



TOGETHER
for a sustainable future

OCCASION

This publication has been made available to the public on the occasion of the 50th anniversary of the United Nations Industrial Development Organisation.



TOGETHER
for a sustainable future

DISCLAIMER

This document has been produced without formal United Nations editing. The designations employed and the presentation of the material in this document do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations Industrial Development Organization (UNIDO) concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries, or its economic system or degree of development. Designations such as “developed”, “industrialized” and “developing” are intended for statistical convenience and do not necessarily express a judgment about the stage reached by a particular country or area in the development process. Mention of firm names or commercial products does not constitute an endorsement by UNIDO.

FAIR USE POLICY

Any part of this publication may be quoted and referenced for educational and research purposes without additional permission from UNIDO. However, those who make use of quoting and referencing this publication are requested to follow the Fair Use Policy of giving due credit to UNIDO.

CONTACT

Please contact publications@unido.org for further information concerning UNIDO publications.

For more information about UNIDO, please visit us at www.unido.org

18413

Consultant: Mr. Stuart SINCLAIR
Sociology Off. Mr. Bolance, PD/184/STAT

THE STRATEGIC BEHAVIOUR OF LEATHER FOOTWEAR FIRMS

Revised, May 1990

INTRODUCTION

The objective of this paper is to explain the strategic options which different types of firms operating in the leather footwear industry have, and then to discuss the prospects facing each. The paper also examines the various ways in which companies based in developing countries can hope to become more involved in the growth of value added in the leather footwear strategies being pursued by companies in developed countries. Companies based in Brazil, Republic of Korea and Taiwan are the focus of this part of the study. From the point of view of consumption, the focus is on the USA, but the arguments apply to other developed market economies as well.

The strategies of the firms examined in the paper will be compared primarily with regard to how each adds value between the treating of hides and the retailing of the finished shoes. In particular, four points of the value chain will be looked at closely; they are: (a) design; (b) manufacturing; (c) wholesaling; (d) retailing. Each part of the value chain has its own problems and opportunities for firms. Moreover, different stages of the chain compete with different levels of intensity against firms in other parts of the value chain.

To illustrate the strategies being pursued within the US leather footwear industry, three companies are looked at in depth. They are Genesco (as an illustration of a large-scale manufacturer, termed here strategy 1); U S Shoe (an integrated manufacturer and wholesaler, with some retail ownership also, termed strategy 2); and Nike (purely a design, marketing and distribution company, leaving manufacturing to others, termed strategy 3). Other companies are referred to frequently to broaden the discussion.

The strategy menu

There are two overall points to be made about the strategic choices which firms on the footwear industry face.

The first is that many strategies can coexist: there is no one best or most appropriate strategy. Given this, it follows that several firms do not compete directly with one another at all.

Second, strategies differ a lot in comprehensiveness. At one extreme, firms can choose merely to be low cost manufacturers serving one or more wholesalers. At the other extreme, firms can elect to be fully integrated designers and wholesalers, responsible in addition for the advertising, public relations and image creation of their products. In this case, the consumer is being made aware of the name of the designer/manufacturer rather than, as in the first case, the name of the retailer.

In the case of strategies 1, 2 and 3, the strengths, weaknesses and prospects of the strategy will be looked at. The intent will be to predict as far as possible which elements of the menu will be attractive over the long-term and which will be threatened by one or more of the forces at work in the competitive environment. The forces which are changing in that environment are discussed at the end of the chapter, after a financial comparison of the strategies has been made.

U.S. Leather Products Background

As is shown in Table 1, there are eleven 4-digit branches of the leather industry distinguished in U.S. official statistics. The two most important are 3143 and 3144, men's and women's leather footwear, except athletic shoes. Together, these two account for \$3,874 mm in output (1988 value), which is 42% of the total value of

TABLE 1

LEATHER PRODUCTS OUTPUT AND EMPLOYMENT BY BRANCH, USA, 1988

SIC	NAME	VALUE OF SHIPMENTS (\$000)	EMPLOYMENT (000)
3111		2,188	13.3
3131*		247	4.3
3142		204	4.7
3143		2,320	31.8
3144		1,554	30.2
3149		488	9.2
3151		221	3.5
3161		746	11.4
3171		507	9.2
3172		418	6.8
3199*		305	5.5
Total		9,198	

Source: US Dept of Commerce

shipments in the sector. Employment in these branches accounted for 62,000, although this figure may be an overstatement since men's and women's shoes tend to be produced by the same companies.

Most of these branches are small, with 1986 or 1988 shipments worth under \$300 mm in many cases. In these branches companies are typically small too: for instance, the biggest company by far in tanning has revenue of \$150 mm/year. Within gloves and mittens, the biggest company has revenues of only \$25mm and only eight have sales in excess of \$10 mm/year. Similarly with women's handbags and purses, where the largest company has \$60 mm in revenues.

The leather footwear companies of interest in this paper have a slightly different size distribution. In SIC 3143, thirteen companies each have revenue in excess of \$100mm/year and the top 15 companies account for \$4,758 mm in total shipments.

Total shipment value is difficult to ascertain due to the rapid changes which have occurred within the footwear industry since athletic shoes became conventional informal wear. Thus while SICs 3143 and 3144 together reported shipments of \$3,873 mm in 1988, looking at the sales figures reported by such rapidly-growing companies as Nike reveals estimated sales of \$2,100 mm in 1990 for that one company alone. While SIC 3149 (footwear, except rubber, etc.) captures some of these sales, they are probably not all captured within the category.

As shown in Table 2, leather footwear shipments fell from \$5,776 mm in 1982 to \$4,147 mm in 1987, while apparent consumption grew from \$8.8 billion to \$10.7 billion. Within this total, the only significant growth came from imports, which accounted for \$6.7 billion, or 63% of total consumption, in 1987, after representing only 41% of the total in 1982. Per capita expenditure on footwear in that year was \$109; for leather footwear the figure was about \$46. As table 2 indicates, leather footwear consumption is about twice as large as consumption of all other leather items.

