal stock has been raised, the methods by which the hides are recovered and the efficiency of the tanning industry of the country.

9. Labour may be unskilled or already have acquired industrial skills. The characteristics of each resource need to be appraised, and these will determine the nature of co-operation for resource development.

The characteristics of the international footwear industry

10. At one time the domestic footwear industry more or less met the needs of each country. With the liberalization of world trade, a pattern of specialization occurred in the production of shoes, with the industrialized countries gaining a technical edge over the developing countries. At present, as has already been observed, the footwear sector of some of the developed countries finds it increasingly difficult to compete with other industrial sectors for its supply of labour, since the characteristics of craftsmanship are still inherent to modern shoe production. To some extent labour-saving technology is being applied in the industrialized countries to provide a fresh impetus to the industry, but the competitive potential for labour intensive manufacturers from the developing countries will remain

sufficiently great for them to enter world markets, in addition to developing the industry for domestic markets. At present, there are three broad categories of countries in the footwear industry:

- (a) Traditional shoe-making countries;
- (b) Highly technically developed countries;
- (c) Resource countries.

11. Enterprises from these three types of countries can find a sufficient degree of complementarity in their capabilities to co-operate in future development of the industry.

The importance of market-oriented business activity

12. Regardless of the support given to a developing country's enterprise by a co-operation project, the greatest insurance of beneficial and lasting operations is obtained by satisfying the ultimate consumer with the product that is being produced. This checklist has, therefore, been formed on a recognition of the fact that the development of marketing know-how is as critical as access to technology and production systems, in the development of the footwear industry.

13. Marketing can be defined as all the activities which:

- (a) assess the requirements of the market;
- (b) define the characteristics of the individual resource area;
- (c) work out a synthesis by developing individual products.

14. Product development, therefore, is considered to be a critical factor in the arrangements for co-operation. Making the right product is more important than obtaining the latest and most modern equipment, on its own. The fundamental decision, therefore, is to specify the market which should be served, since the choice of markets will determine the products to be produced, which in turn largely determines the industrial technology to be used.

15. In specifying the market and the product to be produced, the following elements will need to be clarified:

- The materials available to the enterprise, from domestic and foreign sources, and their quality, quantity and costs;
- The labour skills available locally. (For example, a developing country may have well developed related craft industries such as garment production, which could provide a supply of labour which is skilled in the use of sewing machines);
- Analysis of the market, in terms of the type of product that is required, distribution systems and pricing given consumer purchasing power and competitive products' pricing;
- In the case of export-oriented ventures, the distances, transport facilities available, and costs of transportation to the export market;
- The customs duties and related regulations (such as quotas) which may affect the final price of the product, in the export market.

16. A factor that must be carefully considered is the relative importance assigned to export markets as opposed to domestic markets. While it is a legitimate aspiration for developing country firms to achieve export capabilities as quickly as possible, it must be kept in mind that export markets are generally more competitive and demanding in terms of product quality. An entry into the export market before adequate product quantity and quality control is achieved may result in the sale of defective or unacceptable merchandise, which could damage the producer's reputation from the outset of production. The domestic market could provide a possible cushion against this eventuality by providing a basis upon which the production skills of the enterprise could be enhanced. The speed with which export capabilities can be built up will depend on the speed with which the training of local personnel may be accomplished. The initial skills and craft traditions possessed by the developing country's labour force will, of course, condition the circumstances under which export capabilities will be built up.

17. Market specifications should be undertaken on the following lines:

- Territorially;
- Quantitatively;
- Consumer use;
- Product price brackets and quality;
- Forms of product distribution.

18. To amplify on each point in turn:

- Territorial definitions of markets would include:

- The domestic market or parts of the domestic market, defined geographically;
- Export markets. Certain export markets may receive priority, and others, which while considered desirable, may receive attention only later. Finally, there may be export markets which will not be tackled (possibly because some arrangements have been made by one partner or another prior to the cooperative endeavour).

- The quantitative definition of the market may be divided into various stages of development, i.e. production targets for the beginning, the intermediary and the final stages of the development of the cooperative efforts.

- The consumer use should be defined:

- By the type of usage, for example, casual wear, dress shoes, footwear designed for industrial wear, sports shoes, etc.
- By particular segments of consumer age groups, i.e.: children's shoes, shoes for young people, shoes for the elderly, etc.
- Seasonally, i.e.: the enterprise might concentrate on shoes for summer or hot weather use, or the enterprise may concentrate on all-year or winter use, or on non-seasonal, purely fashionable merchandise.
- By price bracket or quality. Popular-priced shoes, or medium or higher priced shoes (the choice might depend upon available materials or skills). In this area there may be various stages of development, as the product quality will, hopefully, keep improving with time.
- By form of distribution in which consideration should be given to:
 - The method of marketing; for example, locally, retail or wholesale in export, high volume accounts or wider, lesser-quantity spread;
 - The marketing structure, particularly whether or not the firm wants to concentrate on branded merchandise.

19. Co-operation should be formulated in the framework of coherent marketing policies charted for developing country firms. Marketing policies would include policies in respect of the product, areas in which it is to be sold, and the means and methods which are to be used for selling merchandise. A simple but relatively rare case would be when the established arrangements could count on

sufficient orders for one type of merchandise as the main production of the developing country firm. This may occur, for example, if one of the partners controls a major brand and marketing organization in the industrialized country, or if he can obtain orders from such an organization. In such case, the method and export territory to be served is automatically specified, and the cooperation is limited only to making sure that the product quality is maintained and product deliveries are on schedule.

20. The opposite case would be where the arrangement has to start to establish the product and secure the distribution on its own. In this case, the marketing policy would develop in a number of stages over several years. It would start with a substantial part of the product going to the local market and designed to meet the local market's requirements. In the first years only small quantities may be destined for export, mainly for testing purposes and in gradually establishing the direction of the marketing effort.

21. As was previously stated, in some cases, the selection of an export area may be facilitated by the contacts or knowledge of one of the partners, which obviously should be utilised fully. Otherwise, the penetration of the export market would be a lengthy process, requiring feasibility studies, participation in trade exhibitions, submission of samples to a number of possible clients, etc., and this would involve the investment of sizeable sums at fairly high risk.

22. The conclusion of the preceding discussion is that the contractual agreements should rest as much on a conception of marketing strategy as they do on the technical requirements of the developing country enterprise. Further, as is apparent in Section IV, the emphasis of the co-operation agreements should be equally great in the area of marketing and product development as compared to acquisition of machinery and production knowhow.

III. CONSIDERATIONS IN SELECTING THE MOST SUITABLE
TYPE OF AGREEMENT FOR CO-OPERATION

The business objectives of the partners

23. There are several alternative forms of co-operation available in the footwear industry, as the discussion in section IV attempts to demonstrate. The initial factors which must be clarified and mutually understood are the respective developmental needs and business objectives of the developing country partner and the foreign partner.

24. The developing country partner may wish to achieve one or more of the following objectives, through entering into co-operation with the foreign partner:

- The development of new products, or the upgrading of existing ones, in order to serve consumer needs in domestic and/or export markets;
- To better utilize domestically available resources, in order to enhance domestic manufacturing value added in the footwear industry;
- To improve the marketing systems available to the enterprise;
- To acquire technological and management skill;
- To upgrade the skills of local labour;
- To upgrade or acquire new equipment for the enterprise;
- To seek financial or other forms of investment, in order to expand the productive capacity of the enterprise.

25. In most cases, the foreign partner would be seeking opportunities to enhance his profits through one or more of the following means:

- Expanding his market by manufacturing his product in the developing country and marketing it locally or in export markets;
- Selling expertise in the form of management, manufacturing and technical know-how;
- Selling plant and equipment;
- Selling the rights of use of his industrial property, whether they be in the form of patented techniques of production or in the form of established brands, trademarks or other forms of product identification;
- Expanding his operations into the developing country by investing in productive facilities in its territory.

26. The objectives must be clearly specified in the prenegotiation phase of a cooperative endeavour to ensure their mutual compatibility. Furthermore a clear ascertaining of these objectives will in large part determine the choice of type of cooperation that should be contemplated.

The mutual benefits that can be derived from the cooperation

27. The objectives of the partners would largely be dictated by the benefits that could accrue to either partner from the cooperation. For the developing country the improvement of production and marketing capabilities is self evident. What is less often realized is that the footwear industry in some of the highly industrialised countries has had more than its share of difficulties. It faces adverse circumstances due to the shortage of time, money and skilled labour. As a result, international co-operation should attempt to improve the utilization of these three factors of production:

28. Time. The dominating influence of fashion and resulting frequent product changes results in the situation that the traditional time rhythm from the conception of an idea to the sale of the finished product can no longer be maintained. Greater flexibility of personnel and organization are required. This calls for constant close contact with the market, not only in the footwear industry but also from the ancillaries industries. Therefore anything that can be done to shorten the time needed to manufacture shoes and their components will be a real service to the industry. Anything that will enable the shoe manufacturer to take fashion trends into account in good time will be helpful to effective co-operation.

29. Money. In view of the current interest rates and the shortage of capital, stocks and work-in-hand must be kept as small as possible. Therefore it is very important to have the right materials available at the right time. Again, this can only be achieved by being informed on fashion trends in time and by having an appropriate organizational setup. Shoe factories are calling for "instant" chemicals and "instant" finishes. They help to reduce manufacturing time, the work-load on the lasts and the amount of work in hand.

30. Labour. Experts in shoe production are becoming increasingly rare; only those people who have much experience, patience and know-how are able to correct defects which may originate in the components or may have been brought about by the manufacturing process. Hence the demand by the industry for "foolproof" chemicals and methods, and the call for durable and resistant leather finishes.

The product to be produced

31. Once the marketing direction has been established, the product specification is critical in determining the technique of production, and in the elements of foreign collaboration that will be required by the developing country enterprise. The product determines the type of production technology which in turn will help to ascertain the type of foreign partners in co-operation.

32. A shoe is a very complex product. It consists of rational and irrational elements. The rational elements are:

- Materials
- Components
- Construction
- Lasts
- Fit
- Quality

The irrational elements are:

- Fashion
- "Feel/Touch"

The rational elements can and must be specified within any form of arrangement.

33. First of all there is the question of deciding on the construction. This is fairly simplified, and the alternatives are roughly reduced to the following:

- (a) Cemented or stuck-on production. This is by far the most common technique for popular-priced footwear. The sole, in this case, is attached to the upper by adhesive under pressure, and practically any shoe design can be produced by this method;
- (b) Veldtschoen or stitch-down footwear. This construction has lately become very popular for many types of footwear, such as sandals, safari boots, and children's shoes;
- (c) Vulcanized or injected-sole footwear. This construction is used either for popular-priced footwear or for heavy-use footwear (for example, industrial footwear). Instead of using a leather sole, the sole is molded on to the upper by using either hot vulcanized rubber or by injecting PVC directly on to the upper. In both cases non-leather sole material is used, and this production alternative might be worthwhile in countries where there is an indigenous production of rubber and a rubber industry;

- (d) One of the hand-sewn processes, like moccasins, which uses a great deal of handwork and is highly sought after in today's markets;
- (e) Other constructions are used relatively rarely and for very specific market requirements; for example, the goodyear welted construction, or force-lasted (California) construction. The choice of these constructions should be indicated if a special export requirement is imposed. Goodyear welts, for example, still enjoy a certain popularity in North American markets, as do the California construction.

34. In some cases the choice is quite clear, for example, ladies fashion shoes can logically only be cemented, while other types of footwear permit a certain freedom of choice which may be dictated either by market requirements or by domestic availability of materials and production skills.

