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**FELMINI, THE SUCCESS OF A PORTUGUESE FOOTWEAR  
COMPANY IN THE ITALIAN MARKET**

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## **Abstract**

This thesis studies the Portuguese and Italian footwear industries, two of the leading clusters for the manufacturing of high quality footwear. The aim is to understand its characteristics and sources of competition. Also, I studied the case of Felmini, a Portuguese footwear firm that successfully entered in Italy, the world's most competitive footwear market.

The first part of the thesis focuses on the dynamics of the Portuguese and Italian footwear cluster, its business model, sources of competition, markets and trends.

Then, I relate the general behavior of the industry with the one from Felmini, identifying the strategy used in developing an innovative and competitive business model. This required investigating the competitive environment of the footwear industry and its sources of competitive advantage.

The last phase concerns the main recommendations to face the future changes in the industry's competitive environment; which actions should be taken by firms, institutions and governments in fostering sustainable sources of competitive advantage.

The footwear industry is a very important pillar for both Portuguese and Italian economies; it works on a cluster basis in which firms develop supplying relationships over its vertically disintegrated value chains.

The small size of firms increases flexibility; and the vertical cooperation among them increases efficiency and quick access to inputs and equipment. Also, the horizontal competition, gives firms' an incentive for being more innovative and efficient.

Factors like high quality, innovation, technology and rapid response time are the basis of the Portuguese and Italian competitiveness, and it was only possible due to the network system of agglomerations of companies in clusters.

The geographical proximity of firms, the existence of specialized suppliers and production networks is a winning combination for these clusters' success; and the cross-firms synergies are what make them strong.

However, the tougher linkages among Italian firms make it a stronger cluster than the Portuguese. Yet, the Portuguese cluster has been improving its business network, converging towards a stronger and more interrelated cluster, like the Italian.

This project analyses the sources of competitive advantage of the Portuguese and Italian footwear industries, and how the concept of *clustering* helped in sustaining their competitiveness. With a deeper focus Italy, I made a *SWOT* and a *Porter's five forces* analysis, to better understand what made it a leader in the world's footwear industry.

I also analyze a Portuguese firm – Felmini - that successfully reviewed of its value chain to face competition. I focused on *internationalization strategy* and *Value Chain* according to *Porter's framework*. Its value chain shows that its competitive advantage stands on factors as innovative designs, high quality and exclusive materials, the combination of technology with craftsmanship and the quick response to market trends.

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## **1. Abbreviations**

APIC - Portuguese Leather Association

APICCAPS - Portuguese Association of Manufacturers of Footwear, Components,  
Leather Goods and its Substitutes

CEO – Chief Executive Office

CFPIC - Professional Training Centre of the Footwear Industry

CNA – National Confederation of Craftsmen and Small and Medium Enterprises

CTCP - Footwear Technology Centre of Portugal

EU – European Union

HR – Human Resources

ICEP - Portuguese Trade and Tourism Board

IT – Information Technology

R&D – Research and Development

SME – Small and Medium Enterprises

UK – United Kingdom

USA – United States of America

## 2. Introduction

The object of study of this thesis is the dynamics of the Portuguese and Italian footwear cluster, its characteristics and sources of competition of firms and the cluster as a whole. Also, I studied the case of success of a Portuguese footwear firm – Felmini - in the Italian market.

These two clusters were chosen because they're leading manufacturers of high quality footwear. Furthermore, I chose to analyze the specific case of Felmini because it's a Portuguese shoes producer that successfully entered in the world's most competitive footwear market, given the high level of efficiency and maturity of its cluster, being the Portuguese firm that most sells in Italy.

The first part focuses on the dynamics of the Portuguese and Italian footwear industry, its players, business model, sources of competitiveness, markets and trends.

Then, I relate the general behavior of the industry with the one from a single Portuguese firm - Felmini - identifying the strategy used in developing an innovative and competitive business model. This required an investigation of the competitive environment of the footwear industry; both in a world and local scales, and assess which are its sources of competitive advantage.

Finally, the last phase concerns the main recommendations for firms and the overall industry, in facing the future main probable changes in the competitive environment of the industry. This included predicting possible future variables and development of recommendations on which actions should be followed by firms, institutions and governments in fostering sustainable sources of competitive advantage.

Although both countries are facing a serious economic crisis, the footwear industry showed an opposite trend, being considered an important pillar for its economies - exports of footwear grew by 4.3% and 2.8% in Portugal and Italy in 2012, respectively. This sector is the largest contributor to the reduction in the trade deficit of both countries. Being an exports oriented sector, mainly towards markets that currently face a stagnant economy, this achievement is especially rewarding.

In the Portuguese footwear sector, there was a positive evolution both in terms of employment and volume of output between 2010 and 2012, increasing around 10% and 19.6%, respectively. The scenario wasn't as positive in Italy, which faced a reduction by 1.1% and 1.3% in the same variables.

The footwear sectors in Portugal and Italy work on a cluster basis, in which firms develop supplying relationships over its vertically disintegrated value chains. Their leading position is supported by high quality, innovation, technology and rapid response time; and it was only possible due to this network system of agglomerations of firms.

The small size of firms increases flexibility; and the vertical cooperation among them increases efficiency and quick access to inputs and equipment. Also, the horizontal competition, gives firms' an incentive for being more innovative and efficient.

The geographical proximity of firms, the existence of specialized suppliers and production networks is a winning combination for these industrial clusters' success. Also, the cross-firms synergies are what make these footwear clusters strong.

Portugal and Italy distinct themselves for the production of high quality leather made footwear. In its production, firms bet on innovative materials and designs, manual

processes that, together with technology and a very integrated and specialized production chain, allows for high flexibility and sustains their competitive advantage.

This project analyses the sources of competitive advantage of the Portuguese and Italian footwear industries, and how the concept of *clustering* helped in sustaining their positions on such a competitive sector. With a deeper focus on the Italian footwear industry, I made both a *SWOT* and a *Porter's five forces* analysis, to assess what made it a leader and a timeless benchmark in the world's footwear industry.

To better understand how the Italian cluster works, not only in the whole industry perspective but on how individual companies do business, I analyze a Portuguese footwear firm that successfully restructured its business model and has Italy as its main exports market. In this analysis I focused on the study of both its *internationalization strategy* and its *value chain* according to *Porter's framework*.

Felmini is a brand which origin dates back to the 1970s, when the company operated as a subcontractor for international brands. It's an example of a Portuguese brand that was successful in the review of its value chain to face competition. By selling directly to retailers, it got fully control over its production chain to adapt to market's needs and competitive environment.

Through the analysis of Felmini's value chain, its competitive advantage bases on factors as innovative designs, high quality and exclusive materials, the combination of technology with craftsmanship in and the capacity to quickly respond to market trends.

Although these are the two footwear clusters of reference in the world and operate similarly in terms of production processes, the tougher linkages among Italian firms



make it a stronger cluster than the Portuguese, which almost doesn't explore niche markets, lacks pro-active marketing strategies and 100% local supplying networks.

Furthermore, Portuguese firms are almost fully exports oriented, while the Italians' still have a strong home market which helps to faster understand new market trends and customer's needs. However, the Portuguese cluster has been improving its business network, converging towards a stronger and more interrelated cluster, like the Italian.

In the future, footwear firms will need to further develop stronger competitive sources to deal with the effects of the increasing competition of emerging countries and the growth constraints of the traditional markets.

### **3. Framework and Literature review**

#### **3.1. Clusters and competition**

Michael E. Porter developed a lot of studies and publications regarding the advantages of clustering, as well as analysis of specific clusters such as the Portuguese and the Italian footwear clusters. Therefore, this subject is analyzed in many of its works, like *"The Competitive Advantage of Nations"*, *"Clusters and competition: New agendas for companies, governments and institutions"*, *"Clusters and the new economics of competition"* and the *"Portuguese Competitiveness"*.

Other important authors that dedicated their work to the study of industrial districts and the Italian footwear cluster are Giacomo Becattini - in *"Industrial districts and inter-firm cooperation in Italy"*, *"The Marshallian Industrial District as a Socio-Economic Concept"*, and *"The idea of the industrial district: its genesis"* - Ilaria Mariotti - in *"Le strategie di delocalizzazione delle imprese del Nord Est nei paesi dell'Europa Sud"*

*Orientale: reti lunghe o fabbriche con le ruote?*” and “*Italian Investments in the Agglomeration of Timișoara in Romania: Threat and Opportunity for the Economic Development*”- and Roberta Rabellotti – in “*External Economies and Cooperation in Industrial Districts. A Comparison of Italy and Mexico*”, “*How do Italian footwear districts face globalization?*” and “*How globalization affects Italian industrial districts in Italy: the case of Brenta*”.

As a result, these sources were used as basis for the analysis of the Portuguese and Italian footwear clusters, as well as the competitive environment in which Felmini operates on.

To Michael Porter<sup>1</sup>, an industry cluster is a geographical concentration of interconnected companies – such as manufacturers, specialized suppliers, service providers, firms in related industries and associated institutions<sup>2</sup> – specialized in a particular field that compete but also cooperate. It contributes to higher productivity, efficiency and competitiveness; which arise from the joint actions and companies couldn't attain it alone.

Alfred Marshall<sup>3</sup> considers three factors for companies to agglomerate, which create competitive advantages of being located in industrial districts:

- Labor market pooling: clusters attract specialized and experienced employees, benefiting both workers and firms due to lower recruiting and training costs.
- Lower transaction costs: through easier access to specialized inputs - components, machinery and services - in comparison to vertical integration.

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<sup>1</sup> Porter, M. E. (1998)

<sup>2</sup> Universities, agencies and trade associations.

<sup>3</sup> Marshall, A. (1890)

- Knowledge spillovers: through the diffusion of know-how and innovation.

McCann<sup>4</sup> argued that local sourcing of inputs lowers transaction costs. It minimizes the need for inventory, delays and importing costs. Specialist producers are usually more cost efficient and the proximity of suppliers allows a quasi-vertical integration system. Also, intra-clusters sourcing facilitate communication, reduce the cost of tailoring and support services.<sup>5</sup>

Finally, it avoids possible opportunistic behavior by suppliers since the transparency of relationships is very valued and is crucial for companies to remain in the community. This is considered as one of the main strengths of clusters.

A growing cluster offers more opportunities which attract the best talent. Specialized suppliers emerge, information accumulates<sup>6</sup>, local institutions provide specialized training, R&D and infrastructures; and the cluster gets into a self-enforcing system.

Due to a structure that facilitates employees' mobility, clusters usually have low unemployment rates, which foster know-how and experience accumulation on districts.

Clusters agglomerate several types of firms: from different sized manufacturers and small workshops characterized by an extreme specialization and quality; to subcontractors of activities such as consulting and IT services, logistics, storage and transport services. There are also common infrastructures that benefit the overall players such as supporting services, training programs and marketing agencies.

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<sup>4</sup> McCann, P. (2004)

<sup>5</sup> Such as installation, training, troubleshooting and timely repair.

<sup>6</sup> This is fostered by the labor mobility among cluster companies, avoiding the loss of expertise and know-how, which is kept inside the districts.

Clusters' advantages are mostly related to external economies and spillovers across firms, in areas as R&D, component production, assembly, marketing and customer support. However, external factors may also have an impact on firms' competitiveness. Through their capacity to attract buyers, clusters facilitate the access to distant markets; and producers enjoy the benefits of the marketing channels that arise.