Exports have grown steadily, to reach \$165 mm worth by 1987. Separate time-series from the U.S. Dept. of Commerce show that exports in pairs rose from \$14.7 mm in 1987 to \$18.4 mm in 1988,

TABLE 2

Table 3.132 THE LEATHER PRODUCTS MARKET 1982-1987

(\$ million)	1982	1983	1984	1985	1986	1987
<i>Shipments:</i>						
Leather/lined clothing	221	213	194	164	160	172
Gloves & mittens	178	167	181	178	175	180
Luggage	789	814	827	725	704	732
Handbags & purses	624	613	585	560	557	579
Other personal goods	411	442	397	388	379	394
Total shipments	2,223	2,249	2,184	2,015	1,975	2,057
Imports	1,199	1,379	1,828	1,918	2,077	2,714
Exports	84	64	66	53	57	74
Apparent consumption	3,338	3,564	3,946	3,886	3,995	4,697

Source: US Dept of Commerce

THE LEATHER FOOTWEAR MARKET BY SECTOR 1982-1987

(\$ million, msp)	1982	1983	1984	1985	1986	1987
<i>Shipments:</i>						
House slippers	276	250	248	250	252	186
Men's footwear	2,529	2,306	2,231	2,146	1,951	2,008
Women's footwear	1,939	1,908	1,728	1,621	1,382	1,454
Other	803	786	676	548	452	499
Total shipments	5,276	5,250	4,883	4,566	4,036	4,147
Imports	3,655	4,400	4,648	5,424	6,174	6,720
Exports	90	92	98	100	118	165
Apparent consumption	8,841	9,558	9,433	9,890	10,092	10,702

Source: US Dept of Commerce

and an estimated \$17.3 mm in 1989. Much of this growth in exports is, as will be discussed, attributable to the rise of athletic shoe exports.

The major input for leather footwear manufacturers is hides. SIC 3111 (leather tanning and finishing) accounted for \$2,188 mm in output in 1988, and of this 41% went to shoe manufacturers. (The rest of the output of this branch went to a large number of users, such as personal leather goods, automotive trimmings, women's handbags, etc.)

The other branch selling the bulk of its output (62%) to shoe manufacturers is 3131, boot and shoe cut stock and findings, which are leather, cardboard, fabric, plastics, hardwood, felt and other items, worth some \$90 mm/year.

It follows from the fragmented nature of these input industries that footwear manufacturers face virtually no strategic threat or pressure from upstream suppliers. Correspondingly, they typically have little or no need to integrate upstream themselves, for there is little extra value added to capture there. The discussion now turns to the first of the four strategies.

STRATEGY 1: LOW COST MANUFACTURING

This category includes a number of companies in the \$5 mm to \$700 mm/year sales category. Typically the larger companies have established some degree of vertical integration into retailing (either through owned or licensed stores), while the smaller ones have not. All are engaged in wholesaling, with production for large retail chains the dominant practice. Among the larger such companies is Genesco, whose 11 brands accounted for 1989 footwear sales of \$490 mm. In 1987, 34% of its output went to its own stores (numbering 700) and the remainder was wholesaled by a direct sales force. 75% of its output is men's shoes; 24% women's; 1% children's. It makes 40% of the shoes sold in its outlets, while the balance is bought in, 31% from the USA and 29% imported. Its six US plants in 1987 ran at 77% utilisation. It also owns two leather tanning plants, 14% of whose output is for its own use, with the other 86% of output wholesaled. A leather sole manufacturing operation was sold in 1987.

The financial results of the company reveal consistently low margins being achieved: in 1987, its retail sales of \$187 mm attained \$3.5m pre-tax profit, while its manufacturing and wholesaling unit with sales of \$114 mm attained \$3.7 mm pretax. Pretax margins have been in low single digits or even negative (as in 1986) for most of the 1980s. Asset turns (sales divided by assets) were a reasonably high 2.9 in the retail group and 3.0 in manufacturing.

Other companies pursuing a broadly similar strategy have obtained comparable results. Wolverine Worldwide, the largest U.S. tanner of pigskin, and owner of the Hush Puppies brand and 120 dedicated outlets, averaged operating margins of 3-5% over the 1985-90 period. Its sales were flat over the period, posting revenue of \$353 mm in 1983 and \$325 mm in 1989. Similarly, Brown, the largest U.S. domestic manufacturer, reported an operating margin of 5.0% in 1989 on sales of \$1,820 mm.

Prospects for Strategy 1

The outlook for companies following this strategy can be surmised by looking at the aggregate U S Census of Manufacturing data, which is heavily weighted by firms in the \$5 - \$200 mm/year range. For 1986, value added per production worker in SIC 3147 (men's footwear except athletic) and SIC 3144 (women's footwear except athletic) averaged \$32,000, only 37% of the U.S. manufacturing average. Sales per employee were \$50,000, only 48% of the U.S. average, and capital employed per employee was \$500, or only 12% of the U.S. manufacturing average. Salary per employee in 1987 was \$11,804. All of this suggests that typically these companies are without the scale to invest in better manufacturing (and as will be seen there are attractive manufacturing prospects for U.S.-based companies) and without the wherewithall to market aggressively. Those companies are therefore essentially acting as price-takers, and the price which they will be offered is likely to be falling in real terms over time as foreign companies become more efficient in making low-priced shoes. Also, to the extent that retailing becomes more consolidated, small footwear manufacturers will find their price-setting scope further undermined. Pricing pressure felt by retailers will of course exacerbate these problems. A survey of US retailing looking to the 1990s stated recently that "in this gloomy environment, most retail enterprises have come under heavy pricing pressure ... the outlook is for flat to lower profits." (**Forbes**, Jan 8, 1990, p. 198)

STRATEGY 2: FULLY INTEGRATED PRODUCER

The discussion now turns to a different types of strategy: that of a company with more downstream integration into retailing.

U.S. Shoe is a broad line, fully integrated company. It designs shoes in 21 different brand names -- primarily women's non-rubber moderate-to-medium-high priced shoes -- and seven brands of boots. Total sales in 1989 were \$777 mm, most of which was women's shoes, a major men's manufacturing and wholesaling group having been sold in 1987. Recent designs include an attempt to straddle the athletic shoe/traditional shoe gulf with a shoe which, to quote the company, "looks like a pump but feels like a sneaker."

The company manufactures 50% of its sales from 12 plants in the U.S., and sources the rest from independently owned plants in Brazil, Italy, Spain, Republic of Korea, and the the Dominican Republic. It wholesales about 90% of its output through its Cobbie Division, but retails the remainder through a mixture of owned and licensed outlets. These outlets, which number 306, with a further 192 leased spaces within department stores, are matched to particular shoe brands, so that there is a retailing "concept" (location, positioning, serve-intensity, etc) for sub-sets of the 21 brands. Thus, the Hahn division sells branded shoes; the Cincinnati Shoe group leases departments in low-priced outlets like the Burlington Coat Factory chain; the Banister div. ion uses factory outlets on the outskirts of cities; and concept stores (using three different brands of their own, Cobbie Shop, Joyce-Selby and Shop For Pappagallo) sell a wide variety of U.S. shoe brands.

Two aspects of this strategy are worthy of attention. First, to manage its dominant market share in the industry (data suggest that US Shoe accounts for half of total women's shoe sales in the U.S. with \$777 mm out of total industry shipments of \$1,554 mm) the company has decided it must coordinate the product/channel interface very carefully. It is therefore continually buying, selling, growing, and shrinking its channels as tastes and costs change. Thus

in 1988 it changed the name of its largest division, the names of many concept stores and adopted the umbrella brand Cobbie after extensive market research showed the previous name denoted a slightly older woman than the market then being pursued.