35. It is desirable to finalize the first products as far as design, composition and quality is concerned. One practical way of approaching this would be to produce sample shoes, possibly in the production facilities of the foreign partner, using the materials which are going to be used in the developing country, and testing the market acceptability of the product with respect to its appearance and proposed pricing. This is the phase at which a tentative specification of the product and costing should be prepared. As far as the product specification is concerned, one must deal with every component whether it is to be purchased locally in the developing country or whether it has to be imported. An example schedule of such specification is appended to this paper.^{3/} The detailed costing must then be prepared, based on the costs which will apply for the production in the developing country. Thus, it will include all the materials, from leather to nails and small metal materials, whether they may be available locally, or imported.

36. An important part of the costing is the cost of wages, which again must be calculated on the basis of wages, social contributions and other wage-related costs which will apply locally, and it must then include the allowance for overheads. Overheads include salaries and social contributions for the managerial staff, depreciation of the plant and equipment, as well as any other costs not included elsewhere, such as electricity, various taxes etc. When one adds a margin for profit to this amount, the result will be the price at which the shoes can be sold ex-factory.

^{3/} See Appendix I, Example of Shoe Style Specification.

37. Having arrived at the shoe and its price, a market test ought to be conducted to see the product acceptability in its price range in the market. This would be a confirmation or otherwise of the soundness and feasibility of the project.

38. While written specifications and drawing are very important, they are not sufficient without reference samples. The shape of the shoe, for example (last), cannot be adequately described. Samples should be scaled and be clearly identified, dated, etc.

The irrational elements of the shoe

What is fashion?

39. It is not at all easy to define "fashion". We come closest when we say fashion is the concrete expression of the emotional attitude of a large section of the consumer market, expressed by means of their outward appearance: namely clothing, cosmetics and hairstyles. There are two dominant characteristics of fashion - its unpredictability and constant change.

40. Fashion has its history like everything else. At one time there were patriarchs who not only "made" the fashion, but also decided what their subjects might wear. Then came the time of high society, then the epoch of film stars who served as prototypes. Not so long ago, a revolution took place: fashion became democratized. Developments now start among the "masses" and then go to the top, rather than the other way round. This largely explains why fashion not only changes constantly, but has become hectic and capricious.

41. This state of affairs is extremely disturbing for industry, which has a rational bias. No wonder that, on the production side of the industry, resistance to the influences of fashion is still so strong. Nevertheless, fashion forces the situation.

42. Would it not be much better to try to make a virtue of necessity? Indeed, fashion can serve as a powerful stimulus to the industry which, used properly, not only helps to bring in profits but can also be a source of pleasure and variety to the consumer. Today fashion is an intrinsic element of footwear production.

43. From the conception to the launching of the product in the market a period of approximately two years is normal.

Fashion elements in shoes

44. These are: contours, colour and texture, material. And there is one more important element, which may be expressed by the word "feel" or "touch".

45. Contours are defined by the "pattern" which determines the type of shoe (dress, boot, sandal, etc.). The last not only has a functional purpose in the manufacturing process but bestows its character on the finished product. The shape of the last is the "personality" of the shoe. The heel is of great importance. Its form and height influence the looks of the shoe greatly.

46. Colour and texture have recently become of prime importance. Sales success is determined by whether the colour and the texture are "right" at the time when the shoe is offered to the client. The full range of colours and textures is being used in ever changing combinations.

47. The importance which is to be ascribed today to the texture of the material can easily be seen from the wave of "crushed" patents which is now behind us, and the revival of suede leathers which is taking place at present.

48. "Feel" - "Touch". Not only looks but also the feel of the shoe, in the hand and on the foot, are important. A hard, stiff shoe is an old shoe! Softness, flexibility and comfort are the hallmarks of modern footwear.

49. The materials must look natural. Leather must be recognizable as such. Finishes must be transparent and hardly noticeable. Irregularities stemming from organic growth must no longer be hidden. Buffed and heavily finished leathers look "cheap".

The stage of development of a developing country's resources

50. Resources may be totally undeveloped (only raw hides available), semi-developed (leathers available) or semi-industrially developed (shoe production already in existence). Any co-operation envisaged is naturally different in its nature depending on the stage of development of the resources.

51. Since one of the objectives and advantages consists in using locally available materials and labour, thus maximizing their value while maintaining a competitive advantage, there should be an effort to use as many as possible suitable materials of local origin.

52. The most important material is, of course, leather, and use of leather depends upon the existence of local tanneries producing materials of acceptable quality and in sufficient volume. The quality of the available leather becomes especially important if the shoes are to be exported. Sampling of materials should place already in the pre-negotiation period. If there are minor improvements required, these can probably be achieved with advice from overseas tanners, experts, manufacturers of tanning chemicals and machines. Equally important as the quality and quantity, is the consistency of quality and appearance of the leather, particularly its colour. Negotiations with local tanneries should take place at an early stage of preparations, and the first orders placed in time prior to placing volume orders. It will be necessary to obtain sample quantities from which shoe samples for market tests can be made. The alternative of importing leather materials considered only exceptionally, or possibly in an emergency case, or small special-colour runs. In any case, it should be examined whether such a possibility exists from the point of view of licensing regulations, duty drawbacks, transport times and costs.

53. Furthermore, there are many other materials required for manufacturing footwear:

- (a) Special soling materials. Many shoes are being made with soles of molded rubber, Neolith, injected rubber, PVC, or polyurethane. While rubber may be available from indigenous sources, the other materials would probably have to be imported, and the possibilities and costs must then be carefully examined.

- (b) Insoles and counters. Insoles and counters can be made from leather. It is, however, a generally more labourious and expensive process than to use synthetic materials which would generally be imported. Alternatively, if a local manufacturer of artificial leather board exists - and sometimes tanneries do produce these materials to use their waste - the suitability of the material should be tested, possibly by asking for a report from a specialized laboratory of which a number exist in industrialized countries.
- (c) Sewing thread. Generally today synthetic thread would be used because natural cotton thread is not sufficiently wear-resistant. A compromise could be made where synthetic thread would be used partially, particularly for exposed seams like vamps and back-stitching. Cotton thread could then be used for less important seams and for ornamental stitching. In this area, where relatively small amounts of money are involved, a good reserve stock should be built up.
- (d) Eyelets, buckles and various ornaments. In some developing countries these are available and in others they have to be imported. Here the best sources should be used and good quality merchandise obtained because it could make or destroy the appearance of the product.
- (e) Heels for ladies shoes are nowadays mainly molded from polysterene plastic materials. They are wear resistant, do not suffer from humidity and are consistent in quality. The alternative of using wooden heels made locally is a possibility in some types of heels, but they generally provide an inferior product.
- (f) Textile for lining of parts of uppers. In many cases they may be locally available, or specially made available by local manufacturers to the specifications required.
- (g) Adhesives and cements. This is a very critical area since durability of the footwear depends on these. Furthermore, they may deteriorate with time and exposure, and therefore a regular system should exist for testing them before they are issued for production. Again, they

may be available in certain developing countries, and if laboratory tests indicate that they are suitable, they should be given preference.

- (h) Finishes, varnish, dressing. These will give the shoe its final appearance and should be of the very best quality available. One should be careful before deciding on purchasing a product. Both laboratory tests and tests on the samples are required.
- (i) Finally, packing materials, like boxes, cartons and cases. Particularly for export purposes, these must receive careful attention so that the factory is assured not only of good-looking boxes, but of boxes and cases which will successfully protect the shoes en route to their destination.
- (j) Other materials may be required in case of vulcanized or injected-sole footwear. This is a special case. For each single material, however small, a detailed specification must exist to assist the buyer by assuring him that the materials are suitable. Each material, when received in the factory, must be checked and compared with the specifications.

Boundary conditions for successful relationships

54. Even if the product by itself is "right" a number of boundary conditions must be fulfilled in order to assure a stable and satisfactory performance of the co-operation agreement.

55. Reliability is most important because fashion often changes very quickly and the shoes may become outdated if not delivered to the purchaser at the right time for the season. Owing to the high cost of capital, the tendency is to keep inventories low, which means that when the merchandise is not available, for one reason or another, at the right time, sales opportunities are missed.

56. Quality. If the shoes are not up to the agreed standard, the supply to retail stores is interrupted, this also leads to missed sales. It is, therefore, important that strict stipulations in respect to the quality standard and to the quality control are included in any arrangement. An adequate quality control system must be implemented.

57. Logistics. With the long distance involved between the location of manufacturing and the markets, logistics play an important role. It is advisable to engage specialists in these fields in order to assure prompt deliveries and competent handling of all formalities involved.

58. Communications. The shoe business, owing to the changing character of the product and the quick movement on the market, requires close and constant communication between the partners. In most cases, the installation of a telex system is required.

The philosophy of "give and take"

59. Any arrangement should be governed by the spirit of "give and take". This is the only sound basis for lasting results, satisfaction and even pride for all parties concerned.

60. Many instances in the history of the relationship between developed and developing countries show that an over exploitation of resources or near sighted investment of funds or know-how, do not assure lasting and satisfactory results for all parties concerned. The build up of a sound business relationships within the footwear industry is a tedious and slow process. It means training and development of people as well as development of a product. "Giving" always precedes "taking". In the long run the two must balance. Mutual respect and a high degree of independence is the best base for sound and solid business.

The Partners in Co-operation

61. Before any details of an agreement can be discussed, it is imperative that both sides convince themselves carefully that they have found the right partner with whom they can work successfully. The developing country partner must carefully investigate whether a proposed partner foreign partner is:

- (a) A serious, well-established enterprise who has a history and reputation for keeping scrupulously to its engagements.
- (b) Does it have the know-how for which the developing country is looking and in what particular areas? (It should be noted that only a few of the industrialized country enterprises can cover the whole range of know-how).
- (c) Has it the financial strength to carry out its engagement?
- (d) Is its marketing position in the industrialized country or countries sufficiently strong to assure successful marketing of the merchandise to be produced?
- (e) If a brand is involved, how strong is the position of this brand in the markets serviced? Has it got a selling force or is it perhaps just a name without much acceptance in the proposed markets? In this context, it is necessary to ascertain the nature of the distribution organization which the developed country partner has at his disposal, as well as the past performance of his sales.
- (f) Performance of the industrialized country partner over the years.

62. A number of these questions can be checked through enquiries from consular agencies, chambers of commerce, trade organizations, banks, etc.. But it would appear unavoidable to make personal visits to inspect in detail the prospective partner's operations in the industrialized country, and it may be that a great number of candidates should be examined before a choice is made. No efforts should be spared at this stage - there is no better guarantee of success than a good partner and no surer way to failure than by a wrong selection.

63. Similarly, the prospective partner in a developed country must acquaint himself with both the country in which the co-operation is contemplated, and the prospective partner in the developing country. As far as the country is concerned, the following would be the items on which he must obtain full information:

- (a) General information on the country concerned.
- (b) Government commercial policy - controls, incentives, protection.
- (c) Market appreciation.
- (d) Import possibilities - duty - drawback information in relations to:
 - (i) The product under consideration
 - (ii) The materials required
 - (iii) The duty on machines and equipment which will be imported
- (e) Export possibilities
- (f) Facilities - Services:
 - (i) Transport - in and out of the country
 - (ii) Postal Systems
 - (iii) Telegraphs, telephones, telex

64. If the partner should be a government or government agency, it is necessary to ascertain:

- (a) What are the policies of the government in respect to foreign investments, and operation of industry and commerce in general?
- (b) What, in view of past performance, is likely to be the development of such policies?

65. It is most evident that great care must be taken in selecting the partners. Big companies are not necessarily the best partners. Prestige is important but not a value alone. Circumstances are different in each case and adequate solutions must be found.