The benefit of clusters is strongly related to the concept of collective efficiency, which is the competitive advantage that arises from external economies and joint actions of companies<sup>7</sup>, that Putnam's thesis (1993) says it enhances efficiency and performance.<sup>8</sup>

By taking advantage of complementarities between activities, clusters boost productivity in many activities. Joint marketing – through firm referrals, trade fairs, trade magazines and marketing delegations – is an example of complementary actions that enhance the overall reputation of a location; as are the case of both Portugal and Italy in terms of footwear. Since the 1970's, SMEs have been contributing to the economic development in Italy, through the development clusters.<sup>9</sup>

Moreover, industries with well-structured associations, capable of lobbying the sector's interests and diffuse information, outperformed in facing international markets.<sup>10</sup>

For instance, in the footwear business, the presence in trade fairs is critical for companies to sell internationally. Therefore, through cooperation with business associations, these organize trade fairs and sponsor cluster's firms to participate on it.<sup>11</sup>

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<sup>7</sup> Schmitz, H. (1997)

<sup>8</sup> Studies show that companies' agglomerations help to overcome growth constraints and compete on international markets.

<sup>9</sup> Becattini, G. & Sengenberger, W. (1990); Sforzi, F. (2002)

<sup>10</sup> Locke R. (1995)

<sup>11</sup> Another example is the joint actions taken for the certification of firms' products.

In this sector, firms' joint actions are very strong on issues related to production as well. For instance, EU companies facing increasing competition from low-cost countries, focused on faster delivery times and smaller batches. But quality and speed cannot be achieved alone; it requires vertical cooperation to raise efficiency and quality.<sup>12</sup>

However, clusters are characterized by high competitive pressure too, because local competitors operate under similar circumstances – same labor costs and local markets of inputs' access. As a result, competition must be based on different factors rather than the product itself. For instance, factors such as products' design, brand image, services' reliability and quick response become important factors to compete.

Hence, clusters are a combination of competition and cooperation, which can coexist because they occur on different dimensions. Horizontal competition because they agglomerate rivals, focused on acquiring and retaining market share on similar segments. And vertical cooperation involving related industries and local institutions, which give firms the flexibility needed to quickly react to dynamic market trends.

Still, specialization is only worthy if there's scale. There is a strong connection between scale and specialization.<sup>13</sup> Firms' specialization allows for lower capital requirements to operate and invest, facilitating the entry and growing in smaller and less risky steps.<sup>14</sup>

Another typical strength of clusters is the speed of information's spread. Factors as proximity, supply and technological linkages and personal relationships foster trust and facilitates the information flow within clusters. Thus, firms rapidly perceive new market

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<sup>12</sup> Schmitz H. (1995)

<sup>13</sup> For example, inputs may not be produced locally, but they're available when and where are needed, due to the existence of specialized traders and transporters that allow for faster connections to markets.

<sup>14</sup> Schmitz H. (1997)

trends, technologies, materials, services and marketing activities. The effect is a higher pressure for innovation, which is crucial to sustain firms' competitiveness.

Thus, Michael Porter <sup>15</sup> says that clusters can affect competition in three ways:

- Increasing the productivity of the companies in the cluster
- Boosting innovation development<sup>16</sup> and thus for productivity growth
- Stimulating new business formation that supports innovation and expands the cluster.

Concluding, the geographical proximity of competing firms, the existence of specialized suppliers and production networks is a winning combination for industrial clusters' success. Also, the low barriers create a more functional industrial structure. But to sustain a clusters' performance, these need to manage their openness to businesses outside the cluster while facilitating strong inter-organizational relationships.<sup>17</sup>

### **3.2. Porter's five forces framework**

In the Michael Porter's review<sup>18</sup> of "*The five competitive forces that shape strategy*", the author considers that all companies in all industries are influenced by five forces that shape the nature of the competition in the industry, and will affect companies' strategic behaviour and ability to generate profits. These forces include:

- 1) Threat of New Entrants – these threaten the existing companies because it may affect their market share, which depends on the entry barriers of the industry, like:

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<sup>15</sup> Porter, M. E. (1998)

<sup>16</sup> Facilitated by the cooperation and learning among companies.

<sup>17</sup> Eisingerich, A. B., Bell, S. J., & Tracey, P. (2010)

<sup>18</sup> Porter, M. E. (2008)

- Economies of scale – that require large investments to new entrants
- Product differentiation – the higher the product differentiation the largest the investment in advertising needed for the new entrants to acquire market share
- Financial capital requirements – such as up-front advertising, R&D, fixed assets' investments, etc.
- Cost disadvantages – these are independent from the firms' size. They depend on factors as location, access to raw materials, subsidies, know-how and experience
- Access to distribution channels
- Governmental policy – such as license, safety and pollution requirements.

Barriers to entry are typically lower in clusters since assets, skills and inputs are often available; also local financial institutions usually offer more favourable credit access conditions. All these factors may reduce the risks of entry in an industry. The same happens to the exit barriers. The lower need for investment and the presence of specialized assets helps to reduce sunk costs.

2) Bargaining power of suppliers – It can largely influence the industry's profitability, because suppliers<sup>19</sup> can capture more of the value added. It increases when:

- There are few suppliers
- Suppliers are less dependent on buyers for their revenues
- Buyers face high switching costs
- Suppliers' products are very specialized or differentiated
- There are no substitute products
- Buyers are vertically integrated with suppliers.

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<sup>19</sup> Suppliers of raw materials, skills, labour, technology, etc.

Considering the footwear industrial districts, the high amount of suppliers decreases suppliers' bargaining power.

3) Buyers' bargaining power is the opposite of suppliers' bargaining power and it increases if customers are price sensitive. Price sensitivity increases if:

- The product represents a large fraction of buyers' costs
- The buyers' products offer low profit margins or are pressured to cut costs
- The quality of the goods isn't influenced by the production materials.

Assemblers and distributors may gain bargaining power if they can influence the purchasing decisions of their customers.

4) Threat of substitute products – These products perform a similar function as the industry products, and threat if switching costs are low or if the competition for substitutes is fierce, leading to lower prices or higher quality of the substitutes.

5) Rivalry among companies - When competition exists, all companies fight to gain or sustain their market shares. It may lead to price discounts, introduction of new products and advertising campaigns. The rivalry among firms increases if:

- There are many competitors with equal market power
- Industry growth is slow, fostering the fight for market share
- If exit barriers are high, companies fight harder to remain on the market
- Rivals are highly committed to the industry – for historical reasons, etc.

When rivals compete on prices, it leads to lower industry's profit margins; but they can compete on other dimensions – as other markets or niches – which may foster profits. In the case of the Portuguese and Italian footwear clusters, since most firms compete on



quality and other factors of differentiation, rather than on prices, the overall profit margins of the industry increases.

### 3.3. Porter's value chain

The literature review of a firms' value chain is based on the publication "*Competitive advantage: creating and sustaining superior performance*", by Michael E. Porter.

A company's competitive advantage cannot be assessed by looking at a firm as a whole. Instead, a set of activities as designing, producing, marketing and delivering are the basis for differentiation. Firms need to understand how their products affect buyers' value chain, to adapt their business according to buyers' needs.

Michael Porter considers that "the value chain is a tool that disaggregates a firm into its strategically relevant activities in order to understand the behavior of costs and the existing and potential sources of differentiation. A firm gains competitive advantage by performing these strategic activities better than its competitors".<sup>20</sup> Every value chain is composed by nine categories of activities which are linked and divided into two types:

Primary activities are related to the physical creation, sale, transfer and after-sale assistance of products. Their importance depends on a firm's strategy and the industry it's inserted on.<sup>21</sup> These include:

- Inbound logistics: associated with receiving, storing, and distributing inputs for use - handling, warehousing, inventory control, transports planning and returns.

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<sup>20</sup> Porter, M. E. (1985)

<sup>21</sup> For instance, for a distribution firm, inbound and outbound logistics are the most critical for its competitiveness.

- Operations: related with the transformation of inputs into final products, like machining, packaging, assembly, equipment maintenance, testing, and facility operations.
- Outbound logistics: once products are finished, they're collected, stored, and distributed to customers.
- Marketing and Sales: including advertising, promotion, sales force, quoting, channel selection and relations, and pricing.
- Services: after sales services help to enhance the value of the product, such as installation, repair, training, parts supply, and product adjustment.

Support activities sustain the primary ones in gaining competitive advantage:

- Firm infrastructure: it's not related to any particular primary activities but supports the entire chain, entailing activities as general management, planning, finance, accounting, legal, and quality management. These can be a powerful source of competitive advantage by fostering its efficiency and growth.
- HR management: activities involved in recruiting, hiring, training, developing and compensating the workforce. It supports both primary and support activities and consequently the entire value chain.
- Technological development: these are very broad in a company and are crucial to foster competitive advantage through improved products and processes.
- Procurement: it's responsible for acquiring inputs with the best price-quality relation. These include raw materials and other consumables, assets such as

machinery, laboratory and office equipment, and buildings. It's usually spread across departments<sup>22</sup>, and although representing a small portion of total costs, it has a large impact on firms' overall cost and differentiation.

To analyze a firm's sources of competitive advantage, it's necessary to define its value chain, which involves the whole organization and how primary and support activities' linkages create and sustain competitive advantage. In a fashion industry such as the footwear sector, in which other factors than the quality – such as the response time and innovation - also play an important role in a firm's competitiveness, the linkages between primary and support activities are extremely important to be analyzed.

#### **4. Methodology**

This thesis' development can be divided into three phases.

The first relates to understanding how the footwear industry works in Portugal and in Italy, in terms of actors, business models, sources of competitiveness, markets and trends. This was the stage in which most of the research was made, by:

- Searching information on internet, books, newspapers and magazines
- Gathering information with players and specialists from the Portuguese industry through visits and meetings in one of the Portuguese main footwear districts

The empirical research approach is qualitative; since the quantity and quality of public information related to this subject is abundant, authors as Michael Porter, Giacomo Becattini, Ilaria Mariotti and Roberta Rabellotti served as a reference.

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<sup>22</sup> Such as purchasing departments, plant managers, office managers, sales, etc.

Also APICCAPS has been working hard to promote the Portuguese footwear industry as being “sexy” and a reason of proud for the country. Therefore, this industry has been subject of many newspapers and magazines which publish several articles about the Portuguese footwear sector and its most successful firms.

For the second part of the research phase, I visited the Portuguese footwear district of Felgueiras two times as well as the industry association, APICCAPS. The first visit was to meet with Francisco Dias,<sup>23</sup> to better understand the dynamics of the footwear district of Felgueiras and its main players.

In the second visit to Felgueiras I visited two of the most important footwear firms of the Portuguese footwear industry: Felmini and NOBRAND. First, I got in contact with them by email, explaining the purpose of my thesis and scheduling the visits.

At Felmini I met Joaquim Moreira<sup>24</sup> and Paulo Mendes,<sup>25</sup> that explained me in detail the firm’s business model and showed the entire production process of Felmini’s shoes. At NOBRAND, Tiago Cunha<sup>26</sup> showed me another company from the same industry and market segments but with a very different approach to the market. At APICCAPS, Carlos Silva provided me with the most recent statistic data of the Portuguese footwear industry, as well as important world data of the sector.

Considering the theoretical framework and the objective of this thesis, the next phase relates to the qualitative analysis of the data and filtering the information relevant for

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<sup>23</sup> Designer and trainer that worked for several companies related to the Portuguese footwear industry, such as NOBRAND, Solinject - Indústria e Comércio de Componentes, Lda., Academia de Design e Calçado.