Second, rather than looking wholly overseas to source its lower priced shoes, the company has invested heavily in its U.S. plants. Manufacturing investment over the period 1986-1989 totalled \$30mm. The objectives here were twofold. First, by reorganizing the traditional shoe production line with its 97 steps into a much smaller number of work cells, each responsible for far more tasks, it collapsed work-in-process inventory and total cycle time (ie: the time it takes to move one pair of shoes from 3 square feet of material into a boxed pair). This not only saves assets; it allows faster response to new tastes since fewer pairs of an obsolete style are under production at any one time. Second, the new layout improves quality since effort is now rewarded at group, not individual, level, and the group is incented to maximize throughput of quality pairs rather than simply to maximize volume. Those changes allowed leather shoes to be sold at under \$40/pair, for instance, a hitherto unattainable price-point.

Prospects for Strategy 2

The financial results obtained by even the best companies pursuing strategy 2 suggest that there is a ceiling on their long-term profitability, created by the low-cost-based threat from strategy 1, on the one hand, and the slow growing character of much of the market pursued traditionally within strategy 2, on the other. Virtually all the growth in the footwear industry is being captured by - and, indeed, often created by - strategy 3 competitors. Moreover, these companies are also fueled by being in the highest-growth parts of the apparel business too. A third constraint is provided by competition within the retailing industry. As the collective share of general retailers like Sears falls, an increasingly fragmented set of niche retailers is growing up. As

part of their need to differentiate themselves, these shops are looking continually for new, unusual products to stock (including footwear) and thus establish shopping patterns in which customers compare these idiosyncratic offerings with those of the outlets run or owned by the likes of U.S. Shoe. There will thus be continuous competition, both product and channel-based, with ensuing shorter product life cycles and tougher manufacturing/retailing coordination decisions facing strategy 2 companies. The decline in return on sales (ROS) suffered by U S Shoe, as will be discussed at the end of this paper, suggests that even a well-run competitor will face difficult times in this strategic group.

A view of the relative outlook for firms pursuing strategy 2 as compared to strategy 3 can be obtained by looking at the experience of Stride Rite, a Boston-based children's leather footwear company, which has moved some of the way from 2 to 3 in the last five years. In the first half of the 1980's, Stride Rite was similar to U.S. Shoe (although smaller, with 1985 revenues of \$238 mm) in that it manufactured most of its own shoes in the U.S. Between 1983 and 1987 it shut 7 of its 10 U.S. factories and consolidated its manufacturing and international divisions into one sourcing division. As of 1988 the company sourced its raw materials in 8 countries, had sourcing offices in 4 countries, had factories in 2 countries, and had independently owned source plants in another 2 countries.

This change from a U.S. manufacturer to a marketing driven distributor has been associated with a big change in operating results, with sales growing from \$238 mm in 1985 to \$454 mm in 1989 and net income growing from 4.7% of sales to 10.1% in 1989. In part this growth reflects the acquisition and subsequent repositioning of the Keds brand. Sales/employee rose from \$42,000 in 1985 to \$116,000 in 1989. The fundamental change, reflected in the financials, is that of company becoming a marketing and distribution focussed concern with modest manufacturing involvement.

STRATEGY 3: DESIGN AND MARKETING FOCUS

Companies in the athletic footwear sector best illustrate the strategy of maximizing control, but not ownership, over selected activities in the value chain. The objective of this approach, in distinction to strategy 1, is not to provide a range of shoes which retailers will then offer using their own brand names but instead a range which consumers will pull through the distribution channels themselves. There are six critical elements here:

1. Control over the distribution channel: This is effectively ceded by the retailer to the manufacturer because of the recognized power of the shoe brand to create shopping "traffic." In general, the specialist athletic shoe stockist wants as broad a range of brands to stock as possible, while the generalist (independent or chain) wants to carry three to five brands and three to five use-categories (e.g. basketball, tennis, aerobic, running) in each brand, plus two or three others.

Whenever a successful brand is created, demand explodes so that shortages ensue, and only retailers in good standing with the manufacturer can expect to obtain delivery. Since loyalty here is to the shoe, not the store, the prospects of converting a shopper to a different brand are remote. Surveys carried out, for instance by *Sporting Goods Dealer* magazine, indicate that the criteria by which specialist retailers rank Nike, Reebok and other strategy 3 companies include: product innovation, product quality, advertising, packaging, point-of-sale product support, on-time delivery, returns policy and responsiveness to complaints. Note that strategy 1 allows competitors to differentiate themselves only on four of the eight attributes.

2. The nature of shopping: Within this sector there is competition of different kinds between different companies. It appears to be primarily intra-sectoral rather than cross-sectoral in that individuals thinking of buying an athletic/casual shoe will probably go straight to a choice between Nike, Reebok, Converse, Adidas, etc.,

rather than first evaluating such products vis a vis the traditional manufacturers' shoes. The competition between these companies within the sector has led to three size categories emerging: two dominant companies (Nike and Reebok, with a 55-60% combined share since the mid-1980s), then a second sub-group (Converse, Adidas, New Balance, Pony) in the \$100 mm range; then a third group (such as Hyde) in the under \$100 mm sales range. Since 1985 only one company - L A Gear - has sprung to the top rank, and its success has been based as much upon apparel as on footwear.

3. Brand name transferability: Once a prominent name has been established, with care it can be transferred to adjacent products and used to create similar premium-priced items outside of footwear. Nike has helped create 37 distinguishable athletic footwear and apparel segments (see table 3). Establishing a brand of this power requires massive advertising expense. As table 4 shows, three of the top companies pursuing strategy 3 on average spend 6% of their sales on advertising.

Clearly, a critical component of the strategy is ensuring that harmony and consistency exists between each stage of the strategy - all the way from design and materials selection to the choice of retailers, celebrities to endorse the product, and advertising. Not many companies are able to juggle all these elements at once, explaining the small number of companies which are able to earn consistently higher returns than the average being achieved from strategies 1 and 2.