IV. CHECKLIST OF AGREEMENTS

66. Various types of agreements could, individually or in combination, serve the objectives indicated by the considerations mentioned in the previous sections. These agreements may be specified as:

- (a) Know-how agreement;
- (b) Style agreement;
- (c) Licensing agreement;
- (d) Franchise agreement;
- (e) Agency agreement;
- (f) Buy-back agreement;
- (g) Equity (joint venture) agreement.

67. Each of the first five types of agreements may be conceived within the framework of equity or non-equity participation by the foreign partner in the co-operative endeavour. It should be noted that arrangements for equity participation (joint ventures) closely bind the partners in common efforts. Non-equity agreements, however, leave more operational freedom for each partner, but this freedom may place greater demands on the developing country partner, especially with respect to marketing and product quality control. The nature of the method of co-operation will depend primarily on:

- the inclination of the two partners in committing capital to the co-operative endeavour on a long-term basis;
- the attitude of the developing country's government towards foreign investment;
- the objectives of co-operation: i.e. equity arrangements may be more relevant for co-operation in manufacturing than in the marketing or services aspects of the business.

68. The broad sphere which the above-mentioned arrangements cover can be summarised as:

- the provision of production capacity to the developing country enterprise;
- the provision of manufacturing methodology, productivity indicators etc.;
- the provision of a marketing or product-delivery system to the developing country enterprise;
- the provision of product development know-how to the developing country enterprise.

69. The latter two factors should not be underrated, as the emphasis of discussion in the previous sections suggest, since access to efficient marketing systems and market intelligence is as important to the footwear business, as is the development of productive capacity.

70. Table I indicates the coverage by each agreement of the individual component elements under production, marketing and investment. It attempts to provide an indication of the areas covered by t e individual agreements, and the areas of complementarity between the agreements. The balance of this section discusses each type of agreement, specifying a checklist of items for negotiation between the domestic and foreign partners, and providing commentary on areas which are of particular importance to the production and marketing of footwear.

TABLE I: ELEMENTS THAT CAN BE COVERED BY DIFFERENT CONTRACTUAL ARRANGEMENTS

Elements	Type of Agreement	Knowhow	Style	Licensing	Franchise	Agency	Buy Back	Joint Venture
<u>1. Production</u>								
Product Specification		x	x	x	x		x	x
Production methods		x		x	x		x	x
Plant specification and layout		x					x	x
Equipment							x	x
Production planning system		x						x
Quality control system		x		x	x		x	x
Industrial property				x	x		x	x
Training of manpower		x						x
Management system		x						x
Research and development		x		x				x
<u>2. Marketing</u>								
Fashion information		x	x		x	x		x
Market information		x	x		x	x		x
Product development/range- building		x	x		x			x
Brand identity				x	x			x
Advertising/sales promotion					x	x		x
Purchasing information		x	x					x
Domestic marketing					x			x
Export marketing					x	x	x	x
<u>3. Investment</u>								
Fixed assets								x
Working capital								x
Other forms of investment							x	

Know-how agreements

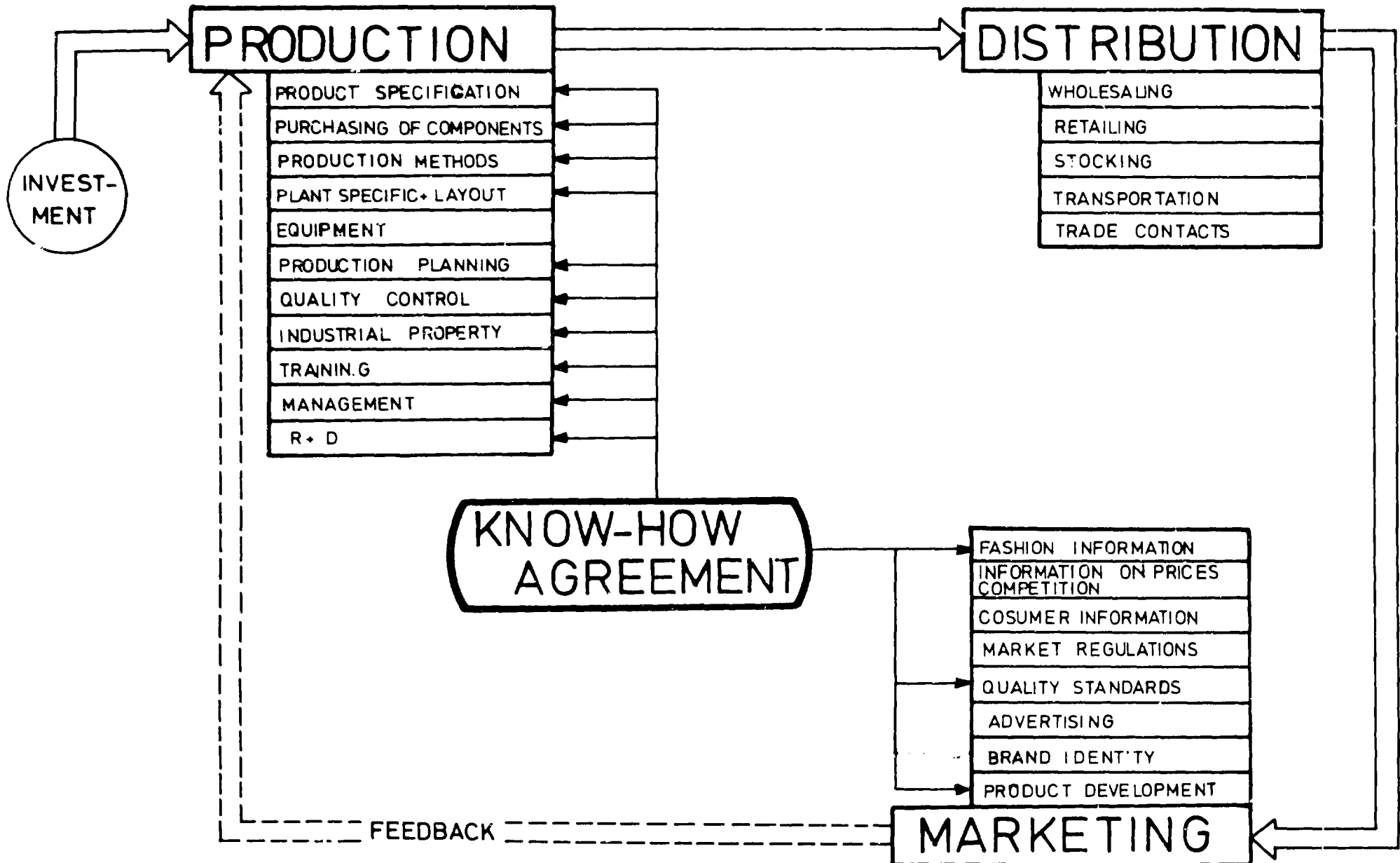
71. Know-how agreements are probably the most prolific and wide-varying form of international co-operation in the footwear industry. Know-how agreements can provide production systems, technical information and assistance for the production of footwear of a suitable quality, quantity and price in relation to a pre-specified market. Know-how agreements may be equally relevant when starting production afresh, or when footwear production is already being undertaken and it needs adaptation or further development. As such, know-how agreements may provide one or more of the following aspects of footwear production:

- Manufacturing Programme;
- Production and pre-production planning;
- Product development;
- Specification of materials and components;
- Specification of machinery and equipment;
- Organization of management;
- Training of personnel and management.

72. Before deciding which aspect of know-how is to be covered by the agreement, it is critical that the partners have a mutual clarification of the level of development of the domestic enterprise's productive capabilities and that the areas for co-operation are clearly identified. This assessment will establish the nature of co-operation, and the type of the foreign partner who should be chosen by the domestic enterprise. Generally speaking, the involvement of the foreign partner will be wider the less developed the domestic enterprise's productive capacity. Furthermore, the wider the sphere of the foreign partner's collaboration the higher the commercial costs to the domestic enterprise in obtaining access to this know-how.

73. Figure 1 indicates the elements of production and marketing systems which can be covered by know-how agreements. The rest of the elements, which are not covered under this agreement would have to be acquired independently by the domestic enterprise, or through appropriate complementary co-operation agreements.

FIGURE 1: ELEMENTS OF PRODUCTION AND MARKETING SYSTEMS COVERED BY KNOWHOW AGREEMENTS



Checklist for know-how agreement

74. Preamble

Definition of terms and expressions
Indicate in detail reasons and scope of agreement
Detailed objectives of domestic partner
Recognition of these objectives by foreign partner
Status and qualifications of each partner
Substantive contribution of each partner to the co-operative activity
Territory for which the agreement is applicable
Responsibilities of the partners in the proper execution of the agreement
Time frame for implementation of the agreement
Specification of proprietary knowhow and secrecy of this knowhow

75. Manufacturing programme - Type of footwear to be produced

Product specification as per preagreed format ^{4/}
Construction of shoes
Manufacturing processes to be used
Quality level
Quantity and plant capacity
Responsibility for decisions on manufacturing programme
Performance guarantees, as applicable

76. Production management

Description and forms of production systems
Description and forms of specification of equipment and tools
Descriptions and consumption of materials and components required for each shoe style
Costing system and product costing based on plant performance and the material and components to be used
Production plans per day, week and month
Production monitoring
Productivity control
Cost control
Quality control system
Responsibility for quality and product testing
Worker payment and incentive systems, such as piece work, etc.

^{4/} See Annex I.

77. Product and Process development

Is a style agreement in existence as a complementary part of this agreement, or separately with a different party?

Responsibility for styling

Responsibility for range building

Responsibility for fashion information

Responsibility for market information

Source of supply of prototypes

Source of supply of patterns, lasts and dies

Organization and equipment of pattern department in the plant

78. Specification of materials and components - Type of raw materials and components to be used

Origin

Responsibility for adequate quality

Responsibility for timely supply

Responsibility for stocking and inventory

79. Machinery, equipment and technology

Layout plans for buildings and production premises

List of machinery and equipment required, including alternatives, if available

Tenders for the supply of machinery and equipment, if applicable

Machinery and equipment to be supplied by the partner

Cost breakdown of machinery and equipment

Responsibility for negotiations and the issue of contracts for purchasing machinery and equipment

Responsibilities for installation of machinery

Responsibilities for basic handling/start up of machinery and equipment and initial training of maintenance personnel

Spare parts

Service and maintenance

Performance guarantees for plant and equipment

Secrecy of proprietary knowhow, if applicable

Mutual sharing of R and D results, as applicable

Performance bonds

80. Organization of management (in case foreign partner supplies management services)

Management structure

Executives

Staff and its responsibilities

Personnel: numbers and qualifications

81. Training of management and personnel

Training of management

Training of technical staff

Total number of personnel required

Anticipated breakdown of costs and responsibility for training

Sources of training, whether in host or foreign country

Expatriate experts - qualifications, number and the time period for which they are required

82. Remuneration

This can be executed, in the case of non-equity arrangements, in one of several ways, i. e.

- Payment of lump-sum on signature of contract;
- The supplier of know-how is compensated for the provision of specific services, on a mutually-agreed schedule of payment;
- Machinery installation, materials and components are to be paid for at agreed prices.

83. Arbitration

84. Termination

Comments on specific aspects of know-how agreements

Choice of manufacturing processes

85. The choice of industrial technique is largely dictated by the marketing objectives and the product specification. In cases where the know-how agreement involves the specification of plant and machinery, the choice of machinery should emerge from what it is that will be produced, and for which market it will be produced. Another factor which determines the type of plant is the extent of flexibility required in the product range of the factory. For example, in a large plant with several production techniques, it could be possible to simultaneously produce shoes using different processes.