<sup>24</sup> The Owner and President of Felmini.

<sup>25</sup> The Commercial Director of Felmini.

<sup>26</sup> The CEO of NOBRAND.

the investigation of the footwear sectors in Portugal and Italy; as well as the information related to the value-chain and strategy of Felmini.

The last phase focuses on the main recommendations for firms, institutions and governments related to the footwear industry in Portugal and Italy.

## **5. Business conditions analysis in Portugal and Italy**

In 2007 Europe got involved in the serious financial crisis which started in the USA, experiencing a negative trend on its GDP and economic recession (appendix 1). Besides the effects of a world financial crisis, Portugal, Italy, Ireland, Greece and Spain were also affected by the European sovereign debt crisis.

Due to high spending over the past decades, Portugal's debt increased a lot in comparison to its GDP. The government couldn't improve its situation and got close to bankruptcy in 2011. As a result, from 2010, austerity measures were implemented to correct the macroeconomic imbalances and structural problems of Portugal.

Therefore, Portugal requested a financial assistance program to the IMF and the European Financial Stability Facility to last until 2014. Measures to cut state spending included wage cuts and tax increases, which had a strong negative impact in domestic demand, and consequently in companies and people. Although the country started to move on the right track, unemployment rose to historically high levels (appendix 2).

Although a large amount of public debt, the case of Italy was different, mainly because its public debt has a longer maturity and is mainly domestically owned. Also, Italy's private savings are higher and private indebtedness is low. All these factors make Italy more resilient to financial shocks.

Though, Italy's debt increased, GDP was constantly lower than the EU average (appendix 1) and many politicians were accused for the practice of clientelism.<sup>27</sup> So, austerity measures were taken in 2010, including real-estate sales, a two-year increase in the retirement age and a gradual reduction in government ownership of local services.

In 2011, Italian borrowing costs fell dramatically after the creation of an emergency government to replace the one of Prime Minister Silvio Berlusconi.<sup>28</sup> The social effects of the crisis have been severe in Italy as well, since many public employees couldn't have their wages paid, child labor started re-emerging in poorer areas and the level of confidence and investment fell dramatically.

The future challenge to these two economies is the unknown territory after the austerity measures are over. The end of the flexible monetary policies is a threat and economies need a more sustainable base of growth.

## **6. Overview of the footwear industry**

A firm's internationalization makes it move from a simple production unit to value the importance of strategy, R&D, innovation and technology. It helps companies to sustain companies' competitiveness in two ways:

- By accessing new markets: geographic growth and diversification, develop firms' value chain and achieve economies of scale

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<sup>27</sup> A system in which municipal employees are seen as a source for votes, creating high local debt.

<sup>28</sup> This was a significant step since the lack of coalition in the Italian government was limiting its ability to manage the economic situation.

- By accessing resources: minimizing costs and access to production factors<sup>29</sup> that aren't available or are too costly in the domestic market.

The liberalization of the world trade in the early 2000s fostered an increasingly aggressive competition from Asian countries. At this point, anti-dumping measures and the mandatory “made-in” labeling regulations became crucial for keeping the competitiveness of the footwear industry, especially the “made in Italy” differentiator of the Italian products.

From 2001 to 2005, Vietnamese and Chinese imports of leather shoes to Europe increased by 100% and 1000%, respectively. This affected dramatically the European production that decreased more than 30% and forced 1000 companies to go bankrupt. Since the footwear sector is very labor intensive, the levels of employment were very much affected and 26000 jobs were lost.

As a result, in 2006 EU applied extra taxes on Vietnamese and Chinese imported footwear. This increased the average price of imports, evidencing the effectiveness of the anti-dumping measures. However, in 2011 these measures expired.

In 2012, Asia accounted for the production of 87% of world's footwear production in volume.<sup>30</sup> China kept a leadership position with low priced products – position that is expected to keep in the future. It was followed by Europe, which accounted with only 4% of global production. This evidences a high concentration of the production of footwear. Also, Asia reinforced its leadership among footwear consumers - 50% of world's exports - in which China and India are the largest markets (appendix 3).

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<sup>29</sup> Such as raw materials, technology and capital.

<sup>30</sup> Which reached 21 billion pairs of shoes.

Exports showed a stable trend over the last years. In 2012, China was the world's largest exporter in volume - 74.1% of exports - and Italy was the largest European exporter with 1.6% - Italy's weight on exports decreased by 10% since 2001 (appendix 4). Conversely, imports changed dramatically, with EU's share dropping and Asia's increasing and overtaking North America's.

The main cause of the deterioration of the EU's market share is China's integration into the global footwear trade. However, it also opened the doors of the huge Chinese market, which led to the increase of exports from EU to Asia by 40% in the last decade.

In terms of value, the average export prices reported a general upward trend. Europe accounted for more than 45% of the value of the world imports in 2012. Thanks to its world's highest average export price (appendix 5), Italy is a clear leader in exports in terms of value. Moreover, exports are mainly between European countries. Countries such as Belgium, Germany, Netherlands and France, base their business models on the intermediation of production from other countries.

The European footwear production is very concentrated in Italy, Spain and Portugal; which produce around 66% of the total EU production. It's a labor intensive industry, dominated by SME's<sup>31</sup> located in districts with low industrial diversity.

During the early 1990s, EU manufacturers held their competitiveness by outsourcing part of its production chain to cheaper countries and cutting costs by reducing in employment. However, due to the rising production costs in Asia<sup>32</sup> and the increasing importance of proximity to core markets, some companies ended up moving back their production to lower costs European areas. However, being a highly labor intensive

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<sup>31</sup> EU footwear firms have an average of 20 employees.

<sup>32</sup> China's production costs rose around 19% in 2011.



industry makes it vulnerable to the competition from low-wage economies. This made it mandatory to restructure the sector.

Furthermore, fashion trends led to a reduction of the life cycle of footwear, requiring constant production of small batches of new models with innovative designs. Also, manufacturers are creating self-owned brands to increase their margins, therefore marketing factors and brand positioning became crucial.

Thus, being a very fashionable product, footwear firm's competitive advantage must be "based on their capacity to promptly adjust their products and the timing of their collections according to changing market demand."<sup>33</sup>

In restructuring, European firms focused on higher segments or niche markets, invested on internationalization and R&D, increased flexibility – offering smaller batches and faster response times<sup>34</sup> - and worked closely with stakeholders, betting on features such as innovative designs and materials to sustain their competitiveness; and hence profits.

In clustering, companies specialize in a few production phases, and the final product is a result of the coordination of a vast network of suppliers and distributors. In labor intensive industries, such as the footwear production, buyer-driven chains are typical.

The footwear distribution, which was made through independent retailers, changed mainly due to the emergence of multi brands' retailers and global distribution networks (appendix 6). Also, global supply networks emerged, offering raw materials, semi-finished and finished products faster, at a better prices and quality.

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<sup>33</sup> D'Amico S., Giustiniano L., Nenni M. E. & Pirolo L. (2013)

<sup>34</sup> With faster response times "the risk of overstocking unsold products can be reduced, since dealer is supplied more frequently and with smaller number of products" - D'Amico S., Giustiniano L., Nenni M. E. & Pirolo L. (2013)

In such a scenario, the geographical and cultural proximity to the main markets has become a competitive factor for the footwear industry players.

Finally, global competition and international brands fostered the fragmentation of supply chains, which helps to increase firms' competitive advantages but reduces the benefits of the agglomeration in clusters. The world's leading footwear clusters are Portugal, Italy, Romania, the USA, China, Vietnam and Indonesia (appendix 7).

In the last decades the footwear sector went through a lot of changes:

- Delocalization of production facilities to Asia
- Europe's small batches production of high quality footwear and the fast response business model
- The life cycle of footwear is increasingly short, which demands for increased flexibility
- Development of new forms of distribution, marketing and technologies.

### **6.1. The Portuguese footwear industry**

Besides being a traditional industry with a history of excellence and high quality, the Portuguese footwear industry is strongly oriented to foreign markets, exporting more than 90% of its production. It is the sector with higher surplus in Portuguese trade account. To sustain its performance, the industry seeks to compete for quality, anticipating trends and investing in technology.

One of the main characteristics of the Portuguese cluster is its geographic concentration in two poles in the north of the country: Felgueiras and Guimarães – employing around 45% of the industry's workers – Santa Maria da Feira, Oliveira de Azeméis and S. João

da Madeira. These five municipalities house 90% of the footwear manufacturers and represent approximately 75% of the employment of the industry (appendix 8). This characteristic is considered one of the strengths of the Portuguese sector, because it promotes the diffusion of knowledge and business network formation.

It consists on territorial production systems, which house manufacturers, related businesses - which include producers of basic inputs and complementary products, machinery and services providers - and common institutions, based on relationships of interdependency between companies.

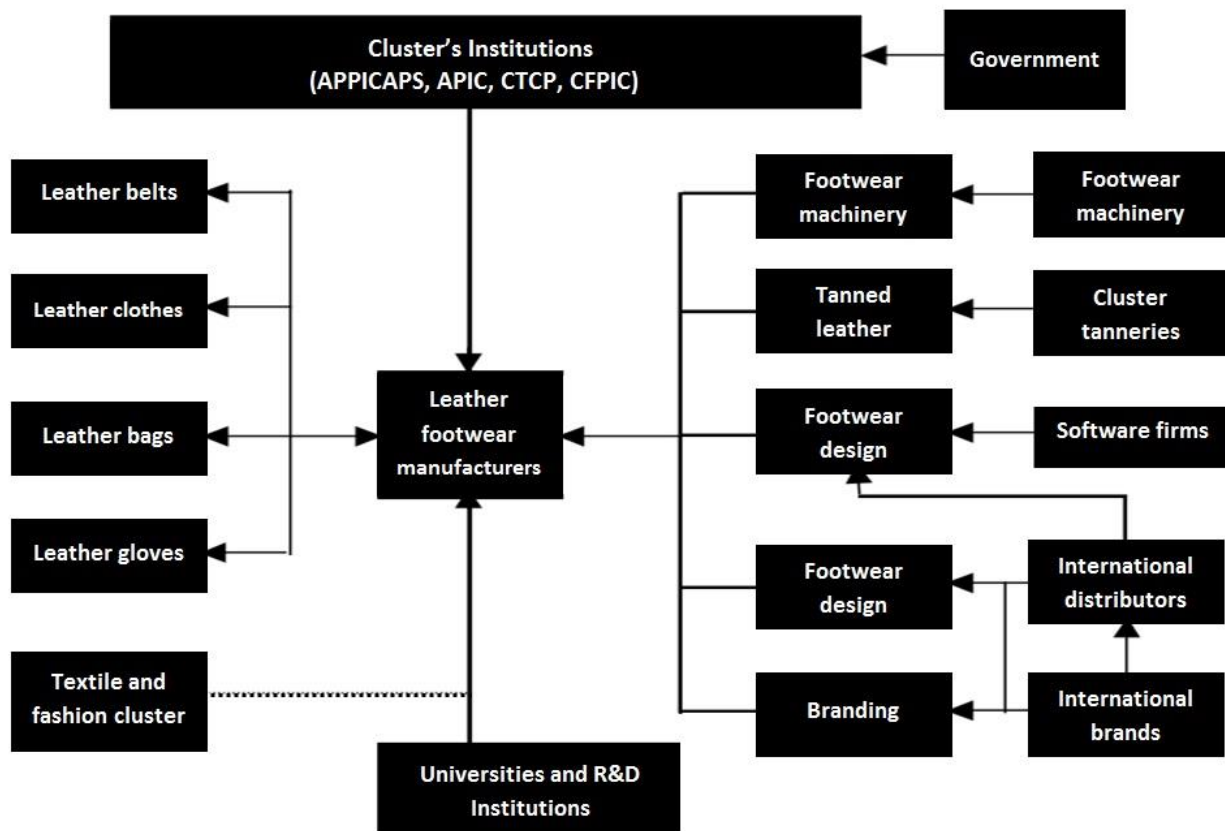


Figure 1 - Portuguese Fashion and Footwear Cluster (Source: Porter M. (2002), On competition)

These players are typically SME's (appendix 3) with a strong division of labor and high degree of specialization. In 2012, 90% of Portuguese footwear sales were leather footwear and almost half of it was women's.