4. Short product lives: Product lifecycles are typically short - as brief as one year for a major (say \$200 mm/year) shoe line - and can be managed to the disadvantage of competitors. Evidence of this comes from the volatility of market shares. In 1986 Adidas, based in West Germany, was the largest worldwide athletic shoe producer, with revenue of \$2.4 billion, with Tiger (\$800 mm), Puma (\$500 mm), Nike (\$240 mm) and Reebok (\$92 mm) a long way behind. Since then, Reebok and Nike have redefined the market and introduced many

TABLE 3

NIKE's Product Segments

Sport Activity	Footwear	Apparel	Accessories
Core:			
Basketball (M, W)	X	X	X
Running (M, W)	X	X	X
Fitness (M, W)	X	X	
Cross Training (M, W)	X	X	
Tennis (M, W)	X	X	X
Racquetball	X		
Aerobics	X	X	
Children's/Infants	X	X	
Specialty:			
Cycling	X	X	
Track & Field	X		
Hiking	X	X	X
Walking	X		
Golf	X	X	
Soccer	X	X	
Baseball	X		
Softball	X		
Football	X		
Squash	X		
Field Hockey	X		
LaCrosse	X		
Volleyball	X		
Cheerleading	X		
Wrestling	X		
Water Sports	X	X	

Note: M-Men's; W-Women's

TABLE 4

**Advertising/Promotional Expenditures of Top Three Athletic Shoe Companies.
\$ Mil.**

<u>Company</u>	<u>1988</u>	<u>1987</u>	<u>1986</u>	<u>1985</u>	<u>CAGR %</u>
Expenditures:					
NIKE	\$110.3	\$ 75.6	\$ 64.3	\$ 66.0	18.7%
Reebok	73.9	35.6	15.5	5.6	136.3%
L.A. Gear	<u>12.6</u>	<u>5.4</u>	<u>2.6</u>	<u>0.5</u>	<u>197.4%</u>
Total	\$196.8	\$116.6	\$ 82.4	\$ 72.1	39.8%
Percent of Sales:					
NIKE	7.3%	7.9%	6.8%	6.3%	
Reebok	4.1%	2.6%	1.7%	1.8%	
L.A. Gear	<u>5.6%</u>	<u>7.6%</u>	<u>7.2%</u>	<u>4.5%</u>	
Total	5.6%	4.8%	4.3%	5.3%	
Percent of SGA:					
NIKE	36.6%	35.9%	30.1%	32.0%	
Reebok	18.0%	13.3%	11.2%	10.5%	
L.A. Gear	<u>23.4%</u>	<u>26.3%</u>	<u>25.2%</u>	<u>18.5%</u>	
Total	25.7%	23.4%	22.8%	27.4%	

Shearson Lehman Hutton

new categories, such as aerobic shoes (bought primarily by women) and fitness shoes (requiring no breaking-in period, unlike conventional athletic shoes). Table 5 indicates the changes in sales and share which have taken place.

The success of individual brands within manufacturers' product lines can be extraordinary. For instance, in 1985 Nike developed the Air Jordan shoe to be promoted by basketball star Micheal Jordan. They expected sales of \$5 mm in the first year; instead, revenue in the first year exceeded \$100 mm (including Air Jordan apparel). However, the following year sales fell off just as dramatically.

5. Served market growth: Since the growth of the market is so rapid, extra strains are placed on competitors. The US athletic shoe market grew from around \$1.5 billion in 1981 to \$3 billion in 1987, an estimated \$5 billion in 1989 and a forecast \$10 billion in 2000. From 1977 sales of \$29 mm Nike alone grew to 1989 sales of \$1.7 billion and forecast 1990 sales of \$2.6 billion. This is equivalent to more than the entire shipments of US men's non-athletic shoes in 1988. Each year Nike and Reebok are each experiencing revenue growth of the order of \$300 - \$700 mm.

6. International management: The brand management of the kind required here is inherently international in scope, even though the essence of the product can be managed by 10 or 20 brand managers based in the USA. Virtually all athletic footwear sold in the US is imported. Having first established a manufacturing plant in the US in 1974, Nike now obtains its shoes from 35 or so overseas plants, with products coming from Republic of Korea (54%), Thailand (18%), Taiwan (15%), Indonesia (5%) and China (7%). Reebok and LA Gear source virtually all their production in ther Republic of Korea. Nike's apparel products are sourced about half from the US and half from Taiwan and Thailand.

Other foreign involvement includes the ownership of distributorships in nine countries in Europe, with sales in a further 50 countries handled by independent distributors and licensees.

TABLE 5

**ATHLETIC FOOTWEAR MARKET SHARE AND REVENUE ESTIMATES,
1986-1989**

Manufacturer	1986 worldwide		1989 US	
	Revenue	Share	Revenue	Share
Adidas	\$2,040	22		
Asics Tiger	\$800	9		
Puma	\$500	5		
Nike	\$241	3	\$1,710	26
Reebok	\$92	1	\$1,710	26
Others: total	\$5,610	61	-	-
Others: LAGear			\$329	5
Others: Adidas USA			\$263	4
All others			\$2,558	39
TOTAL	\$9,283	100	\$6,570	100

1

Foreign footwear sales amounted to \$280 mm in 1989 and foreign apparel sales to \$70 mm for Nike. The bulk of foreign sales were in Europe (\$233 mm) and Canada (\$32 mm.)

Prospects for strategy 3 producers:

The outlook for companies in this group over the next decade will be shaped by three main forces:

1. The market for athletic wear of all kinds will be fast-growing. Shoe sales are forecast to double between 1990 and 2000, to reach \$10 billion/year.
2. The intersection of leisure, fitness and fashion is likely to be full of opportunity for manufacturers.
3. US-based companies are well-placed to gain a growing share of this expenditure since much of the trend is fuelled by interest in US sports and culture generally.

All this suggests immense opportunity for the four, six or eight companies which can keep balancing the manufacturing/marketing judgements needed to stay in the public eye. But there will be few such companies: for others, the best option will lie in being suppliers of inputs.