86. The choice of process may be dictated by the fact that a certain type of market is available through the foreign partner's business activity, or through connections with a foreign marketing organization. These arrangements will decide on the product, and the technique and machinery would have to comply with it. In a large factory where several assembly techniques could be used, careful consideration should be given to choices (taking into account the advantages of simplicity of one technique against the greater elasticity of several), which could provide for the alteration of the product as necessary.

87. If there are no such requirements, the simplest and most efficient method in the production of leather footwear would be to utilize cemented construction, balanced by consideration of available materials. For example, some of the heavier good-quality materials could be most profitably used by producing hand sewn moccasins, or similar footwear.

88. Although the specification of technology, machinery and equipment for a shoe factory is quite unique to each case, some simple guidelines may be useful to keep in mind.

89. The main task of a good technologist is to develop a product technology which uses the available machinery and equipment to its maximum efficiency. There are many examples of factories, especially but not only in developing countries, where the technology selected and applied does not utilize the advanced machinery available to its potential, thereby showing very poor economic results. On the other hand, basically simple machines can be used to great advantage for a very rational and economic production by applying suitable product technology and by improving the simple machinery and using small work aids such as jigs, guides, clipping devices, etc., especially applicable to an ever changing product range.

90. Similarly it is totally impossible to suggest suitable machinery or "appropriate technology" without knowing in detail the production mix, material availability, market requirements and the labour and social conditions of the country in question. Serious errors have been committed by accepting studies made without sufficient knowledge of the above conditions. A rational production machine or a production line designed for the conditions of an industrialized country with the service of highly skilled technicians and necessary support services may, in a developing country, turn out to be an inappropriate alternative and end up producing either highly uneconomic articles compared to less sophisticated and cheaper alternatives or, not producing at all.

Specification of plant infrastructure

91. Shoe manufacturing plants do not require expensive and heavy construction. Generally a ground-level building permits best lay-out and work-flow.

92. The first item under consideration must be the area required. Land and factory area calculations involve:

- (a) Land
- (b) Buildings:
 - (i) Immediate
 - (ii) Intermediate
 - (iii) Final.

93. The above division takes into consideration the fact that not all the land would be built up, since some would be used as part of the landscaping. Neither would all the buildings be built in one stage. Initial construction should fulfill the immediate requirements with provisions for future expansion of the plant.

94. One approach could be to build a modular building on the ground level plan, leaving space available on at least two sides to add extensions as required.

95. There is a general trend towards constructing plants in one large integrated area for the entire manufacturing process. This area can be sectioned or physically separated for reasons of security and control by wire or glass partitions. This would provide enclosed spaces for stocks of raw materials, ready goods, spare parts, etc., and at the same time provide a full view of the whole operation. This type of building lends itself to the best possible flow of work, starting with material coming in on one side of the building, and the ready merchandise coming out on the other. In addition this layout affords the advantages of good ventilation, lighting and economy of costs.

Layout of plant machinery and equipment

96. The start-up of the work rests on the lay-out of the operations which can be provided either by:

- (a) The supplier of machinery, if the machines come from a large reputable manufacturer who could provide this service along with the machinery, or
- (b) The organization which provides technical services to prepare this layout.

97. In shoe manufacturing, there are really no heavy unmovable machines which would need special foundations besides a good concrete floor. This makes for an elastic lay-out, and the machines, conveyors and equipment can be moved to give a different lay-out, depending on changing production requirements. The services required for the shoe factory are electricity and water, which should be provided for with the factory's final capacity in mind. The design of the building can be provided either by:

- (a) One of the partners if he has the necessary know-how and facilities available;
- (b) Architects and consultants.

98. As far as architects and consultants are concerned, in view of the relative simplicity of a shoe manufacturing plant, it would be an advantage to use a local architect who would have the advantage of knowledge of local conditions, materials, etc. It would be helpful in such a case if plans of a larger shoe factory building in similar climatic conditions were made available to the architect to give him some guidance.

99. If an architect from a developed country is used, it would be necessary to provide him with full information which he should then verify and supplement by a visit to the proposed location. Such information would include:

- (a) Appreciation and suitability of the location;
- (b) Land and factory area calculations;
- (c) Local building regulations;
- (d) Information on local costs of building;
- (e) Site information which would include town plan, site plan, photographs and description. Plans of general lay-out at initial stage, and plans of expansion;
- (f) Information on services: electricity, water, access roads (and possible steam and natural gas availability).

100. The building and construction of the factory itself can either be carried out under the supervision of the partners, particularly the local partner, or it can be entrusted to contractors with supervision by the architect. In case a contractor is engaged for civil works, it may be desirable to choose from various tenders.

Performance guarantees for plant, equipment and know-how

101. Manufacturers of shoe machinery are generally quite willing to guarantee that their machines can perform a specific number of operations, and, of course, guarantee against any faulty material or workmanship.

102. However, it is quite another matter to prove that the machine does not perform to specifications in different operating circumstances, since much of the performance of the machine depends on the operator and other factors.

103. Shoe machine manufacturers are usually willing to demonstrate the performance of machines in their home countries, if desired, and they may even be willing, from case to case, to make such performance testing in the purchaser's country to demonstrate that the machine is capable of the specified performance given certain minimum operator skills.

104. However, the best guarantee of machinery performance is purchase from reputable manufacturers; in cases where machinery is purchased from not such reputable manufacturers, there has been substantial variation in the quality of machinery supplied, to the extent it has been observed that reconditioned and repainted old machinery has been shipped in the guise of new.

105. A third alternative is when one of the partners of the co-operative agreement supplies the machinery. Here, it would be advisable to have the machinery inspected before shipment by an expert. This does not imply lack of confidence in the partner, instead it would protect the supplier from facing a conflict of opinions, later on.

106. It must also be kept in mind that break-down of machinery can result from many extraneous factors, such as poor maintenance, bad handling, etc., and these factors must be evaluated when judging the performance of equipment.

107. Another aspect of the guarantees for machinery and equipment is the question of price. The best possible pricing could be obtained after comparing several tenders of offers from reputable machinery manufacturers. This would apply regardless of who is the supplier of the machinery. In some of the machinery supply agreements, clauses are included which specify that "the basis of the guarantee is that the prices and terms should not be less favourable than the prices and terms available from other suppliers, assuming that competing offers relate quantities, delivery schedules, comparable

qualitative specifications and production capabilities". Such a clause has only a relative value. Unless the comparisons and controls are exercised beforehand, endless and inconclusive arguments could occur. This applies to almost any guarantee formula if price is taken as part of the issue.

108. Guarantees become even more difficult when it comes to performance of know-how. One could specify several criteria for know-how. For example, the performance of production know-how to be provided by the foreign partner could be considered to have been adequate in terms of:

- (a) Achievement of a specified output per operator per day.
- (b) The production of seconds or faulty shoes not exceeding a certain percentage.
- (c) The materials and goods used in production not exceeding a certain multiple of daily output. This is very important from the point of view of the utilization of working capital.

109. While these would be reasonable goals and performance, it is questionable whether the supplier of know-how would be willing to unconditionally accept such guarantees. It can be argued that there are too many elements which are beyond the control of the know-how supplier, such as, for example, materials not arriving in time, labour absenteeism, electricity supply problems, etc. It would be difficult to specify all such circumstances. Generally speaking, the provider of know-how would probably be willing only to accept an obligation to 'make his best efforts to achieve such performance'.

110. These considerations only underline the necessity, mentioned earlier, of selecting a most reputable and serious partner or supplier of technical services who would owe it to his name and reputation to achieve the best possible performance.

Style agreements

111. Styling agreements provide the information and technical documentation necessary for product development and range building, with the objective of enhancing sales potential in the envisaged markets.

112. This information can be supplied in conjunction with the other types of agreements described herein, or by itself, i.e.: style agreements can be concluded by themselves, or provide range building know-how in combination with know-how, licensing and brand marketing agreements. Figure 2 indicates the elements of production and marketing which could be covered by a styling agreement.

Checklist for style agreements

113. Preamble

Objective of agreement

114. Type of footwear covered by agreement

Children

Ladies

Men

Utility

Fashion

Comfort

Anticipated markets

Anticipated consumer target group

Quality level

Degree of fashion content

115. Market information

Markets involved

Description of forms in which the information has to be delivered (reports, prototypes etc.)

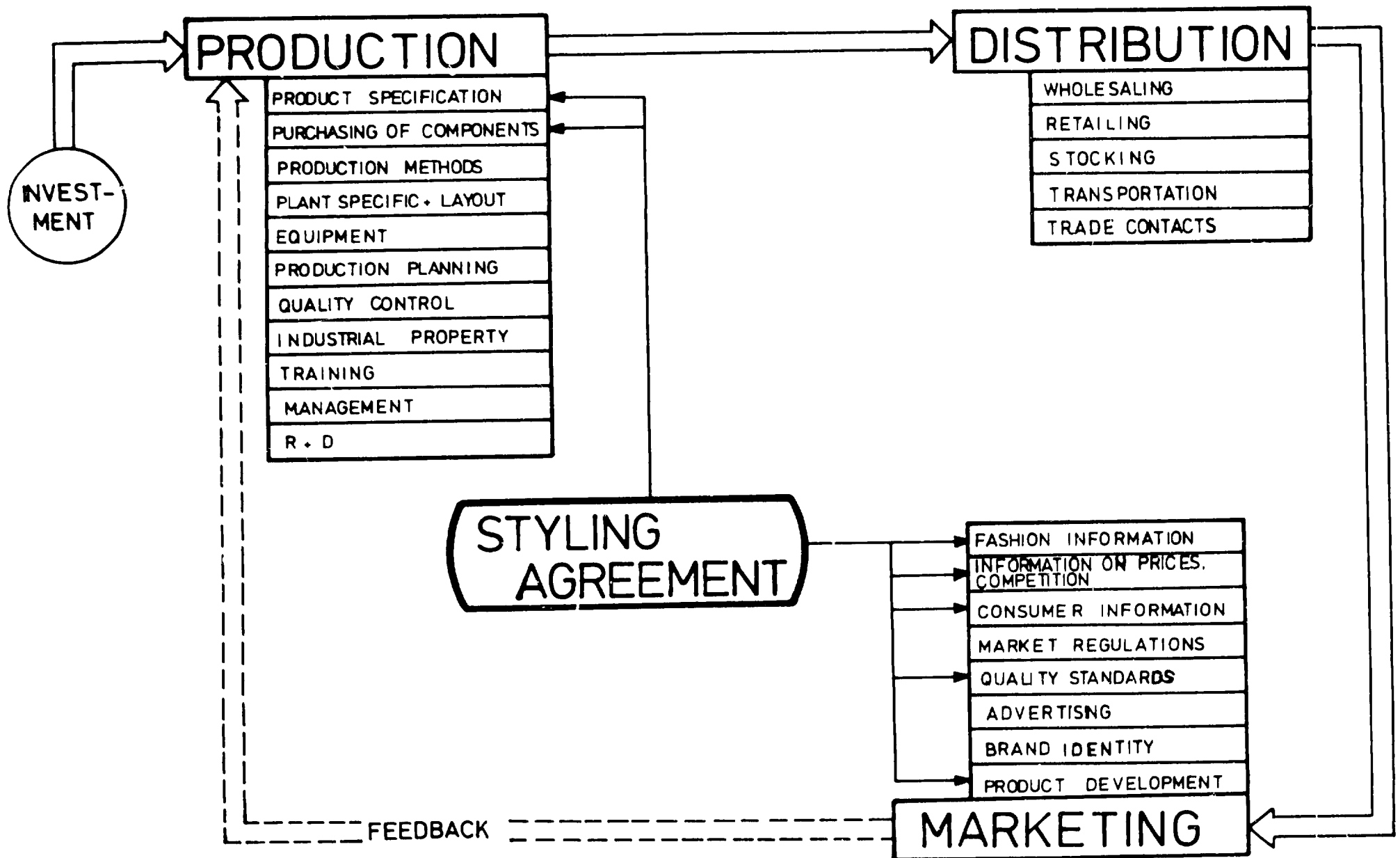
Sequence of delivery of information

Description in detail of information material to be delivered

Prototypes of lasts and fits

Illustrate sketches

FIGURE 2: ELEMENTS OF PRODUCTION AND MARKETING SYSTEMS COVERED BY STYLING AGREEMENTS



Market information (cont'd)

Pullovers

Patterns

Specimens of shoe components and ancillaries

Indication of supply of pertinent trade magazines

Assistance to representatives of licensee in trade events (shoe fairs)

Visits to the markets

Use of shoe style specifications ^{5/}

116. Remuneration

This may consist alternatively of:

A flat-fee for all services

A flat-fee plus a royalty per pair sold

A flat-fee per pattern adopted

A royalty per pair sold

For guest stylist, a flat-fee based on time-plus-expenses

Comments on Style Agreements

117. It is most important that the supplier of styling services be fully aware of the basic fashion trends - world-wide and within the target markets - and that he has the capacity to work out a synthesis for each individual client, considering the characteristics of the resources available to the domestic enterprise, and the trends in the target markets.