The pole of Feira accounts for 60% of the footwear firms. S. João da Madeira is known as the “Capital of Footwear”. Besides manufacturers, it houses also sector institutions’ headquarters such as CFPIC and CTCP. Santa Maria da Feira is one of the world’s largest cork and footwear manufacturing center. Nowadays they’re strongly oriented to foreign markets and focus mainly in the leather shoes’ segment.

CTCP promotes several business cooperation activities to foster the introduction of new organizational models and technologies. Oliveira de Azeméis created the Business Innovation Center, a project that aims to host the marketing, sales and administrative areas of footwear companies. These are examples of joint actions, infrastructures and cluster linkages that have a positive impact on the efficiency and competitiveness of the overall firms of the Portuguese footwear cluster.

The Portuguese footwear industry was born in the S. João da Madeira and targeted the Portuguese market and its African colonies, manufacturing high value added footwear and adopting very labour intensive methods. According to APPICAPS, it’s “a centre of excellence in the footwear industry, both in Portugal and in the world.” The district grew sustainably since the 1980s; but due to the changing economic environment in Portugal, companies began to expand to the global markets.<sup>35</sup>

These firms have a more traditional structure, are typically smaller, use lower technological resources, more artisanal labour-intensive methods and consequently have lower levels of productivity. Its footwear is more classic and usually of higher quality, using manually produced leather and leather soles.<sup>36</sup>

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<sup>35</sup> APPICAPS, 2010

<sup>36</sup> Some use rubber soles but carefully crafted.

Felgueiras is a younger pole; it was born after 1974 when the domestic market was very limited. Therefore, its players show a stronger entrepreneurial spirit and always focused on the international markets. Its production expanded quickly, based on bigger and cheaper batches. As a result, it's the main district in terms of volume and profitability.

According to Vasco Eiriz<sup>37</sup>, these two footwear districts are complementary to each other and the promotion of joint-actions is important to foster productivity, efficiency and competitiveness; advantages that firms couldn't attain by themselves.

In the beginning of the last decade, this cluster went through a critical period, especially after the down-grade on the antidumping barriers to Asia. Consequently, both the levels of production and employment were seriously affected (appendix 10). After the closing of many large foreign-owned manufacturing units<sup>38</sup> - which were responsible for 40% of the exports - the structure of the industry changed, increasing the importance of SMEs, which business model's rely on smaller, higher value added batches.

For a long period, companies worked exclusively as subcontractors for several international premium brands, which helped to improve the technical capacity of the industry. With increasingly demanding customers, more informed about the quality of shoes, last decade's structure reorganization of the Portuguese footwear sector involved a strong specialization in the higher value added segment. In 2012, 90% of sales were leather made products, which enhanced the average price of sales. This means that there was a convergence towards the Italian cluster business model and features.

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<sup>37</sup> Associate Professor of Management at the School of Economics and Management, University of Minho - Braga, Portugal

<sup>38</sup> Examples: Rodhe (Germany) and Clark (UK).

This was a general strategy followed by countries such as Italy, Portugal or Spain, with a long tradition and prestige in terms of design and fashion. By choosing to move to a more demanding market segment, both the value chain and human resources qualifications' needed restructuration as well.

Nowadays a growing number of manufacturers are investing on firming its identity, creating strong self-owned brands, and fostering the control over their value chain. New forms of distribution were developed, in which the principles of centrality and proximity led to a focus on specialized retailers, which sell several brands.

This initiative was supported by trade associations and the State, which developed design and technology centres, focused on pushing the Portuguese footwear towards upper quality standards. These include: APICCAPS - Portuguese Association of manufacturers of footwear, components, leather goods and its substitutes; CTCP - Footwear Technology Centre of Portugal; CFPIC - Professional Training Centre of the Footwear Industry; and APIC - Portuguese Leather Association.

These facilities are very important for the cluster because, as stated before, industries with well-structured associations outperformed the remaining in facing international markets – which is the target of the Portuguese footwear production.

APICCAPS was founded in 1975 with the aim to promote a sustainable development of the Portuguese footwear sector. Its main areas of expertise include internationalization; consultancy services, statistics and studies, training, technology, quality and environment, innovation and industrial property.

To foster the internationalization of the sector, the association researches intensively for expansion opportunities for companies. It also promotes the presence of Portuguese firms in 80 international fairs and develops international marketing campaigns for the national footwear. Regarding industrial property and sustainable development, APICCAPS looks forward to link competitiveness to social responsibility.

CTCP is a non-profit private organization founded in 1986 to support and train technical and technologically the firms of the sector<sup>39</sup>, to promote improvements on products and processes' quality, spread technical information and to stimulate R&D. This is an initiative that fosters the knowledge spillovers among the Portuguese cluster.

Through CTCP, APICCAPS develops studies in technological and environmental areas and on feasibility of investments. Lastly, it promotes innovation as a decisive tool to foster the competitiveness by developing partnership projects with CTCP, manufacturers, related firms and universities.<sup>40</sup>

To finish, CFPIC was created to develop skills and knowledge of the human resources in the footwear sector, promoting both school and professional training.

Thus, the Portuguese footwear manufacturing firms can be divided into three groups:

- Small companies located predominantly in S. João da Madeira, which also produce for the domestic market or work as subcontractors for large national exporting companies. Although they have a good supply capacity, they just copy international brands' designs.

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<sup>39</sup> Training in areas as industrial and management methods, new production technologies, quality management and control, environment and social responsibility, marketing and sales.

<sup>40</sup> Now CTCP is developing the "Be Nature" project to find ecological solutions for the industry – reusable cork insoles, etc.

- Larger firms producing under subcontracting agreements for large retailers - such as Timberland and Rockport. These have a high level of expertise, quality and technology, and are located predominantly in Felgueiras.<sup>41</sup> They generally don't own a design and creation department, depending on subcontracting firms.
- Companies that adopted differentiating strategies, focusing on niche markets and developing self-owned brands – e.g. Aerosoles, Felmini and Kyaia. A common practice of these companies is to settle a design team in their target markets and produce their products in Portugal.

Portuguese footwear exports are geographically concentrated in Europe - 94.5% of total exports in 2012 (appendix 11). This is due to factors as market dimension and proximity; the fact of belonging to the EU, a common currency<sup>42</sup> and high purchasing power. Besides the high quality and innovative designs, the time factor became crucial to compete. Therefore, betting on European markets was a strategic decision for firms.

Also, exports' value increased due to higher selling prices; as well as the successful strategy of focusing on design, quality and evolution in the value chain.<sup>43</sup> In contrast, imports growth rate decreased, consequently the trade balance improved (appendix 12).

In 1994, Porter analyzed the Portuguese footwear cluster and considered it weak. There were no settled interconnections between tannery, components and machinery producers – materials were frequently imported from Italy, Argentina and France. Designs were often copied from Italian shoes, because there were no local design specialists, as it existed in Spain. These factors threatened the competitiveness of the sector, especially

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<sup>41</sup> For example: Jefar, Jewel, Pinfel, Picoto and Arlitd.

<sup>42</sup> Except for the United Kingdom.

<sup>43</sup> Occasionally exports exceeded 100% of production due to strategies of re-exporting previously imported products, a strategy followed by most European countries.



in a business in which a fast response time is so important and “require close cooperation between the subjects responsible for the different production phases”.<sup>44</sup>

Furthermore, there were almost no well-known brands and the distribution channels were dependent on foreign agents and distributors. This was a barrier for companies to quickly adapt to market trends. Therefore, despite its high quality products, the Portuguese footwear sector’s potential wasn’t recognized abroad.

There was the urge to restructure the cluster and take advantage of Portugal’s strategic geographical position in comparison to the Asian producers. To do so, companies had to increase both their productivity and flexibility to allow the production of small batches, through the reinforcement of players’ interaction, through the development of “quasi-vertical integration systems” that allow for increased efficiency and lower transaction costs. Finally, operations and production schedules’ restructuring were also vital, as well as the development of self-owned resellers network.

In 2002 there was some progress in terms of productivity and response time. Exports were increasing, and APICCAPS was strongly dedicated in the repositioning of the "Portugal Quality Shoes" brand and the development of national distribution channels.

About half of the leather used for footwear production is supplied by Portuguese companies, the remaining is imported in the form of finished and semi-finished leather. Regarding soles and production equipment, these are provided mostly from Italy.<sup>45</sup> However, CTCP has been developing partnerships with Universities to customize equipment to the specificities of the Portuguese firms. This external dependence on raw materials and equipment is considered one of the main threats for the sector; and

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<sup>44</sup> D’Amico, S. Giustiniano, L., Nenni, M. E. & Pirolo, L. (2013)

<sup>45</sup> ICEP - Portuguese Trade and Tourism Board

evidences the weaker linkages and integration of the Portuguese footwear cluster in comparison with the Italian.<sup>46</sup>

Also, EU funds were used to develop technological readjustments to ease firms' operations layouts, the production of smaller batches and further increased productivity.

The last decade was very important for the Portuguese footwear industry. It successfully overcame a period of crisis for the sector, by moving to a higher value-added segment for the most demanding markets. Now, Portuguese products are traded in more than 130 countries. The big investments on innovation, the focus on fashion and design, quick response and technology modernization, enhanced the flexibility to produce small batches and meet each customer needs.

However, the cooperation among manufacturers and related industries is still weaker than in the Italian districts, almost no niche segments are explored and companies lack pro-active marketing strategies. Finally, exports are very concentrated on European markets and there are almost no self-owned commercial networks.

## **6.2. The Italian Footwear Industry**

Italy has always been recognized as the most important center of footwear, sustaining its success by focusing on designing and manufacturing high-end shoes, based on values such as excellent design and high quality.

As a leading shoe manufacturer in Europe – it accounts for around 50% of the EU production - and the 10<sup>th</sup> biggest world-wide footwear manufacturer<sup>47</sup> (appendix 3), Italy also represents the 4<sup>th</sup> largest exporter of footwear in the world (appendix 4).<sup>48</sup>

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<sup>46</sup> Freire, A. (1999)

With a long tradition, Italian shoemakers' success began during World War I, thanks to famous brands such as Gucci and Salvatore Ferragamo<sup>49</sup>. After World War II, Italian designers could count on deep tradition of shoemaking craftsmanship to push shoe design towards new limits, offering high heels and innovative materials.

The evolution of the Italian footwear industry is divided into three main periods. The first lasted until 1985 and was characterized by great expansion. By this time, countries such as Spain, Portugal, Taiwan, Brazil and China – which had a relative labor cost advantage - became very cost competitive.