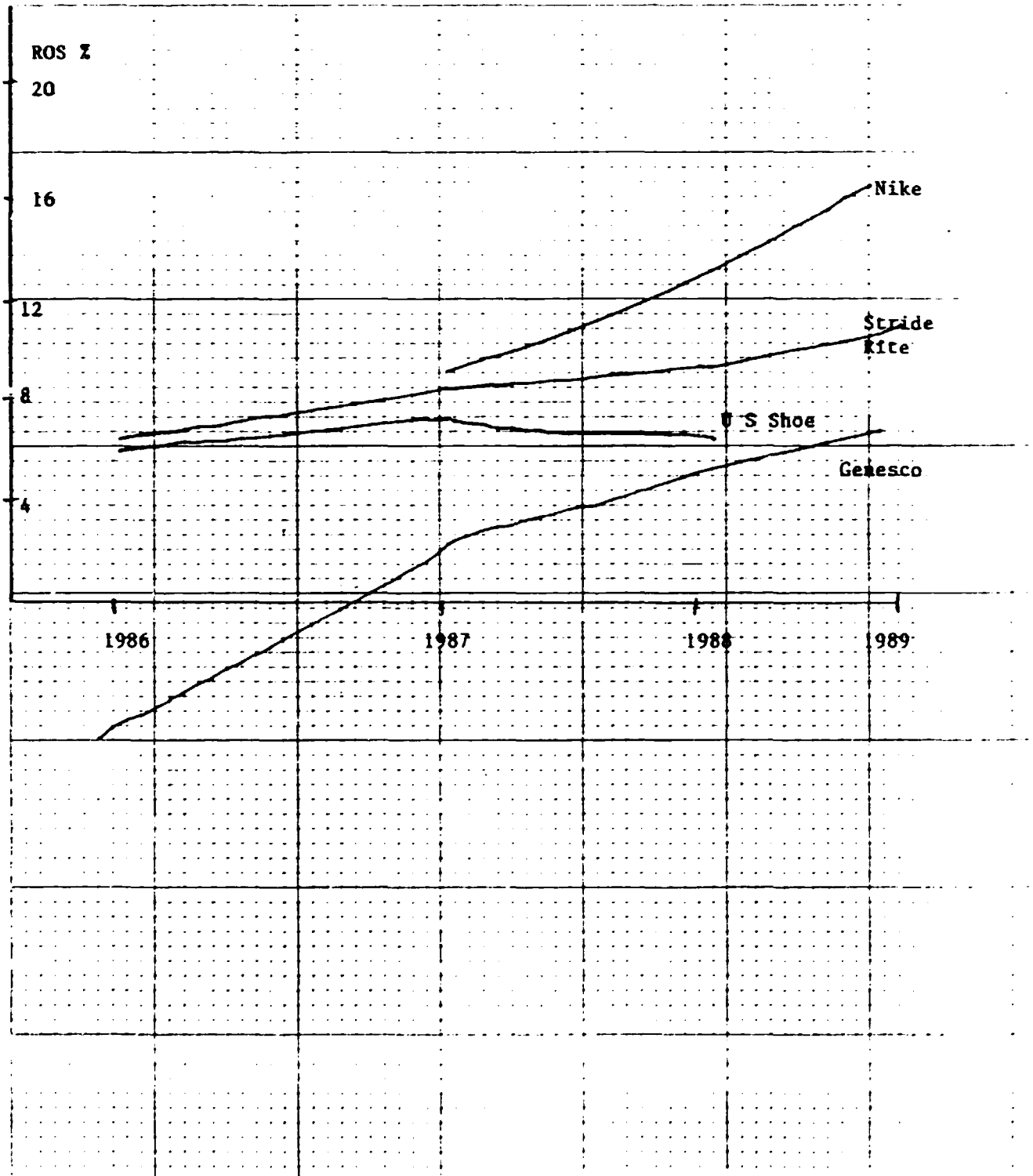
THE STRATEGIES COMPARED

It is possible to characterize the results of these different strategies in three ways.

First, a simple comparison of return on sales (ROS) shows that, largely by virtue of the premium prices its products can command, Nike and others in group 3 are able to achieve high and consistent ROS. (See Table 6.) U S Shoe, by comparison, has experienced a falling ROS and a lower average ROS than the strategy 3 group. This reflects the fact that its customers are more price-elastic, and have more substitute non-branded products available to them. The ROS attained by strategy 1 is even lower than this, and reflects the fact that these companies are typically price-taking, atomistic

TABLE 6

RETURN ON SALES OVER TIME



suppliers to their customers. The bar chart of ROS for 1989 shows the full dispersion of results, and reveals a broad mapping of ROS to strategy. (Table 7)

The second comparison is illustrated by a return on managed assets chart. (See table 8.) This shows that Nike enjoys both high gross margins and high asset turns (or sales/assets ratio) reflecting its use of other companies' assets for production. It also reflects the way it locks its customers into six-month forward orders for shoes (this will be discussed later in detail.) U S Shoe is again showing a less advantageous position on both axes, despite its efforts to shorten manufacturing cycle times and inventory in general. Its asset turns in 1989 remained at 1.7. Strategy 1 companies tended to have higher asset turns if they were not also integrated into retailing.

Finally, table 9 compares sales/employee for each company for 1989. The range there is large - with about a 10 to 1 range between the high and low observations. This indicates the different degrees to which companies have been successful in their pursuit of efficiency and it also hints at the degree to which different strategies allow different efficiency levels to be reached. Clearly, running an operation with only sales and marketing in the US requires very different levels of employment and asset intensity from a fully-integrated manufacturing and retailing operation.