118. Style agreements may be equally useful for new enterprises as well as for already operating enterprises. They help, or are even necessary, in conquering new markets or in better exploiting existing market opportunities.

119. Style services may be rendered by large or small organizations, or by individuals. Large organizations do not necessarily render the best services.

120. One form of style service consists of engaging a guest stylist who works on the premises of the enterprises for an agreed length of time, and usually completes a collection on the spot. The selection of an individual stylist should be undertaken with great care. It must be realised that each stylist has his own "style" and therefore may be in or out of fashion. (Rising and falling stars!)

^{5/} See Annex I.

License agreements

121. License agreements provide the licensee the right to exploit designs, patents and brand names which are owned by the licensor in the defined area. Such agreements provide the licensor the opportunity to enter a market with plants and processes that are already well developed. Where patents are involved he does not have to go through the tedious and costly process of patent development. Figure 3 indicates the elements of production and marketing which are covered by licensing agreements.

Checklist for license agreements

122. Preamble

Statement that the licensor is the owner of:

Patents

Brand names

Design rights

Industrial processes

Statement that the licensee is desirous to acquire, utilize and exploit the above

Designation of territory for which the exploitation is granted

Functions of each partner in the proper handling of the agreement

123. Detailed statement of patents, brand names and design rights involved

State country, number and date of patents granted

State country, number and date of deposit of brand names

State country, number and date of deposit of designs

124. Rights of Licensee

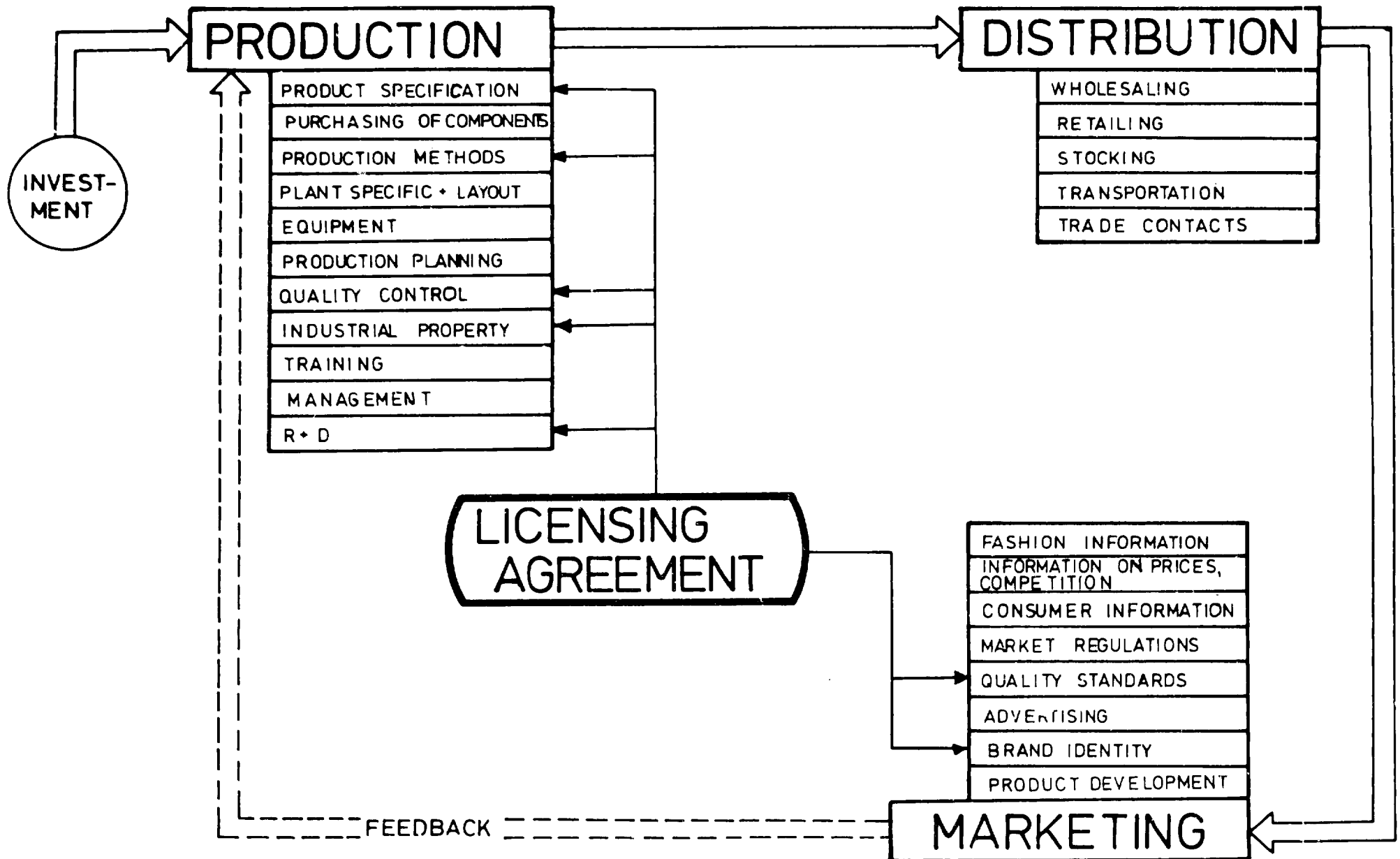
Use of patents, brand names and designs within the designated territory

Manufacture and sale of products covered by patents, brand names and designs mentioned

Rights to sublicense

Right to export to third countries

FIGURE 3: ELEMENTS OF PRODUCTION AND MARKETING COVERED BY LICENSE AGREEMENTS



125. Licensor's obligations

Information on materials, technical data, drawings etc., pertinent to the manufacturing process involved

Visits of representatives of licensee to licensor's manufacturing premises

Visits of licensor's representatives to the licensee's premises

Defence of brand names and patents

126. Maintenance of quality

Specification of product quality characteristics to be supplied by licensor

Assurance of licensee to maintain the demanded product quality level

Ways and means of quality control

127. Remuneration

This is usually done on a royalty per pair sold.

Comments on Licensing agreements

Industrial Property:

128. In licensing industrial property, it is necessary for the licensee to ascertain whether the licensed patents and brand names are well established. There are strong and weak patents and brand names, and it would be wasteful for the licensee to commit resources to utilize weak industrial property. The process of establishing the "novelty" of patents varies from country to country, with some countries exercising very severe examination of patent application, and others exercising relatively relaxed examination. Therefore, particularly in the case of patented processes, the licensee should carefully consider the alternatives available, if any, before entering the licensing arrangement.

Brand names:

129. In the wider sense of the word, a brand is a name or design which distinguish a given type of footwear. This identification has commercial importance in so far as the brand is known by consumers as a guarantee of certain features, quality or style, which the consumers may consider important, and for which they are usually willing to pay a higher price. A brand which has no such acceptance by the consumers is of little value. On the other hand, it may have a great value if such consumer acceptance is strong and widespread. The actual value of the brand name should be very carefully assessed by the licensee, in relation to his target market.

130. A well-known and widely accepted brand name is a very valuable asset. It is usually established over years of successful operation and sales promotion. Investments made by the owner of the brand name may be very considerable. For example, the establishment of a brand name on a national basis in the USA may cost between one million and five million dollars per year, over a period of several years.

131. A partner who may be the owner of an important brand name would be using the brand name for the shoes supplied under the licensing agreement, but he would undoubtedly consider it to be his exclusive property, and would wish to exercise full control as to which shoes would be allowed to carry the brand markings.

132. If the brand name is known world-wide and is a registered brand name, there could only be limited areas in which the licensee could obtain the right to use it at his discretion, and under certain conditions. For example, the brand name could be used in the domestic market of the developing country. Indeed, it may be one of the motives for the owner of the brand to enter into a licensing agreement in a developing country, i.e.: to place its brand in the developing country's market.

133. On the other hand, some good brands have value only in limited geographical areas. For example, an American brand may not be marketed in Europe, or vice versa. In this case, there could be an opening for negotiating the right to use the brand for markets in which it is not presently being used by the brand owner. In general, the countries with centrally planned economies would also be open for such use.

134. In the countries where the brand has not been established, it would have little or no consumer acceptance, but the licensing agreements would have the advantage of providing the licensee the product specifications and features, and the existing promotional materials, so that market penetration may be made easier with relatively smaller expenses in marketing and product development.

135. From the foregoing, it is clear when considering the licensing of brand names, it is necessary to establish:

- a) The territory in which a brand is registered and protected.
- b) The real consumer acceptance of the brand, in the target market, i.e.: the extent to which the consumer will pay more for the shoe with this brand than for other shoes.

- c) The extent to which a licensing agreement will be a more economical means of entering the target market compared to an independent effort in marketing and product development.

136. Finally, it must be taken into account that a certain number of shoes produced will be under the standard specified by the brand owner due to normal production variations, and thus it may not be possible to sell such shoes with the brand in protected markets. In addition, the brand identification may be difficult to remove, being either molded into the sole or being part of the upper. Provision must therefore be considered in any licensing agreement for the disposal of such shoes, possibly in some area where the brand is not protected or promoted by either party.

Franchise agreements

137. Under a franchise agreement, footwear can be produced, distributed and sold through already well established systems developed by the franchiser. Relevant documentation and information on production, management and marketing systems are supplied under such agreements. Figure 4 indicates the elements of production, marketing and product distribution covered by franchising agreements.