Then, there was a time of crisis and restructuring of the sector until 1992. The last phase relates to the devaluation of the Lira and the continuous improvement of the production's quality which led to an outstanding growth of the Italian footwear industry.

Nowadays, this sector has more than 5300 small, family-owned companies; accounts for more than 79000 employees (appendix 10) and a positive trade balance in terms of value (appendix 13 and 14). This is a very important sector for the Italian economy and it represents one of the pillars of the world's fashion network. 95% of the sector's production is women footwear. Here, handcraft work is extremely good and valued. Around 70% of sales in Italy are leather made footwear.

The Italian firms are also concentrated in specialized industrial districts, which agglomerate networks of SMEs, developing subcontracting relationships on its vertically disintegrated production chain. Specialized districts include Veneto, Marche,

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<sup>47</sup> In terms of volume.

<sup>48</sup> But the 2<sup>nd</sup> in terms of value.

<sup>49</sup> A Neapolitan emigrated in America between which made business in Hollywood, and attracted many international clients when he came back to Italy.

Tuscany – that account for 66% companies and workers, and 75% of the value of exports - Lombardy, Campania, Puglia and Emilia Romagna (appendix 15 and 16).

These companies were the result of skills developed over family generations. The geographic concentration and size of the companies provide them with flexibility that, together with advanced technology and design, are essential to quickly respond to the market trends and support the "Made in Italy" reputation.

In 2011, its seven main footwear industrial districts accounted for more than 93% of the total production, workers and exports value. In its vertical disintegrated production chain, each company specializes in few stages<sup>50</sup>, benefiting from economies of scale. This affects their efficiency and productivity, and is considered as one of the key sources of success of the cluster.

These districts house specialized suppliers of components - uppers, heels, soles, cutters and patternmakers - accessories, machinery and molds producers, equipment, customer and design services, leather tanneries, as well as training and other institutions. They are usually linked by common channels and technologies, employing common marketing strategies and competing in similar market segments. The strength of the Italian clusters is also due to its strong cross-firms linkages and synergies.

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<sup>50</sup> For example, footwear or component production; services like transports, logistics, training, etc.

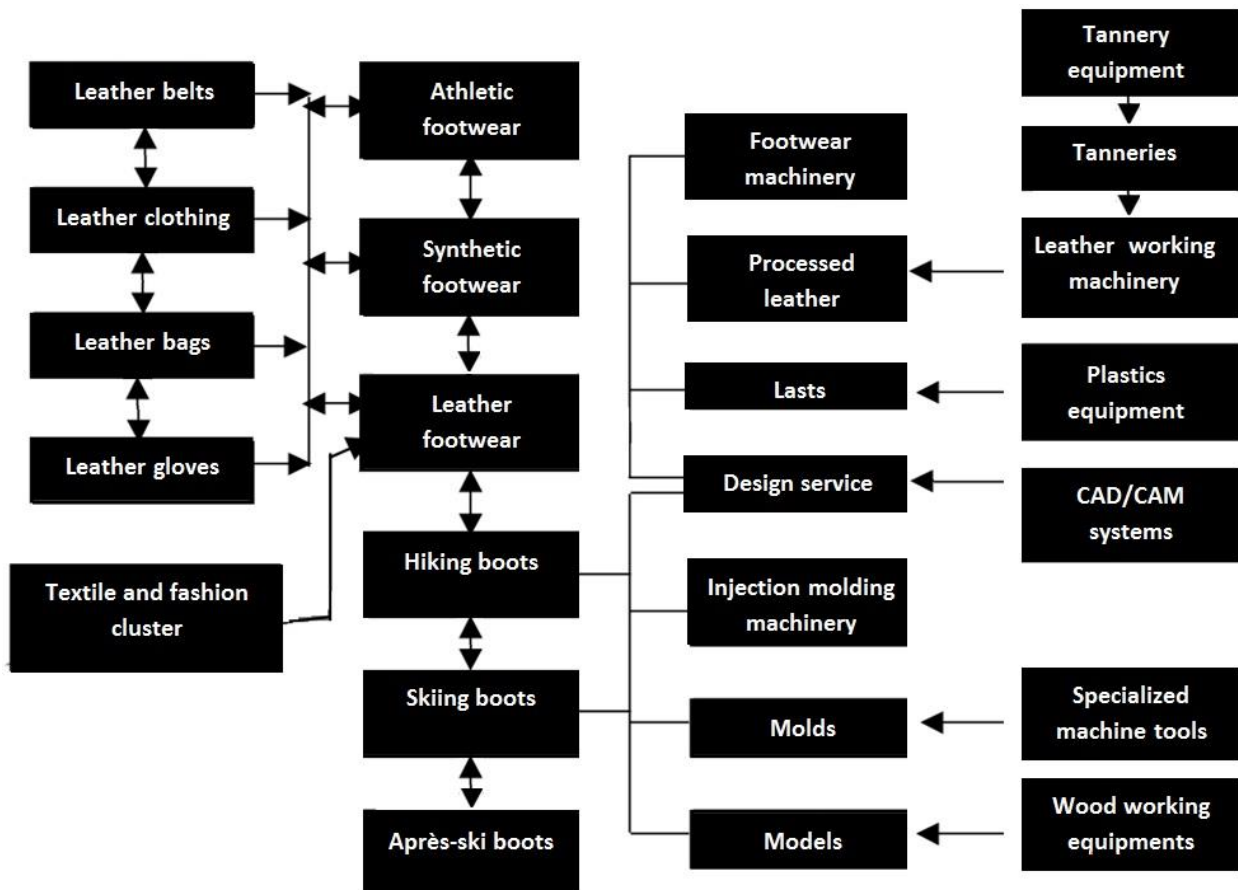


Figure 2 - The Italian footwear cluster (Source: Research by Claas van der Linde, 1993)

In the mid-1990s, many Italian firms relocated part of their lower value-added production phases to Eastern Europe countries; especially to Romania (appendix 7 and 17). The most valuable and creative phases are the product design, prototyping, R&D and specialized component production. Although Italian firms aimed to exploit cost advantages, it also contributed for the intensification of trade with Eastern Europe.

The competition of Asia is one of the reasons for the sector’s loss of its leading position in exports in the last decade. This drove the Italian industry to review its business model through a repositioning process, shifting production towards higher quality segments – investing on its value chain restructuration with product and process innovation, smaller batches and exploit new markets. This led to a steady increase on average selling prices.

Despite the segment chosen, firms focused on quality and style, offering more comfort, innovative designs and finishing. Innovation relates to the combination of elegant

designs with different materials - wood, cork, recycled material, breathable waterproof synthetics, etc. - colors, technology and comfort. Also, many companies introduced environmentally friendly processes – such as vegetable tanning techniques.

The economic crisis changed the macroeconomic situation which limited growth perspectives on traditional countries - raw materials costs rose, budgets were cut, political tensions, limited bank credits and increasingly conscious consumption.<sup>51</sup> However, the decreasing demand wasn't related to the competitiveness of the cluster and didn't affect firms' philosophy of investing in its products' features and operations.

The leading position of the Italian high-end shoe industry on the international markets is due to its high level of competitiveness. Its players have a high entrepreneurial spirit that led to top quality, creative talent, skilled labour and a great capacity to constantly innovate – creation of knowledge spill overs and labour market pooling. Since the footwear market is very sensitive to the fashion factor, a high focus on innovation is crucial for the industry's performance.

Its vertically integrated system<sup>52</sup> of professional expertise ensures the high standards of quality and design, as well as a culture of shared learning among different sized firms, shifting the competitiveness of the cluster.

Italian firms are aware of the benefits of belonging to the community. There, firm's relationships are based on reliability and reputation, reducing possible opportunistic behaviors. This results into a network that stimulates competition but also transparency.

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<sup>51</sup> For many companies the difficulty of access to financing remains one of the biggest barriers.

<sup>52</sup> A system of several sub-supplying relationships.

Also, it's common for companies to be loyal and develop long-term, flexible relationships with its suppliers; through informal agreements. This helps decreasing uncertainty and transaction costs, as well as promoting long-term investments in customized assets. As a result, although transactions are highly frequent, firms' vertical integration is unnecessary as transaction costs are very low.

There is a high level of vertical cooperation within the Italian districts, in which companies seek economies of scale by developing complementary activities. This also has an impact on performance and efficiency.

Furthermore, there's high horizontal competition, not only on prices but also on product features, organizational structure, and technologies. This balance forces companies to increase efficiency and innovate.<sup>53</sup>

However, the cooperation with local governments is weak. The Italian cluster developed without public support - apart from regional financing of infrastructures, promotion of training and presence in trade fairs by Assocalzaturifici and Chambers of Commerce.<sup>54</sup>

The members of the footwear cluster formed trade associations to work on activities that strengthen the competitiveness of the sector. Examples of these associations are Assocalzaturifici<sup>55</sup>, CNA, Confindustria and Confartigiano.<sup>56</sup>

These associations offer financial services, training programs, collective lobbying activities on the national and European level, organize and promote the participation of

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<sup>53</sup> Van Dijk, M. P. (1995)

<sup>54</sup> The Chamber of Commerce is a regional organization, responsible for networking activities between companies other support organizations. It helps SME's on marketing purposes, facilitates certification and tests, and training sessions.

<sup>55</sup> Previously named ANCI.

<sup>56</sup> It represents around 147000 artisan companies and 700000 autonomous entrepreneurs from all sectors.

Italian companies on trade fairs – which are of extremely importance for companies to show their brands and develop business relationships. They also organize members' meetings to determine long-term strategic plans for the sector.

According to Brusco, industry associations play an important role in stimulating innovation and productivity – for example through the creation of common technological centers. Companies regularly develop collaborative actions, such as joint marketing campaigns, collective bargaining with transporters and on fiscal issues.

For a long time, Italian shoe firms didn't value the potential of marketing initiatives: entrepreneurs focused their efforts on quality and design features instead of developing a sustainable brand image and distribution channels.

The 'made in Italy' label is one example of the marketing joint actions. It aims to differentiate Italian products from low costs foreign competition and fight against counterfeiting and piracy. Consumers are willing to pay higher prices for products from Italy, because of its modern design and quality guaranty. Consequently, protecting its image is very important for the sustainability of the Italian footwear sector.

Also, the increasing international competition and the importance of large fashion groups have fostered the concentration of the distribution channels. This affected many footwear districts which lost control over part of its activities. These large firms focus on the design, advertising, marketing and branding; subcontracting highly skilled shoe manufacturers for the manufacturing phases.

Although remaining as the most expensive footwear producer (appendix 5), Italy faces significant growth problems, especially in the domestic – which fell by 4.1% in 2013 –



and the European markets. Since exports account for 90% of the industry's turnover and that EU was destination of 70% of Italy's production, this trend is a serious threat for the Italian industry (appendix 11). Nonetheless, the footwear industry is one of a few to contribute to the Italy's trade balance (appendix 13).

Also, companies face liquidity problems mainly due to the vicious circle of the systemic delayed customers' payments and the limited access of SMEs to credit from banks, which is crucial for investments and thus for growth and innovation.<sup>57</sup> To overcome this issue, local banks and trade associations develop financing programs with better conditions to these firms.

The increasingly prudent purchasing decisions of the industry's players and the higher costs of production factors fostered the number of job losses (appendix 10).