TABLE 7

RETURN ON SALES COMPARED FOR 1989

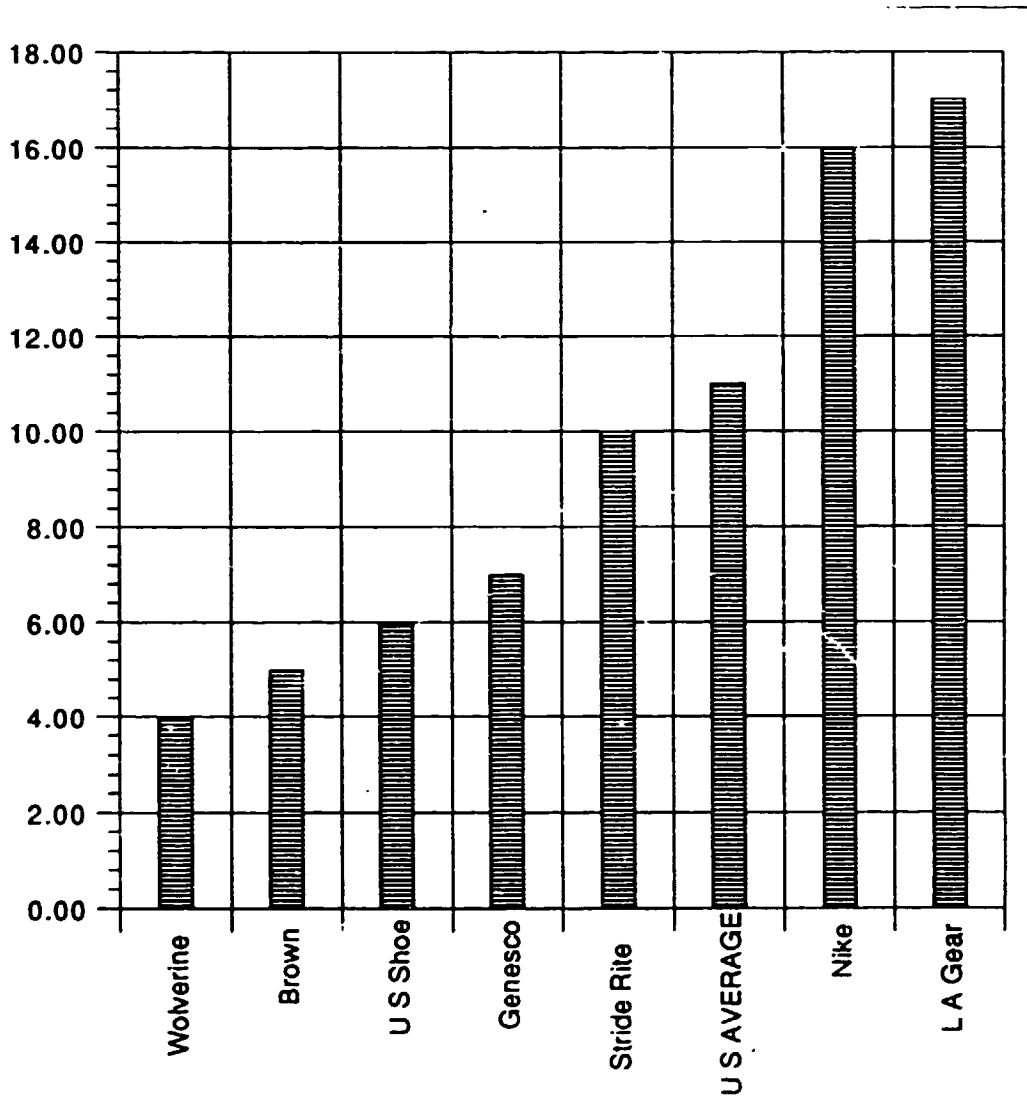


TABLE 8

RETURN ON ASSETS EMPLOYED, 1989

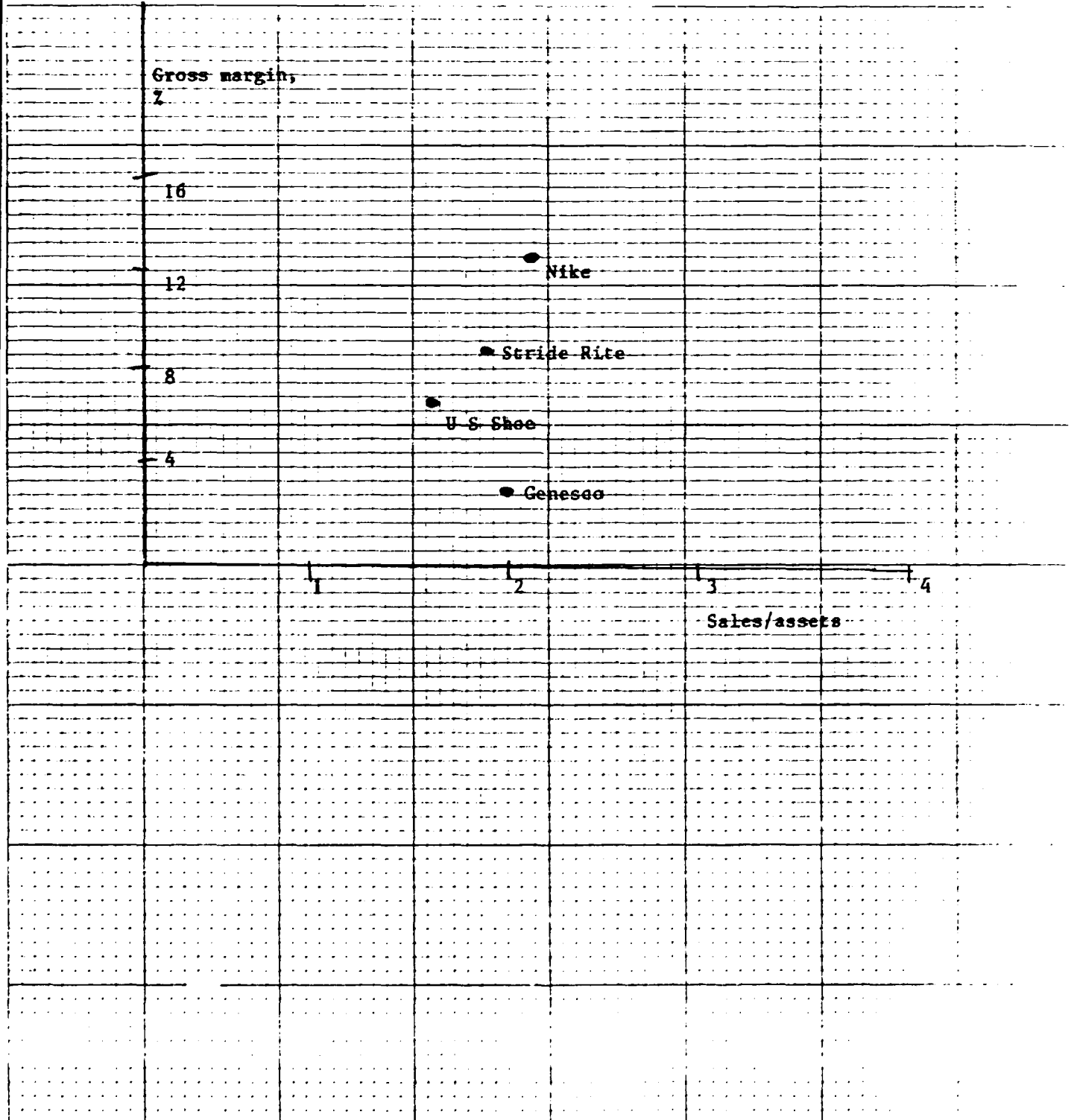
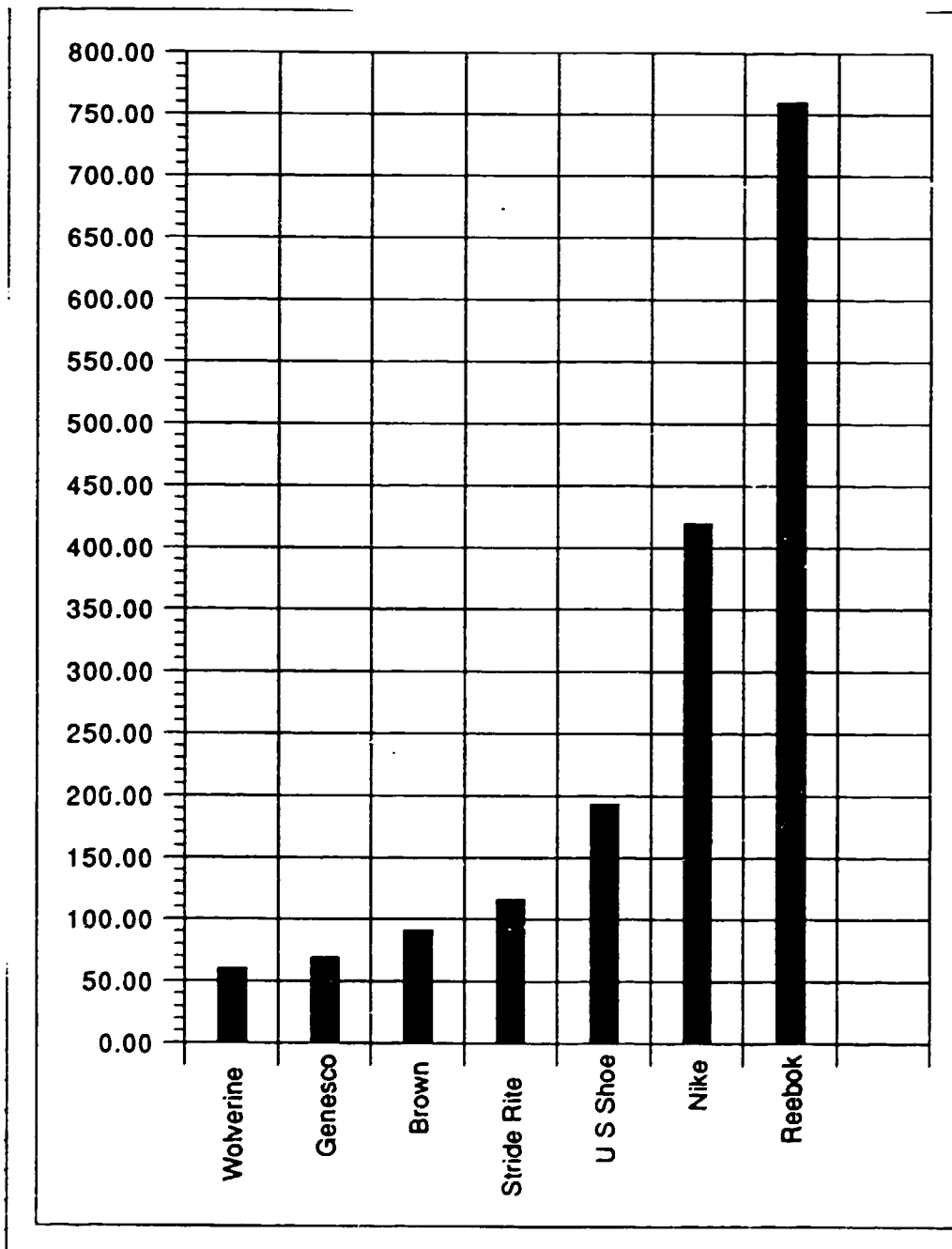