Checklist for franchise agreements

138. Preamble

State the franchiser's properties in general terms
State the franchiser's desire to exploit these properties
Describe territory for which the agreement is applicable
Describe functions of each partner who is responsible for the proper handling of the agreement

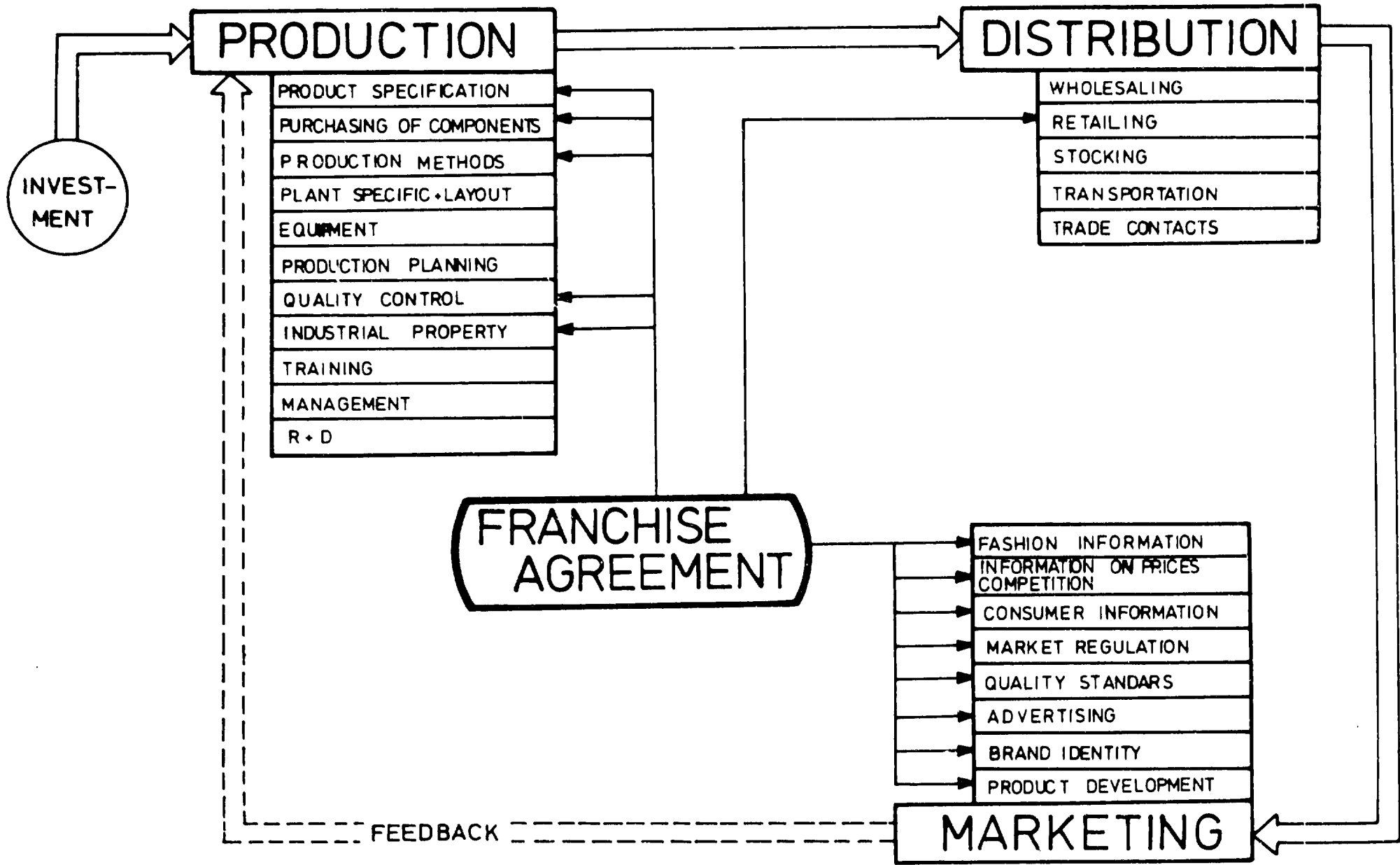
139. Detailed description of franchise property

Trade marks
Service marks
Device marks
Designs
Merchandising property
Store layouts
Advertising materials and other sales promotional materials
Trade secrets
Technical information
Styling property
Industrial property
Industrial design
Product configurations

140. Rights of franchisee

Use of franchiser's property in the territory defined
Rights for sub-franchises
Authorization to act as exclusive agent within the territory agreed
Exclusivity of utilization of productive capacity and other industrial processes covered by the agreement

FIGURE 4: ELEMENTS OF PRODUCTION AND DISTRIBUTION SYSTEMS COVERED BY FRANCHISE AGREEMENTS



141. Obligations of franchiser

Form and sequence of transmission of information on:

Marketing know-how

Designs

Trade secrets

Styling

Merchandizing

Store operation etc.

Providing the franchisee access to franchiser's premises

Informational visits of franchiser's representatives to franchisee's premises

142. Supervision and quality control

Control to be exercised by franchiser

Ways, means and frequency

Control to be exercised by third parties

Ways, means and frequency

143. Remuneration

Each franchiser has its own standard contract which is usually based on arrangements already made in other areas. Adaptations to the special conditions of a new franchisee must be negotiated.

Comments on franchising agreements

Marketing aspects:

144. Franchising can be applied not only with respect to the domestic market of the franchisee, but also for other territories conveniently accessible to him, and not already covered by the franchiser.

145. Franchising is playing a growing role in international marketing. It provides the franchisee with relevant marketing and production know-how, leaving him the task of production according to clear specifications, and the distribution and retailing of such products.

146. A very important element of franchise agreements are the product specification, quality control systems, quality standards and methods of quality control which are transmitted to the franchisee.

147. One of the more important issues for negotiation under the franchising agreement would be the exclusivity of the know-how acquired by the franchisee. If the production system is non-exclusive in relation to the agreement, the franchisee could profitably develop parallel product lines which could conform to the same quality specifications as those covered by the franchise agreement.

Agency agreements

148. An agent is appointed to obtain business for his company within assigned territory, and is bound to serve the interests of his principals to the best of his ability. He is supposed to do his best to provide all information necessary for the purpose of promoting business. Figure 5 indicates elements of marketing and distribution which could be covered by an agency agreement.

Checklist for agency agreements

149. Preamble

Exclusive or non-exclusive contract

150. Particulars of principle and agent

Addresses

Territory

Type of products

151. Agent's obligations

Best effort to obtain business

Serve the interests of the principal

Provision of the necessary market information

Convey orders in proper forms

Adherence to give prices and payment conditions

152. Principle's obligation

Provision of all necessary samples

Provision of sales promotion material

Information on business contacts

Information of acceptance or refusal of orders

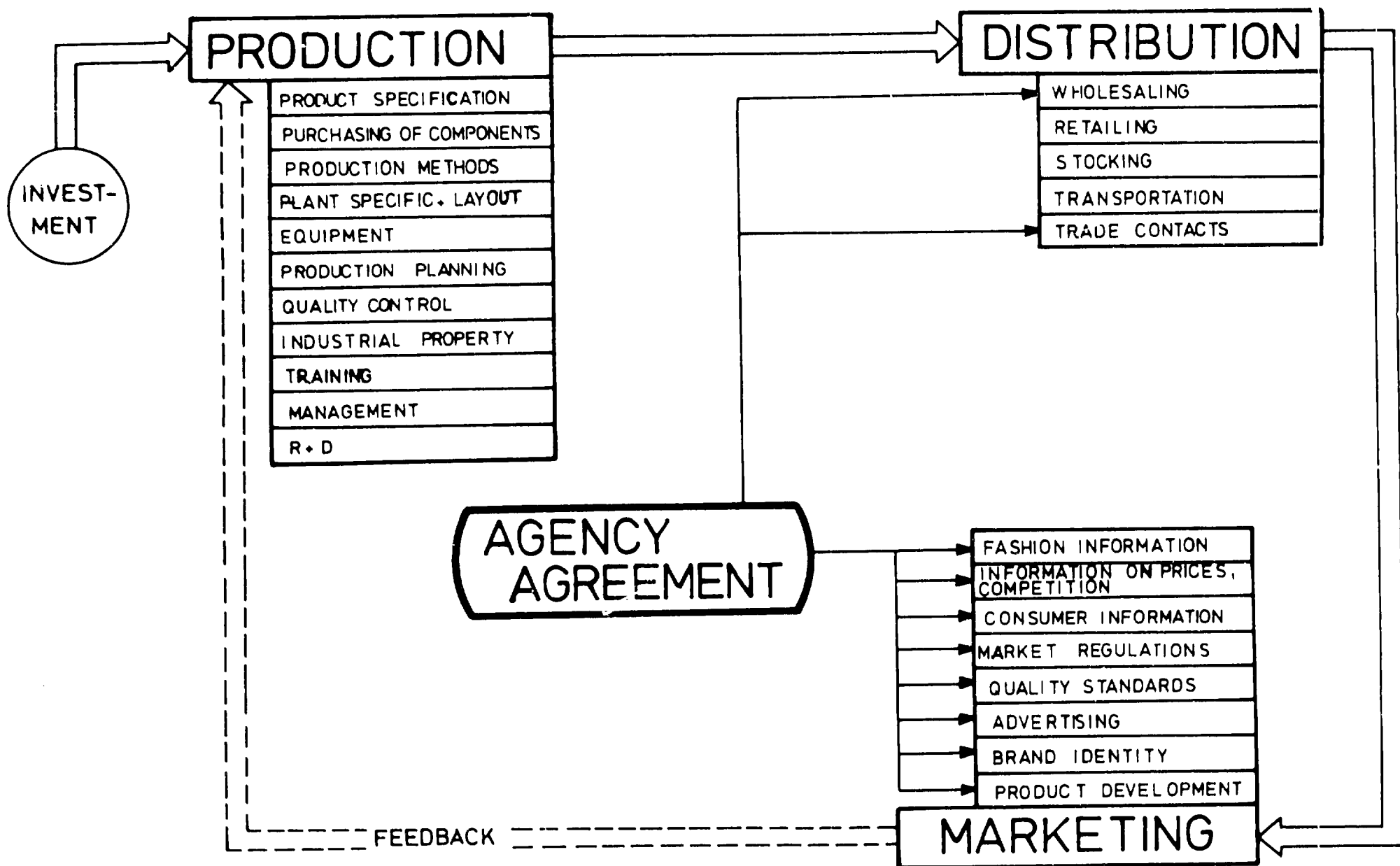
153. Claims

Legal liabilities in case of the termination of the contract

Specifications on handling of claims against defective quality or late delivery, or because of violation of patents, style, trade marks or copy-rights

Responsibility for collection of debts

FIGURE 5: ELEMENTS OF DISTRIBUTION AND MARKETING SYSTEMS COVERED BY AGENCY AGREEMENTS.



Remuneration

154. Agents are normally remunerated on a commission base. Commissions vary greatly as do the obligations of the agent. Commissions may vary as much as between 1 and 10 per cent. In some cases a sliding scale for commissions may be applied.

Comments on agency agreements

Selection of agents:

155. An agent's knowledge of an export area or access to a distribution organization in the area, or in contacts in the trade, can greatly facilitate trade promotion.

156. Since most agents, or at least the most successful of them, work on a commission basis, they may be reluctant to represent an unknown company which is trying to get a foothold in the market. The company is therefore likely to encounter certain difficulties since such an agent would be investing his time without obtaining any sales and commissions. In some cases an alternative arrangement may be made by which a certain amount of income is guaranteed to the agent whether or not he obtains sales.

157. On the other hand, if such an arrangement is contemplated, full information must be obtained on the agent's reputation and performance to ensure that he will not be complacent in his sales promotion effort. The selection of an agent is the most critical aspect of establishing an agency agreement.

158. Names of agency firms are readily available through chambers of commerce, leather and leather products associations, trade directories and journals. A well established large agency company, well respected in the target market, may sound like the best selection. However, it may not always be the suitable choice. Such an agent may already have competing lines in his sales programme and accepts to take the agency of a newcomer only to be able to control the market and not to let the newcomer cause any disruption on his other sales. Such an agency will not necessarily "promote" the new product, on the contrary, the product will be put "on ice". In many cases a rather small agency with a dynamic and competitive approach may be found much more effective in promoting a new article.

159. Of course, it must be realized that the above examples are not intended to give an impression that an old and well established agency would always act as described, nor is it meant that a new agency can always work wonders. The above examples are only given to illustrate the many different aspects which must be considered when selecting an agent.