Nowadays, the sector faces a problem of lack of experienced and young workers interested in working for the industry. The industry isn't considered "sexy" to work for and the wages are not attractive. This is a big threat for the continuity of the sector, since the artisan skills are one of the pillars of the success of the Italian shoes; it also compromises the labor market pooling, an important source of competitive advantage of firms' agglomeration. Furthermore, it contributes for an increase in wages.

According to Vito Altioni<sup>58</sup>, "protecting labor means protecting the integrity of the technical and hand-crafting skills that make Italian products so special, that is, protecting the productive industry". Therefore, Assocalzaturifici developed a plan of

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<sup>57</sup> There are companies that refuse to work with Italian retailers, because situations as indefinitely delayed payments to footwear manufacturers are becoming increasingly common.

<sup>58</sup> Ex-President of Assocalzaturifici.

action that includes the employment of young people, a credit for investments in R&D with lighter terms, training and the promotion of international growth.

Cleto Sagripanti, the actual President of Assocalzaturifici, considers that, analyzing the 2013 results, a historically demanding market and therefore a stimulus to continue to improve is in risk. The contraction of the domestic demand lead to both a slowdown in imports (appendix 14) and a drop on average import prices of 1.2%. China was Italy's main supplier.<sup>59</sup>

Despite this, the production increased both in real and value terms - around 3% and 1.8%, respectively - reversing the annual average rate of -2.2% in value and -5.6% in volume.<sup>60</sup> Italy has also a high level of temporary exports, due to the exports of intermediate products and re-importation in the form of finished products.<sup>61</sup>

Also, between 2007 and 2013, exports more than doubled and are the sector's driving force (appendix 14). In 2012, Italy was the 2<sup>nd</sup> largest exporter by value and the 4<sup>th</sup> in volume<sup>62</sup> - the first was China with 39.9% and 73%, respectively (appendix 4).

Although most countries have reduced its average export prices, Italy's increased to 33.25€, strengthening its leadership in this matter. Portugal and France came next, rounding 21€. In contrast, China's average prices are the lowest - 3.19€ (appendix 5).

These facts make Assocalzaturifici believe that the sustainability of the Italian footwear sector depends on foreign markets and calls to the need for more government support in

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<sup>59</sup> In 2013, China sold 116.6 million pairs of shoes to Italy, with an average price of 6.21€.

<sup>60</sup> The different rates of value and volume are explained by the focus on higher value luxury footwear production.

<sup>61</sup> Romania is one of Italy's main interchange players.

<sup>62</sup> Accounting for 8.8% in value and 1.7% in volume of world exports.

stimulating consumption and growth. Also, innovation and the “Made in Italy“ continue to be the main strategic marketing points for the sector.

As trading partners, companies expanded to emerging markets such as Russia, China, India, Brazil, and Eastern Europe; which provided the best rewards. Non EU exports represent 47% in value since the sales prices are twice as those charged within Europe.

Moreover, besides being its main competitor, Asia is also a huge opportunity, and it’s predicted that China will be one of the main export markets for luxury footwear. The success of sales on these markets was fostered by the support of Assocalzaturifici, through several promotional initiatives – for example the creation of the MICAM fair in China. Also, many campaigns promoting the ‘I love Italian shoes’ were taken aiming to communicate the quality and style of the Italian footwear.

Being one of the main pillars of the European footwear industry, CEC - in 1945 the European Confederation of Footwear Industry - founded the Assocalzaturifici Italiani - Association of Italian Footwear Manufacturers – to represent the Italian footwear manufacturers, protect the “Made in Italy” image and the cluster’s value chain.

Assocalzaturifici’s<sup>63</sup> main activities relate to institutional lobbying, marketing and internationalization, training, testing and research, studies and statistics, consulting services, trade-union relations and promotion of firms’ participation in trade fairs.

Recognized the importance of high quality materials for the reputation of Italian footwear, in 1985 the ex-ANCI founded CIMAC - The Italian Centre for Footwear Application Materials - to offer tailored services and expertise in the fields of research,

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<sup>63</sup> Previously called ANCI - Associazione Nazionale Calzaturifici Italiani, which then changed its name to Assocalzaturifici.

testing and quality control. It plays a critical role in supporting manufacturers to innovate, especially since the small dimension of firms makes it unaffordable the huge investments needed to perform these activities alone. Therefore, it supports the adoption standards, as well as innovative technologies, processes and materials, as well as the certification of operational procedures.

Finally, Assocalzaturifici organizes the MICAM ShoeEvent in Milan, the world's most important international footwear trade fair<sup>64</sup>; plus two trade fairs Obuv' Mir Koži (Moscow) and Moda Made in Italy at MOC (Munich). Moreover, it offers workshops in emerging countries to help the Italian industry to open doors in new markets.

The most important events are the trade fairs, in which the main players get together, show collections and develop business relationships with the major retailers:

- Expo Riva Schuh, Riva del Garda – It's the leading exhibition for mid-range priced production. It's the first event in the international fair calendar, so visitors can preview trends and exhibitors can test their collections' acceptance.
- Lineapelle, Bologna - It's dedicated to leathers, accessories, components, synthetics for footwear, etc., offering top quality and stylish innovative products.
- MIPEL, Milan – It's considered the most important showcase for products made in leather, fabric and alternative materials. It's the ideal fair for firms that focus on product research and technical innovation.

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<sup>64</sup> There participate around 1600 companies, of which 1000 are Italian.

- theMICAM ShoeEvent, Milan – It's the leading international footwear fair, organized by Assocalzaturifici Italiani, crucial to present the new collections and to establish commercial contacts with the most important buyers.

In the near future, firms' production levels are expected to remain stable and the capacity utilization will keep at 83%. Firms must look for new markets since the political instability of Eastern European countries is threatening – Russia is a very important market for Italy. The political tensions in Russia and Ukraine suggest less positive results in 2014, and the exchange rates can threaten Italy's competitiveness.<sup>65</sup>

The objectives of the industry include fostering consumption through tax wedge, subsidized access to finance and more internationalization. Thus, Assocalzaturifici is developing "network bonds" to foster growth in foreign markets; as well as a financing program with subsidized rates for payment by retailers. This support for internationalization, R&D and access to credit are a matter of survival for many firms.

Moreover, it's vital to keep companies' flexibility to quickly follow up and respond to market trends. Also, distinctive factors as customization, rapid delivery and a prompt service are crucial to face the aggressive competition from emerging markets. Finally, the human resources will always be a strategic element, so investing in continuous training and providing an environment that facilitates knowledge transference is key.

The history of the Italian sector made it clear for companies the importance of many factors in keeping their market position, such as:

- Innovative design and technology

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<sup>65</sup> This is also supported by a slowdown in orders from these countries in the last quarter of 2013.

- Flexibility and high quality
- Integrated and flexible specialized production chains
- Cooperation among industry players.

Concluding, the industrial organization of the Italian footwear clusters are characterized by a high degree of phase specialization; which results in a more efficient vertical inter-firm cooperation and in performance enhancing. Also, the horizontal competition is an incentive for businesses' productivity and efforts to innovate.

However, the Italian footwear cluster sustainability depends on the technological transfer, through the development of partnerships, specialized services and internationalization strategies – such as cooperation agreements with other clusters to foster the joint learning processes.

#### **6.2.1. SWOT analysis - the Italian footwear cluster**

A SWOT analysis is a tool used to assess a business strengths, weaknesses, opportunities, and threats. The strengths/weaknesses refer to the internal features that give an advantage/disadvantage in relation to competitors. The opportunities/threats refer to elements of the business' environment that may bring advantages/troubles for the business. Below is the SWOT analysis of the Italian footwear cluster:

Strengths	Weaknesses
<ul style="list-style-type: none"> <li>• Proximity to the main markets and fairs</li> <li>• Very demanding home market</li> <li>• Long experience on the business and markets</li> <li>• Well-developed infrastructures and supply chains</li> <li>• Strong cluster relationships</li> <li>• Technology availability</li> <li>• Strong reputation and brand image</li> <li>• High flexibility of firms</li> <li>• Bargaining power with suppliers</li> </ul>	<ul style="list-style-type: none"> <li>• Labour-intensive sector in a labour-costly country</li> <li>• Aging and scarce skilled workforce</li> <li>• Limited access to financing</li> <li>• Weak government support</li> <li>• Systematic delayed payment from retailers</li> <li>• Vulnerability to low cost competition</li> <li>• High dependency on European markets</li> </ul>
Opportunities	Threats
<ul style="list-style-type: none"> <li>• High segment are relatively unaffected by the recession</li> <li>• Growing fashion consciousness</li> <li>• New niches which are too small for large producers - comfortable, environmental friendly, etc.</li> <li>• Emerging markets – new elites</li> <li>• Technological development</li> <li>• New joint actions</li> <li>• New channels: E-commerce</li> </ul>	<ul style="list-style-type: none"> <li>• Design team is crucial for the business and very difficult to develop</li> <li>• Counterfeiting and piracy</li> <li>• No EU “made-in” labelling regulations</li> <li>• Competition of emerging countries</li> <li>• Increasing production factors’ prices</li> <li>• Decreasing demand in EU</li> <li>• Exchange rates fluctuations</li> <li>• Increasing quality of emerging countries’ products</li> </ul>

**6.2.2. Porter’s five forces framework - Italian footwear cluster**

The ability of companies of a given industry to generate profits depends on five forces.<sup>66</sup> Below there are the forces affecting the Italian footwear cluster:

Threat of New Entrants

Specialized machinery is the main capital requirement for companies in the footwear sector. Since these are asset specific<sup>67</sup>, these machines require a big investment and foster the importance of economies of scale.

<sup>66</sup> Porter, M. E. (2008)

<sup>67</sup> Because it cannot be used to the production of other goods.

Also, firms need to continuously follow the new trends and offer innovative products. Typically, Italian footwear firms are generational family businesses therefore it's difficult to compete with such long time expertise on the market dynamics.

Reputation is also important. Particularly, suppliers play an important role in guarantying quality and quick delivery; this is why companies and suppliers typically have loyal and long lasting business relationships. Additionally, retailers are the ones who interact with final customers, so their likelihood towards a product is fundamental.

Similarly, since business relationships in Italy are informal and flexible, trusting on business partners is key and this type of relationship takes longer to achieve than when there are written contracts. Thus, the access to suppliers, distribution and promotion channels represent a high entry barrier in this industry.

However, transparency is a characteristic of clusters' relationships, therefore firms are less likely to exploit strong cost advantages against both competitors and new entrants. Yet, knowhow and experience is very important and economies of learning are high. Finally, the Italian government never created particular barriers to this industry.

To sum up, the entry barriers are considered high and the threat of new entrants is low.

#### Bargaining Power of Suppliers

Considering that, especially in the medium-high segment, the quality of raw materials has a high impact on the quality of the finished products, companies have limited number of loyal suppliers. However, due to the high number of highly specialized firms, suppliers are much diversified into different firms.

Thus, the bargaining power of suppliers is low.



### Bargaining Power of Buyers

By buyers I will consider both the final customers and retailing stores. Since Italian footwear is highly differentiated in terms of design, quality, technology and brand image, final consumers' price sensitiveness is relatively lower. Also, the high number of small sized retailers and the relative low price sensitiveness from final consumers make the bargaining power of buyers weak.

### Threat of Substitutes

Given the economic crisis and the concentration of Italian exports on European countries, the switching cost between the medium-high and the lower price segments have been decreasing because customers are becoming more price sensitive. This may result in a threat for the Italian medium-high footwear producers. Regarding the higher quality segment, it's less vulnerable to the economic environment.