TABLE 9

ESTIMATED SALES VALUE/EMPLOYEE, 1989 (\$000)



THE EVOLVING STRATEGIC ENVIRONMENT

1. Internationalization

a. retailer-led

An important aspect of the athletic shoe market is that it is being taken international by retailers to a large extent. For instance, the FootLocker division of Woolworths is growing fast in Europe, and, as the biggest Nike customer in the US, will funnel sales growth into Europe for that supplier. Adidas and Puma, the established brands in Europe, are expected to see some share declines as a result.

b. product-led

Foreign sales of shoes by Nike in 1989 amounted to \$349 mm, up from \$303 mm in 1988. This suggests major new trends in the international flow of value added in footwear. If one assumes a 63% cost of goods sold on Nike's shoes (the reported figure in their 1989 annual report) then total import value accounted for by the company must have been 63% of total sales (\$1,710 mm) or \$1,074 mm. Export revenue was \$349 mm, so that the US net shoe deficit for Nike was \$725 mm. However, this figure is falling fast, as exports are growing much faster than total sales. Exports are forecast to grow 25% per year over the next five years whereas the unit cost of imports is falling by 4% or 5% per year.

A factor which might, however, impede the growth rate of trade in footwear in certain categories is the recent ruling on synthetic leather shoe tariffs entering the USA. In April 1990 it was decided that Nike's synthetic leather shoes should bear a 20% tariff instead of the 6% tariff applied to leather shoes. Other companies which have invested in the material - notably Avia of Oregon - are appealing the ruling. Support for the ruling is thought to have come from the Rubber and Plastic Footwear Manufacturers Association, which was anxious to forestall a major shift of the successful leather sports footwear companies into non-leather materials. (Wall Street Journal, 18 -4 -90)

26

c. design-led

For years, design studios - typically small and often in Italy and Spain - have sold designs to footwear manufacturers in the US. Now US design groups like those within Reebok and Nike are able to export their work back to Europe and other regions.

2. Technological change

a. process improvement:

As noted in the discussion of U S Shoe, manufacturers in developed market economies have the option of tightening product cycle time by re-organizing the flow of work through their plants. In the case of U S Shoe this has resulted in an estimated inventory/sales ratio of 16%, which is comparable with the 13% achieved by Nike, which does not have any US plants and merely imports. (See Table 10 for several comparisons of asset efficiencies.)

b. ordering improvement:

Using information technology and decision support software to help predict the length of product cycle times has allowed some manufacturers further to reduce their shoe inventories. Nike has introduced the "Futures" program, whereby, if retailers book their orders 5 to 6 months ahead, Nike guarantees 90% delivery within the targeted date and at the agreed price. In 1989 this agreement covered nearly 80% of all its US orders. For Nike a dramatic fall in inventory to sales, from 31% in 1984 to an average of 15% over 1987-89, has been achieved, allowing the company to save very large amounts of working capital.

c. design improvement:

CAD/CAM is increasingly used in the design of shoes, both to allow prototypes to be looked at early in the design cycle, and to help build "manufacturability", or ease of production, into the shoe from the start. As the number of parts in a shoe and the number of assembly steps required fall, cost savings will follow, although there is as

TABLE 10

ASSET EFFICIENCIES COMPARED

<i>Strategy</i>	<i>Company</i>	<i>Inventory/ sales (%)</i>	<i>Sales/ assets</i>	<i>Plant/ sales (%)</i>
1	Genesco (1987)	31	2.0	N/A
2	U S Shoe	16	1.7	20
3	Nike	13	2.1	5.3

Note: Assumes US Shoe footwear assets are proportional to weight of footwear within total company sales.

yet no clear evidence of this in the ratio of cost of goods sold to sales revenue in aggregate US data. Between 1972 and 1987, materials as a percentage of non-rubber footwear shipment value actually rose from 43% to 48%, while for men's non-athletic shoes it also rose, from 48% to 50%.

SHORT TERM OPPORTUNITY FOR NEWCOMERS TO LEATHER FOOTWEAR

The nature of the changes described above should imply considerable opportunity for developing country-based suppliers. The evidence for this would be:

- a. rapid growth of demand in some shoe categories
- b. explosion upwards in price-points, reaching \$200/pair for some categories
- c. increasing need for suitable sub-contractors able to deliver quickly at high quality, with cost no longer the paramount criterion for retaining the business (although, to be realistic, still very important.)

As much of the preceding discussion would suggest, however, it transpires that the opportunity is more constrained than the broad picture would suggest. This is for three types of reasons.

First, the key value-adding functions outside manufacturing tend to be tightly controlled by the companies with brands. Thus while some revenue growth will pass to suppliers, the bulk will be retained by the holder of the rent-producing asset, which, in the case of strategy 3 companies and some in strategy 2, is their name.

Second, where opportunity most plainly exists it will continue to be in the most margin-sensitive parts of the business, specifically provision of hides and skins to lower-value manufacturers following strategy 1, and to a lesser extent, strategy 2. Design opportunities will exist, but by their very nature will be modest in revenue terms.