160. It should also be noted that the legal aspects in appointing an agent must be taken into consideration and some countries have very strict laws protecting the agents' interests. For instance, an agent agreement cannot be easily terminated, and in many countries the agent must be paid goodwill money equalling a few years' sales turnover of the product on termination of the agreement.

Buy-back agreements^{6/}

161. A buy back arrangement can be concluded for any of the aforementioned agreements for the supply of technology, know-how and equipment. There are many variants of buy-back agreements and this checklist deals only with the simplest case, whereby the supplier of technology provides the recipient enterprise the alternative of paying for all or part of the acquired inputs in terms of products produced, rather than in cash. There are many more complex variations of payments through the supply of goods, which come under the classification of countertrade arrangements or compensating trade arrangements.

162. Figure 6 indicates the elements of production and product distribution which can be covered under buy-back agreements.

Checklist for buy-back agreements

163. Preamble

Parties to the agreement

Description of technology, equipment or know-how supplied

Specification of the product(s) to be produced

164. Trade arrangement

Value of the technology, equipment or know-how supplied by the foreign partner

Percentage of this value which can be paid in terms of products

Period over which the payment will be effected

Interest rate imputed on the value of the technology etc. as a result of the deferred payment

Quantity of the product which will be produced and traded under the agreement

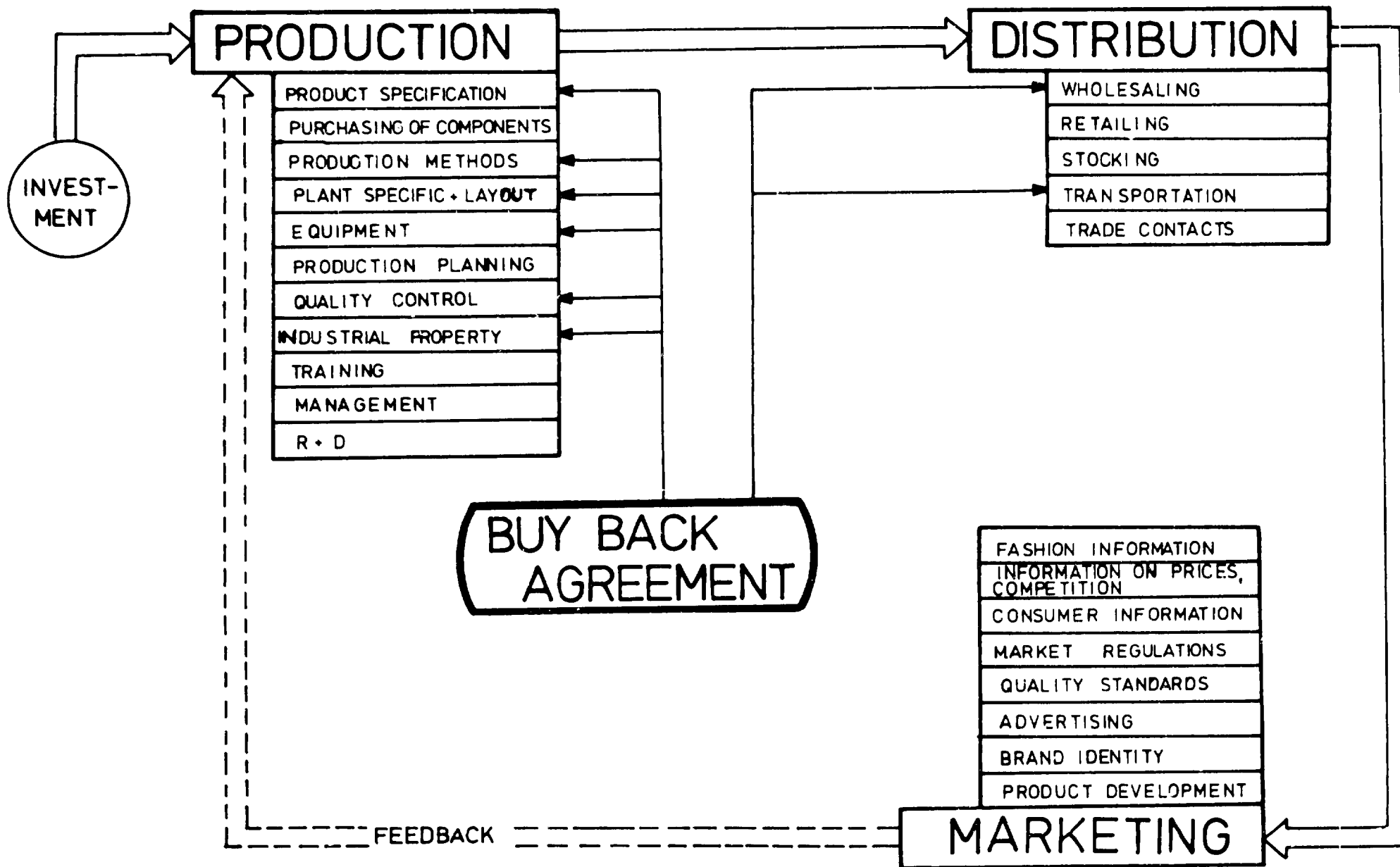
Pricing of the product

Price adjustment mechanism

Possibilities for product range building

^{6/} For a more detailed discussion, see: UNIDO/EX. 78, Report of the Expert Group Meeting on Buy-Back Agreements, Vienna, 29-30 March 1979.

FIGURE 6: ELEMENTS OF PRODUCTION AND DISTRIBUTION COVERED BY BUY-BACK AGREEMENTS



165. Guarantees and responsibilities

Supplier's performance guarantees for equipment, as applicable
Product quality/quality control guarantees by the producer of footwear
Ability of either party to transfer obligations to third parties
Market restrictions, applicable to both parties

Comments on buy-back agreements

Potential benefits and drawbacks of buy-back arrangements:

166. The potential benefits to developing countries of buy-back agreements lie in four basic areas:

- (a) Since the purchase of know-how is transacted in terms of products rather than money, there could be a potential alleviation of the requirement for cash payments in scarce foreign exchange.
- (b) In view of the fact that a buy-back arrangement simultaneously provides for marketing the product and the supply of technology, the need to develop separate marketing arrangements can be simultaneously met.
- (c) The deferment of payment over a number of future years implies that the foreign partner has arranged a type of supplier's credit in the arrangement.
- (d) If the foreign partner is serious about successfully executing the buy-back arrangement, then he may be providing an implicit performance guarantee for the plant equipment and know-how supplied, in view of the fact that he has made an a priori commitment to arrange the marketing of the product.

167. Against these potential benefits several potential drawbacks should be noted:

- (a) Buy-back arrangements work best in situations where the traded product is relatively homogenous and where the quality levels and quality variations can be easily established and analysed. For the footwear industry, the complexity of the product, the many variables in the specification of product quality levels, and the changeability of market requirements make it difficult for firm marketing commitments to be made covering a number of future years. Therefore it is highly unlikely that successful buy-back arrangements could be executed in, for example, fashion footwear. On the other hand, it could be reasonable to contemplate such agreements in relatively standardised products, such as industrial footwear, or in specialised product categories which are not subject to changes of fashion, tastes etc., and where product quality levels can remain stable over a period of time.

- (b) Although the developing country may have to pay a smaller percentage of the transaction value in cash, its total outlay on the transaction may be higher, as a result of the deferment of payments. As with any credit system, the foreign supplier may quote for the value of the equipment and services plus an interest rate on deferred payments, in addition to attaching a risk premium on the value of the transaction, in order to protect himself against a malfunctioning of the agreement. This higher payment for equipment and services needs to be carefully analysed and weighed against alternative methods of payment.
- (c) The problem of product pricing and product price escalation is a critical area for negotiation and clarification between the parties to the transaction. In a situation where price volatility occurs in the basic raw materials of the product, an overly rigid pricing formula could undermine the basis of the buy-back agreement, in addition to causing substantial operating losses to one or the other partner.

In addition to these considerations, the following items need to be given careful attention in formulating a buy-back arrangement.

Contract Structure:

168. In most instances, the buy-back arrangement is formulated in the framework of separate contracts, one for the supply of equipment etc. and another for the purchase of marketing of goods. These parallel contracts are usually linked by appropriate cross references. In order to maintain the linkage between the two, it must be established whether or not the invalidation of one contract would imply the invalidation of the other.

Transfer of obligations:

169. In view of the fact that relatively few equipment or technology suppliers have, at the same time, a marketing operation in footwear, it would be necessary to involve a separate marketing organization in the buy-back agreement. In addition to this, there should be some scope for the developing country to sell to third parties in case the contracted marketing agent is unable to market the products in the quantities required. For both these situations, it would be necessary to stipulate conditions which allow the transfer of marketing responsibilities by the principal contracting parties to third parties.

Alternatives to buy-back agreements:

170. In view of the constraints of buy-back agreements, it may be useful for the domestic partner to contemplate alternatives to the strict buy-back agreement, such as the combination of supply of equipment etc., with long term marketing arrangements of the types specified in previous agreements. If the feasibility of these arrangements is considered sound, it could be reasonably easy to obtain financing of technology purchases, through normal commercial banking channels.

Equity (Joint Venture) agreements

171. Joint Ventures with equity participation could cover any or all of the aforementioned agreements in addition to providing investable resources in the domestic enterprise. They are probably more of an exception than the rule in the footwear industry, since the total capital requirements are usually not large enough to impose the requirement of foreign investment in individual projects. Figure 7 indicates the scope and coverage of joint venture agreements.

Checklist for joint venture with foreign equity participation ^{7/}

172. Preamble

Purpose and objectives of joint ventures, from the developed country's point of view and from the developing country's point of view;

173. Production, Finance and Management

Production and market specification;
Forms of equity participation;
Ownership and capital structure of the project;
Operational responsibilities and authority of partners;
Management structure and policies;
Financial policies;
Project feasibility and sharing of project feasibility studies between domestic and foreign partners.