Also, the piracy and cheaper replications of Italian footwear models increases the substitutability of their products. Consequently, the threat of substitute products is high.

### Rivalry among Existing Firms

The Italian labour law is very protectionist therefore it's difficult to fire workers. Additionally, the high investments necessary<sup>68</sup> are asset specific, increasing the exit barriers and consequently the rivalry among firms.

Also, 60% of sales belong to the immense number of small sized firms.<sup>69</sup> The fragmentation of the cluster in several similar firms increases rivalry and fosters competition based on quality and cost efficiency.

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<sup>68</sup> Specialized workers, machinery, etc.

In addition, the market is composed predominately by Italian brands, which have been sustaining the “made in Italy” quality and style reputation. Hence, these are quite similar on what they offer.

Concluding, the competition is high, since they all struggle to remain on the market.

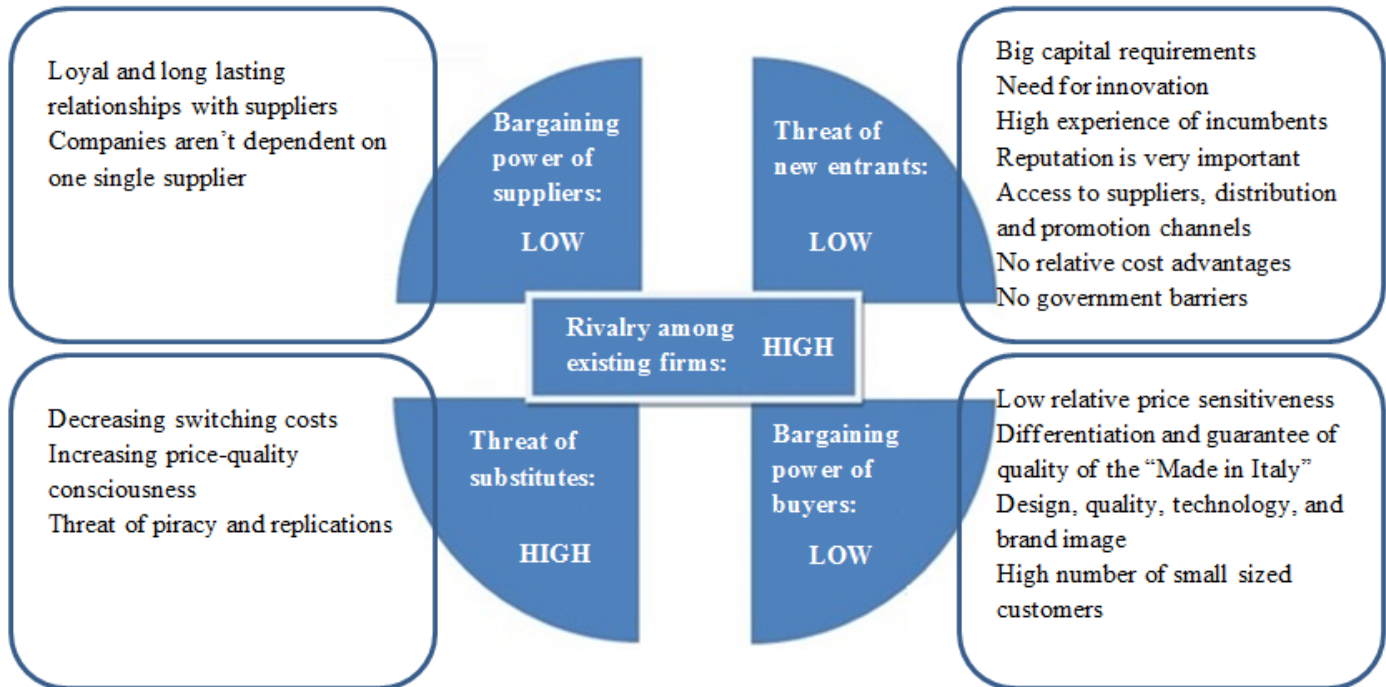


Figure 3 - The five forces affecting the Italian footwear industry

## 7. The Felmini's Case

Felmini is a Portuguese footwear brand established in 1973 in Felgueiras by the company J. Moreira, Lda. The company started by producing children's footwear but after one year started to produce women boots.

As the other firms in the district, Felmini begun by producing for 20 foreign subcontractors. But the orders started to decline while its business partners moved their

<sup>69</sup> Euromonitor International - 13 April 2012

subcontracting agreements to Asian producers. According to Joaquim Moreira,<sup>70</sup> its “products weren’t aggressive enough” and the company got close to bankruptcy.

Felmini started a deep restructuration process in 2002, to sell directly to retailers instead of producing big volumes for subcontractors.<sup>71</sup> By decreasing the number of intermediaries, the company had a closer relationship with its customers, could impose its brand and increase both the price of the products and the profitability of the firm.

From a company near bankruptcy in 2001, Felmini’s sales reached €5.5 million in 2007 and €14 million in 2013; and since 2004 the company is using 100% of its production capacity. However, this required an adaptation in terms of operations and management, a high level of specialization, the constant launch of new collections and therefore the creation of design teams and coordinators of collections.

The “new Felmini” targeted the medium-high segment focusing on women between 18 and 30 years old. Although average reselling prices reached 55€, Felmini boots’ retail prices start on 120€. In 2012 the company launched the *Felmini Premium* collection which retail prices range from 200€ to 330€, and the difference mostly rests in the details and leathers working.

Nowadays, the brand is recognized by its quality, a young and trendy image, offering collections that feature innovative design, shapes and colors.<sup>72</sup> J. Moreira admits that “this is the only way to face foreign competition”.

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<sup>70</sup> The owner and CEO of Felmini.

<sup>71</sup> It was a complex process because people resisted to the internal reorganization, suppliers were failing to respond and there was a limited access banking credit and tax benefits.

<sup>72</sup> Its technology enables Felmini to produce the same model in 20 different colours.

The brand outstands by the design, which is the result of the work of a Portuguese team of young designers, and two other teams in Italy and Spain. These designers visit suppliers, retailers<sup>73</sup> and trade fairs, to better understand the market trends and transform their inspirations into contemporary looking footwear. Also, they closely follow Felmini's competitors' collections and moves; and travel to fashion trendsetter countries – as Italy and France – to observe the newest tendencies and styles.

The new business model and the increasing concern over its clients' needs led to a reduction of the production rate from 3000 to 1300 pairs of shoes a day; however, the profitability levels grew. The quality of the leather plays a big role on the final products. Also, the production is a very manual process that includes hand painting and washing, and dipping the leather, as well as the finishing, that is one of the main firm's strengths.

Felmini has 100% control over its products, ensuring its creation, development and manufacturing. Almost everything is made in-house, from top quality raw materials. It's a combination of craftsmanship, technology and high-quality materials that makes every pair of boots different and unique - an aspect very much valued by its customers.

The company considers that its success stands on the collections that have been pleasing its customers in terms of design, quality and comfort, which are the result of high investments on the manufacturing process. Also, the strict control over final products ensures the high quality of every boots.

Being highly fashionable products, the focus on innovation and fast response is very important to hold competitiveness. J. Moreira, says that there is no one with its agility to respond to orders in Europe within four weeks and the reliability of delivery in time.

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<sup>73</sup> In this chapter, the meaning of clients relates to the retailers.

The company now sells to 2200 stores in 30 countries, and these have been increasing by 15% over the last years. Its regular presence in the best trade fairs, such as MICAM, GDS MAGIC, and TEC/ITALMODA, is the best source to acquire new clients.

Boots' production is very a manual process, therefore specialized workers are essential and very important to keep. Felmini encourages close relationships as well as an informal environment. Due to the lack of skilled people on the market, the company highly invests in the internal training of its workers.

Furthermore, one of the main problems for the brand is the counterfeiting of its products, especially in Naples. It harms the company by pushing down its prices. On the other hand, the company also sees it as recognition of its quality and reputation, resulting in extra motivation to work better and be more creative. However, Felmini doesn't tolerate the copying of its self-created and patented liner. Hence, besides having its own and patented liner pattern, every finished product receives Felmini stamp as a certification of its uniqueness and origin.

Bearing the future in mind, Felmini's main challenge is to continually sustain its competitive advantage through differentiation, design, high quality and exclusive materials. It's also important to improve the capacity of response by strengthening both productive processes and management. Finally, its ambition is to acquire more market share of customers that are willing to pay the difference on quality.

### **7.1. Felmini's internationalization strategy**

When Felmini called a fresh start in 2002, the first thing to do was to develop business partnerships with international retailers. By developing its value chain to diversify

geographically, the company could enjoy economies of scale. So Felmini began to sell in Spain in 2002, mainly due to its closeness to Portugal.<sup>74</sup>

First, J. Moreira visited the market to understand how the retail business works; the next step was to refine the business model to foster its innovative capabilities, which drives the uniqueness of collections. In 2004, Felmini created a subsidiary in Vigo and in Alicante - for commercial purposes and to follow the Spanish designers' team work – and developed its first distribution strategy, which is based on local representatives that are in charge for the management of networks of local selling agents, organized by regions, to sell to local retailers.

Then the firm broadened its sales to France, which is an extremely important pole for fashion. There, Felmini attended TEC/ITALMODA – a representatives and selling agents' fair in Paris – where the company settled its first representative agreement with an Italian agent.

Hence, in 2005 Felmini started exporting to Italy, and nowadays its boots are sold in 600 stores. The first client was based in Firenze, and the city is still the one that sells the most. It wasn't easy to penetrate the Italian markets because, at that time, the collections weren't differentiated enough and the retailers didn't know the brand - reputation is crucial and the likelihood of retailers towards a brand may be decisive for its success.

Businesses in Italy are based on relationships of trust, and it takes time to build. Therefore, it took approximately two years for Felmini's boots to be accepted in the Italian market; after then the demand from Italian retailers started to increase sharply.

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<sup>74</sup> Although Spain is a strategic market for Felmini, it's highly affected by the economic crisis.

Today, Felmini is the biggest Portuguese exporter to Italy, accounting for 36% of its production. Being successful in such a demanding market is a very good starting point to succeed in the other markets. Italy benefits from a strong reputation and brand image, therefore Felmini's acceptance in the Italian market works as certification of quality and trustworthiness of the brand.

The company knows that "being well represented in Italy opened the doors to the world's markets" and this success is also due to an excellent team of selling agents with a very refined sense of commercial strategy. Furthermore, labor costs are higher in Italy, so Felmini benefits from cost advantages in competing with the Italian manufacturers – an advantage that an Italian firm cannot enjoy, mainly due to the strong cluster integration and transparency among Italian suppliers and manufacturers' relationships.

According to J. Moreira, the key factors to win in such a challenging market, with a long time experience, were the "design, innovation and quality, exactly in this order of importance". This market is an important school for the firm, because it's very demanding and forces the company to excel in every aspect, from designs to materials, processes and delivery service.

Since the production in both countries is similar, the quick response time – in terms of orders, new models and troubleshoots services - is an important asset. Also, Italians are riskier on fashion and are more open minded, therefore Felmini tests its products' acceptance the Italian market. The fast response and the production of small batches help "to minimize the risks and costs of a collection not appreciated by the market".<sup>75</sup>

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<sup>75</sup> D'Amico, S., Giustiniano, L., Nenni, M. E. & Pirolo, L. (2013)

Subsequently, benefiting from a greater experience in predicting market trends,<sup>76</sup> Felmini moved to the northern and non-European countries, diversifying the markets and thus reducing the risk of depending on the traditional ones that are more susceptible to the effects of an economic crisis.