Third, the improvements being made in manufacturing by some strategy 2 companies suggest that the traditional role of developing country-based companies in manufacturing may be constrained in future. The tension between the repatriation of production on the one

29

hand and the blanket use of overseas production on the other will probably evolve company-by-company rather than crisply along strategy group lines. But the recent experience of companies in the US, who have found that there are many changes they can make which enhance their cycle times, time to market, asset efficiency, and response to retailers' needs, indicate that in future developing country -based suppliers will be competing against capital improvements within their clients' plants in developed countries. Table 11 summarizes these points.

SHORT TERM OPPORTUNITY FOR BRAZILIAN COMPANIES - A BRIEF CASE STUDY

To take a fuller look at the forces just described, a selection of leather footwear companies in Brazil was examined. This section reports on the ways in which they are responding to the increasing competition they face from tied suppliers in Asia, on the one hand, and to a revitalized US-based footwear industry, on the other.

The background to the Brazilian footwear industry is as follows:

- about 4,000 companies produce 570 mm pairs per year, with total production value of \$3.5 - \$4 BN in 1989.
- Brazil was the fourth-largest footwear manufacturer in the world in 1989
- Brazil was the sixth-largest footwear exporter in 1989, with exports worth \$1.3 BN and 155 mm pairs sent abroad
- 85% of exports are women's shoes, made primarily in the Rio Grande do Sul area. Men's shoes are made chiefly in Sao Paulo state.
- 69% of exports in 1989 were sent to the US; most of the rest to Europe
- average export price per pair in 1989 was \$9 for women's shoes
- 95 mm pairs of athletic shoes are made per year, of which 10% are exported. Most of these are low-end canvas shoes

Within this large collection of companies, needless to say there is a

Table 11 OPPORTUNITIES FOR NEW ENTRANTS IN THE LEATHER FOOTWEAR INDUSTRY

STRATEGY GROUP	OPPORTUNITY AS SUPPLIER	OPPORTUNITY AS WHOLESALER	OPPORTUNITY AS OVERSEAS AGENT	OPPORTUNITY AS DESIGNER
1. Low cost manufacturer	Always chances to bid below current suppliers; low margin the norm	Low fashion content militates against shoes being keenly sought	Value/weight ratio unfavorable	Moderate; depends on good communications
2. U S Shoe	As above	Always opportunities	Limited appeal beyond narrow niches (e.g. boots)	Opportunities exist
3. Nike	Restricted to highest-quality, high-volume, flexible-mix suppliers	None; company in US controls this key lever	None	None

variety of efforts underway. Efforts tend to be directed at three objectives:

- a. an effort to sell directly to US retail chains, rather than going through importers
- b. an effort to establish and support indigenous brands rather than relying upon brands established by US retailers
- c. a general effort to enhance design and material quality, particularly for export customers

Examples of each are as follows:

Calcados Ortope is opening a Miami office to sell its children's athletic shoes direct to US retail chains

Propenasa Produtos Petroquimicas Nacionais, a trading company subsidiary of *Dow Quimica*, is pursuing a \$50 mm order, to be fulfilled over five years, to sell shoes to Edson Brothers, a major US importer and supplier to 2,000 retail outlets.

Three big children's shoes producers are pushing hard to establish their names in the US:

oppi Industria e Comerciode Calcados, which makes 25,000 pairs per day in Sao Paulo state, is planning to export more than last year's 150,000 pairs to the US. *Sabry SA* in 1988 exported 210,000 pairs, and planned in 1989 to export 370,000 pairs, 80% of them to the US.

Grendene in 1989 exported 1.5 mm pairs of children's shoes to the US, up from 1 mm in 1988.

Among those most fully pursuing a brand-led strategy are *Grendene* and *Valerie Barad*. *Grendene*, the largest plastic shoe manufacturer, owns *Vulcabras*, which is paying a 1% of sales royalty to Puma for the use of its name on domestic sales of athletic shoes in the \$80 - \$100 per pair range. These will be made in Brazil with leather and nylon uppers. This company also has import and local manufacturing licenses from Rider, Panda, Pony, le Coq Sportif and other foreign brand names. Currently only Nike of the major brands is selling in Brazil in any volume.

Valerie Barad has decided to pursue a brand-led approach to US sales after the failure of its recent efforts at unbranded sales. After trying to introduce another moderately-priced women's shoe line in the US in 1988 it found the response, to quote the company, "disastrous.... all they need is another line from Brazil." In an effort to change the basis of competition, the company therefore acquired the brand name Barad and is now trying to beat the US companies at their own game.

While there are clearly a variety of strategies underway in the Brazilian footwear industry, one can see in them an echo of the experience of the US industry. Two starkly opposed approaches stand out: staying with anonymous exporting of shoes, sold in bulk to US importers, in competition with many other Brazilian manufacturers; or trying to preempt more of the value added by creating a brand to which, ultimately, consumers in the importing country will be attracted. Neither path is easy, given that many companies can pursue both simultaneously, but a reading of the forces at work in the US suggests that it is important at least to try the latter to see if a change in the basis of competition can be achieved.

LONGER TERM IMPLICATIONS

a. the internationalization of consumption patterns

To the extent that tastes become more similar across countries, athletic shoes will be among the products most affected. Moreover, as brands increasingly assume cross-border power, the outlook for strategy 3 companies based in the US will be immense. The challenge for companies in the importing countries will be to try to convert some of this growing demand into domestic value added. Some of the appeal of US shoes is, however, their very foreignness, so this will present considerable problems. As the section on Brazilian manufacturers indicated, some are trying to do this now, having seen the disproportionate benefits which can accrue to this approach. The problem, of course, will lie in managing a new brand from overseas.

For companies not already able to exploit the changes underway, the challenge is severe. The drift of value-added is unmistakably toward the brand creator in the value chain. The drift of value is also toward the parts of the value chain closest to the end-user (the customer) and away from the manufacturer. All the trends afoot in the industry point to the extreme difficulty of being a newcomer; having said that, it must be remembered that in 1974 Nike was a newcomer to an industry which looked mature, low-profit, and staid -- and twenty years later it had created revenues greater than the entire industry it started out in. Evidence from Brazilian shoe manufacturers suggests that some at least are reacting aggressively to these changes, and will attempt to create and retain more value per pair than hitherto has been the norm.

Bibliography

1987 Census of Manufactures: *Tanning Industrial Leather Goods and Shoes*, U S Dept of Commerce, 1990

Survey of Current Business, U S Dept of Commerce, various issues

Manufacturing USA, 1989, Wards

Value Line, various issues

Forbes

Stockbroker's reports from Smith Barney, Shearson Lehman Hutton, Drexel Burnham Lambert

Annual Reports and 10-Ks of various companies