174. Membership

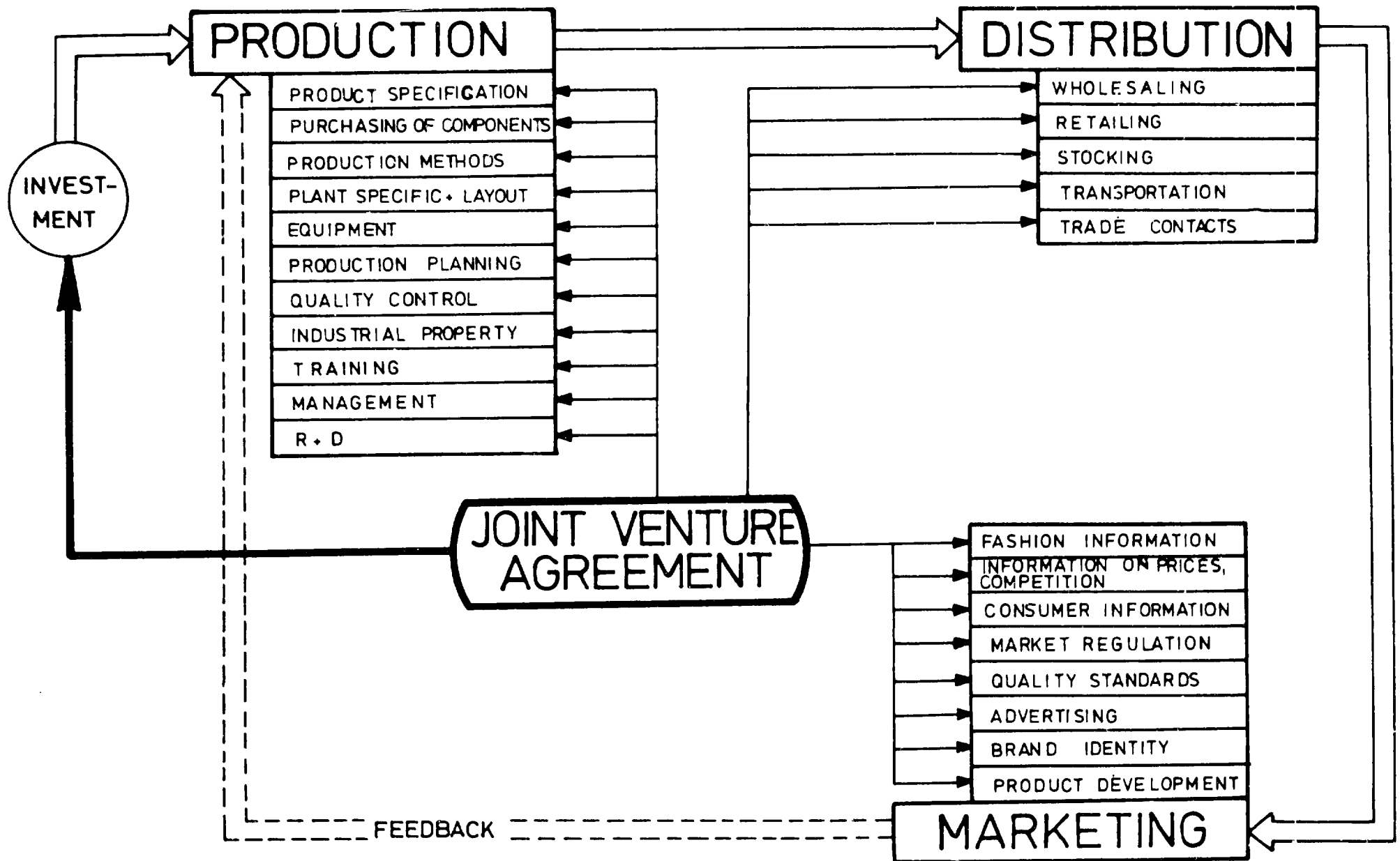
Marketing policies, especially export marketing responsibilities and export market segmentation;
Brand name policy; whether licensed from the developed country enterprise, or whether developed by joint venture;
Patent licensing arrangement;

175. Know-how and Manpower training

Provision of technical information and application of know-how by each partner;
Training of skilled workers, technical and managerial personnel

^{7/} It should be noted that the points mentioned here would be issues for negotiation in addition to the conventionally accepted articles of association. For an elaboration on the latter points, see, for example, ID/68 - Manual on the Establishment of Industrial Joint Venture Agreements in Developing Countries, UNIDO, Vienna 1979.

FIGURE 7: ELEMENTS OF PRODUCTION, DISTRIBUTION AND MARKETING SYSTEMS COVERED BY JOINT VENTURE AGREEMENTS



176 Technical specification of operation

Responsibilities for the choice of production technique and specification and installation of equipment;

Responsibilities for the provision and specification of infrastructure for plant;

Sourcing of inputs;

Performance guarantees for plant, equipment and know-how;

177. Supplementary issues

Investment guarantees and government incentives/disincentives to trade;

Change of partnership/liquidation of joint venture

Settlement of disputes/arbitration.

Comments on joint ventures with foreign equity participation

178. The objectives behind entering into joint ventures with foreign equity participation are usually varied, and differ between the partners. It is essential therefore, that the objectives be clarified and mutually understood in the prenegotiation phase of the arrangement, and that appropriate objectives be specified for the short (eg: 1 to 4 years) and long terms. In addition it would be desirable to produce a preliminary study to ascertain the feasibility of the operations and to ascertain whether the assumptions on which the objectives are based are realistic and attainable.

179. One area which requires special attention is that of management and operational control of the enterprise. The balance of this section is devoted to a discussion of this area.

Management Structure and Operational Control:

180. In an operation where both partners are owners of equity or shares, the responsibility and authority would generally depend upon the extent of capital ownership by each partner, with the partner who owns the majority shares having the main decision-making responsibility.

181. In some cases, however, the nature of operational responsibility may depend primarily on the extent of knowledge and experience of both partners. The foreign partner may usually be more knowledgeable about export markets. He may also be more knowledgeable with respect to production techniques. However, it is possible that the domestic partner would be more knowledgeable of local conditions from the point of view of legislation, purchase of local materials, local markets and local customs. In cases where either of the partners

holds an equal part of the shares, or the more knowledgeable partner has a minor share (because for example, of legislation in developing countries), special arrangements may be required.

182. A means of arriving at such an arrangement could be to make a separate know-how agreement by which the joint venture company would agree with the foreign partner requesting him to provide production know-how which is not available locally to the joint venture enterprise. This would give the foreign partner the authority and responsibility to organize production even if, as far as share-holding is concerned, he is the owner only of the minor part of the equity.

183. Similarly, an agreement could be envisaged under which the joint venture company would make a full management agreement with the partner from the industrialized country in which his obligations and his reward would be set independently of the joint venture agreement. Such a separate agreement could also deal with marketing of the products, or possibly only the marketing of the products.

184. With the exception of very large and experienced companies from industrialized countries, it may usually happen that the foreign partner would not have all the know-how required for managing an integrated enterprise. He may, for example, be a large distributor with little technical knowledge, or vice versa, a manufacturer with little marketing experience. If such knowledge is not available from the partner in the developing country (he may for example be an experienced manufacturer himself), an agreement could be envisaged by which the joint venture company would make a separate arrangement with another specialized organization which would provide such knowledge or services against a separate financial consideration.

185. In many cases, such assistance could be obtained without a cost to the joint venture company. For example, a number of prominent machinery manufacturers would be willing to provide advice in respect of setting up the machines and the production as part of a service, if they were the suppliers of the machinery. In addition, there are numbers of organizations in industrialized countries which specialize in providing technical services, management services, product and market advice, and an agreement could be made by which they would provide technical services without participating in the ownership of the joint venture.

186. These aspects have to be clarified between the partners, and to form part of the agreement. In any case, a provision in the articles of association is desirable which would protect the minority shareholder from the majority shareholder changing any essential item of the agreement without the consent of the minority shareholder. This could be provided for by requiring an unanimous board decision for such changes, or by some such similar provision. Obviously any such arrangement would require provision of safeguards for the interests of both partners so that both can satisfy themselves as to the correctness of carrying out their obligations. For example, the developing country partner may be in charge of the purchase of local materials, and the developed country partner may have the responsibility of selecting and purchasing machinery. The other partner should have, in such a case, the right to control and check that the best possible prices are being paid by the joint venture.

187. Depending upon the size of the venture, the management structure would consist first of all, of a manager or a managing director to whom the other key executives would be responsible. He in turn would be responsible to the board of directors. The principal executives - who should be professionals as far as possible - would be:

- The chief administrative officer or chief accountant.
- The production manager.
- The personnel manager.
- The purchasing manager.
- The marketing manager, who should supervise a product development officer

188. Some of these executives may be available from the trained manpower of the developing country. If this is not the case, the best possible expatriate professionals should be engaged, with the provision for training local manpower within a specified period of time. These executives should in turn be responsible for training the lower echelon of executives, such as specified buyers, maintenance engineers, foremen for sewing workshops, etc.

189. The manager or managing director should normally have all powers and authorities necessary for day-to-day management. These would include :

- Purchasing of materials.
- Selling of merchandise.
- Hiring and firing of personnel.
- Production planning and changes within the general plan approved by the board of directors.

190. The partner's agreement should be established on the extent to which the board of directors may reserve certain decisions for themselves, or make them subject to their prior approval. For example: sale or purchase of real estate, orders for larger quantities of materials, price reductions, major dismissals, etc.

191. The manager establishes the authorities of his main executives, the extent of which will depend upon circumstances, and the individual executive's capabilities. For example, the purchasing manager may have authority to approve orders up to a certain amount of money.

192. Being an important document, the organization chart may require the approval of the board of directors or partners.

193. On the other hand, cases are known where partners may hire a manager or managing director of a high standing and professional experience, who is a complete stranger to both partners. In such cases, very large powers are usually given to the executives. The partners then limit themselves to reviewing the performance of the operation from time to time.

194. Another variation would be when the joint venture makes an agreement with a specialized management organization which undertakes the task of managing the enterprise on behalf of the partners. In such cases goals and performance criteria are usually established, with rewards, at least in part, based on performance.

195. A similar alternative would be where one experienced partner would undertake the management of the entire joint venture. Again, a question of rewards, performance criteria and audit would have to be established.

196. Any management operates with certain parameters, given by the goals established and specified policy which indicates the actions and activities through which the goals are to be reached. Such documents should be prepared and should be well-known to the management and partners. Such policies may establish not only the commercial means of operation, but also a number of points which may appear be required by either partners. These could include for example, specification of certain goals in employment. Another example is the number of expatriate executives employed initially and the time period after which they will be replaced by local managers. It may establish particular criteria of marketing in a certain area, or policies in respect of

incentive payments, or other points. Detailed and well thought-out work in establishing these policies is the job of the management, and the control by the partners will thus be greatly facilitated.

197. In order to attract investors from industrialized countries, the Governments of developing countries usually offer a number of incentives. These could be:

- Profit tax holiday for a certain number of years.
- Special scales for depreciation of the plant and machinery.
- Duty-free import of machines, spare parts and some materials.
- Guarantee of repatriation of capital, dividends and savings of expatriates.
- Guarantee of permits for expatriates to work, some permanently, some temporarily, in the enterprise.
- Availability of local loans for the joint venture.

198. On the other side of the scale would be circumstances which could be defined as disincentives. These could be:


- Restrictions on importation of spare parts and certain materials.
- Imposition of price controls or profit limits.
- Demand for absolute guarantees or certain quantities of exports.

199. Generally, the best incentive for investment in a developing country is a climate of confidence that the joint venture will be able to carry on with its business without restrictions, and in accordance with the pre negotiated conditions.

ANNEX I: SPECIMEN SHOE STYLE SPECIFICATION

Technological data

ASSEMBLING		LASTING		PREFABRICATING		Component	Process	Semi-finish	Finish
Cemented (stuck)	Cemented								
Direct vulcanized	Nailed								
Direct moulded	Stapled								
Direct injection	Force (slip)								
Machinism	String					Insole			
Wetted						Stiffener			
Wettschoentherapie	Combined					Toe-puff			
California	CLOSING					Platform			
		Sewn				Sole			
		HF welded				Unit sole			
		HF moulded				Heel			
Combined									



Wetting

WORKCONTENTS						MARKING	
Technological phase	min	min	min	min	min	Color(s):	
Cutting							
Stitching							
Machine work							
Manual work							
Subtotal							
Components' prefabricating							
Lasting							
Making							
Finishing (shoe-room)							
Subtotal							
Shipping							
Total							

STAMPING																			

TOOLING																			
SIZE																			Mark
Stiffener																			
Toe-puff																			
Shank																			
Heel																			
Width (fitting)	Quantities to be produced																		Total
Total																			

SPECIAL REQUIREMENTS

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Style code

SHOE STYLE SPECIFICATION

Trademark: _____
 Patent No: _____
 Purpose of use: _____
 Shoe type: _____
 Heel height: _____ mm / inch
 Quality standard: _____
 Buyer: _____
 Quantity: _____ pairs
 Unit price: _____ / pairs FOB CIF

photo or sketch

UPPER	Material Color	LINING	Material Color

Special remarks: _____

_____ th _____, 19__

_____ for marketing

_____ for design