The Portuguese market is one of the most recent moves of Felmini - in 2011. Until then it only sold in other countries than Portugal, although the national market still accounts for a small fraction of its sales, with little perspectives to grow. In 2012, the company expanded to China, through a joint participation in a trade fair with an already existing Japanese customer. China is strategically important, not only due to the dimension of the market, but for commercial and marketing purposes.

The company is constantly in search for potential markets, therefore in July 2014 it visited the International Footwear and Leather Show in Colombia for the first time, aiming to expand sales to South American countries.

Felmini's history evidences how a small change can be so decisive for a company. Considering the economic situation of many important markets for the company, Felmini's performance is an outstanding example of success.

Nowadays, Felmini's products are sold in 30 countries<sup>77</sup> through 28 local selling representatives.<sup>78</sup> In its expansion, the company is very meticulous in choosing the local representative to manage a team of local selling agents.

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<sup>76</sup> "Demand forecasting is one of the biggest challenges for retailers, wholesalers and manufacturers in any industry" - D'Amico, S., Giustiniano, L., Nenni, M. E. & Pirolo, L. (2013)

<sup>77</sup> Australia, Austria, Belgium, Bulgaria, Canada, Croatia, Denmark, England, Finland, France, Germany, Greece, Ireland, Italy, Japan, Lebanon, Luxembourg, Netherlands, New Zealand, Norway, Poland, Portugal, Romania, Russia, Saudi Arabia, Scotland, Spain, Switzerland, Ukraine and USA.

<sup>78</sup> Some agents are responsible for the sales in more than one country.



Being a fashion product, the intangible factors associated to it are more important. “This is why the point of sale has become a place where consumers and firms interact”<sup>79</sup>, communicating what the brand is about. The commercial strategy of each country is developed by each region’s representative.<sup>80</sup>

Moreover, the company moves to a new market only after consolidating the previous one, which is also a process of adapting the products sold to each market’s characteristics. Since it works at its full capacity, the company doesn’t aim to quickly broaden its export markets.

## **7.2. Felmini’s value chain**

### Inbound logistics

Felmini’s inbound logistics involve receiving the inputs for the production of Felmini’s boots, such as leathers, materials - lines and glue - components - soles, liners, counters and insoles – accessories and packing materials; as well as organizing the firm’s supply-chain. 88% of Felmini’s inputs are national and are provided by firms belonging to the cluster. The remaining 22% are imported from Spain and Italy – these include soles, molds, printing papers, advertising material and applications.

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<sup>79</sup> D’Amico, S., Giustiniano, L., Nenni, M. E. & Pirolo, L. (2013)

<sup>80</sup> For example, Felmini’s boots are sold in a retailer only if the representative agrees that the retailer and Felmini share the same vision and target.

## Operations

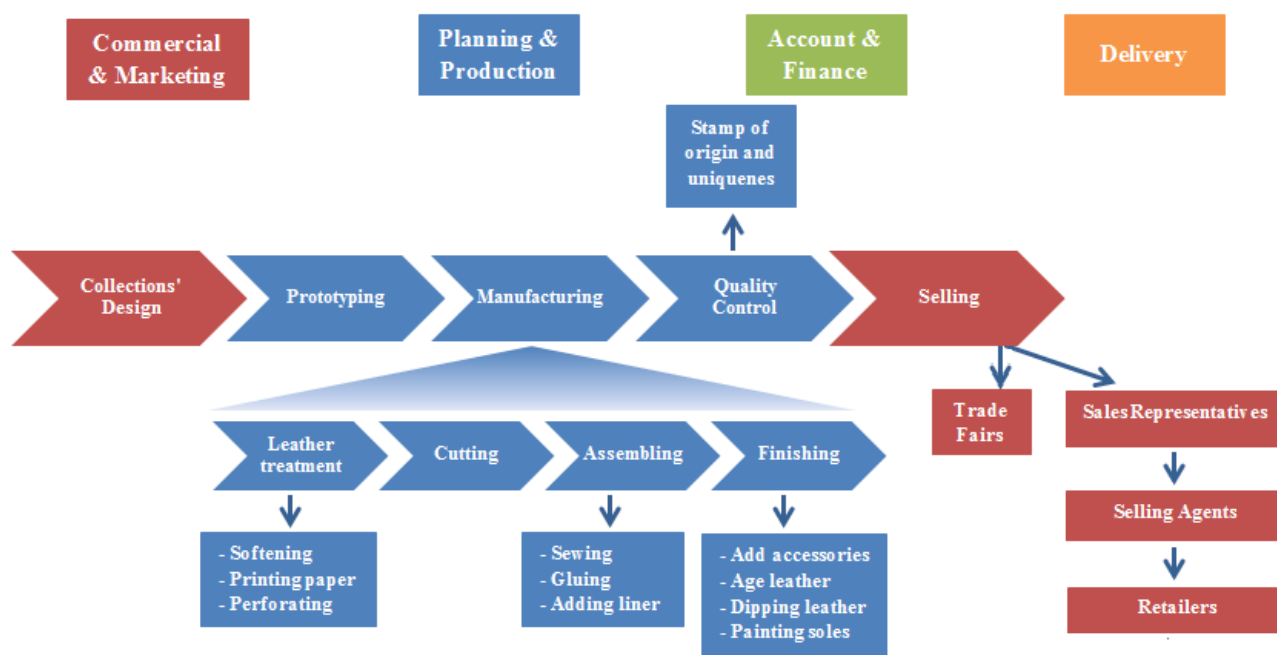


Figure 4 - Felmini's departments and process' map

The first phase of the process is the designing of the models of the collections. Felmini highly emphasizes the role of the design in its success. Contradicting the local tendency of copying others' designs, this phase is in charge of a team of young Portuguese designers; as well as its two other designing teams – in Italy and Spain - which are very important to faster track international trends.

Felmini's closeness to Italy is a very important "school", therefore J. Moreira regularly visits its design teams to review the collections with them; as well as the Italian and French representatives to better understand retailers' needs and new market trends.

Being a highly fashion product, it requires the constant launch of new collections. Felmini's collections reflect innovation and "differentiated products' design, shapes and colors." In preparing its collections, designers follow fashion blogs, travel, visit trade fairs and clients to acknowledge the newest trends.

Each collection usually means a five months process, in which designing the collections represents half of the work time. It starts to be developed more than one year before its launching. The result is modern, colorful, hand-washed and hand-painted collections.

When the collections' designs are ready, the next phase relates to transform the designs into real models, which is made in the prototyping section of the production process.

Regarding the manufacturing phase, it's mostly made in-house. It's a very labor intensive process that includes activities such as leather treatment, cutting, assembling and finishing. It combines craftsmanship, technology and high-quality materials to offer contemporary and innovative products.

Even if the leather bought from APIC is of top quality, it still has to be treated. One of the main strengths of the firms' production is the in-house working of 90% of the leather, which is softened and worked, either by printing paper<sup>81</sup>, cutting or perforating to get different textures.

The section of cutting the leather requires a high amount of workforce. Therefore, part of it is made in-house, and the remaining is made under subcontracting agreements with firms from the Portuguese cluster.

In the assembling phase, boots are sewed, glued and liners are added. Since sewing boots is also very labor intensive, Felmini locally subcontracts the sewing of part of its production. All subcontracting agreements are made with local firms to guarantee the quick response time, which has been crucial for Felmini's success.

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<sup>81</sup> For example to get a gold effect.

Furthermore, every boot requires manual work in terms of the finishing that is one of the strengths of Felmini's boots. It includes adding accessories, age and dipping the leather, as well as painting the soles. The high quality and the handmade finishing is what make Felmini's boots so unique and every product is labeled saying so.

Then, as referred by the firm, "nothing is sold without major quality tests", in which the maximum comfort and durability are assessed. In the controlling process every sample refused is separated; as J. Moreira assures "it costs a fortune to get the perfect boot" because the company is very meticulous regarding the specifications and quality standards of its boots.

Finally, only the boots that respect all the quality requisites are sold through Felmini's network of sales representatives and agents.

### Outbound logistics

The fact that Felmini is constantly launching new collections - sold in 2200 stores in 30 countries - demands a lot from the orders and outbound department. However the flexibility and responsiveness to orders within four weeks in Europe is one of Felmini's main competitive factors in comparison with both European and Asian manufacturers.

### Marketing and sales

100% of the company's production is to be sold under Felmini's brand, to the medium-high segment, targeting women between 18 and 30 years old. Its retail prices range from 100€ to 200€; but in 2012 the company launched the "Felmini Premium" collection that can go up to 330€. The premium collection's quality is similar to that of the best

European luxury footwear brands, and its main difference is on the more detailed design and leather work. This segment is less affected by the economic crisis.

Although the Commercial & Marketing department is responsible for identifying new trends and markets opportunities, the designing teams also travel to develop relationships, exchange experiences and cultures with people from the business.

The brand is known by high quality and trendy footwear. This is fostered by their renewed and interactive website with a highly appealing design. The brand also benefits from the joint international advertisement campaigns of the Portuguese footwear and local main brands, developed by APPICAPS. One example is “The Portuguese footwear is sexy”, which aims to communicate the high quality of the overall Portuguese footwear producers. Felmini also created and patented its own liner pattern to differentiate its products and fight against counter faction. Furthermore, every boot receives a final stamp to certificate its origin.

The company doesn't invest much on traditional forms of advertisement<sup>82</sup>; since “Felmini's best advertising is being perceived and valued as a distinct and credible brand”, therefore it rather invest on the firm's development and production process.

Finally, the presence on the main trade fairs is a very important form of promotion; and its presence on these fairs is highly encouraged by APICCAPS. The association helps in part of the logistics required to participate – for example through joint transportation of Portuguese brands' collections to the trade fairs' venues – and finances part of the costs of participating. Every year, Felmini participates in the best international footwear fairs,

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<sup>82</sup> Such as newspapers, radio, TV, etc.

as PANORAMA (Berlin), PURE LONDON, MAGIC (Las Vegas), MICAM (Milan), GDS (Dusseldorf) and TEC/ITALMODA (Paris).

By moving to a direct sales business model – which is a usual practice in the footwear business – Felmini fostered more direct and close relationships with its clients. Today its products are sold in 30 countries through a network of 28 local selling agents. The company first started to sell to Spain, through a network of agents that covered the whole country, in which created the Felmini SL in Vigo and Alicante to follow both the designers and selling representatives and agents work.

Only in 2005, Felmini started to sell in Italy and nowadays it's present in 600 stores. These have great commercial skills and know that “retail stores have a critical role in creating brand image and have an influence on customer satisfaction”.<sup>83</sup> Therefore, they carefully chose which retail location better strategically fits Felmini's brand image instead of selling everywhere possible.

Being heavily present in the Italian market – this is the most relevant market for Felmini – is also a self-promoting strategy that has been facilitating the business expansion to other markets. Also, since it's a country that risks a lot on fashion products, Felmini always tests its collection's acceptance in Italy.

Today, the brand is sold in most European countries, USA, Canada, Australia, New Zealand, Lebanon, Saudi Arabia, Japan and China. The company recently started to sell in Portugal, which only accounts for 3% of its production, but it recognizes that the national market is too small for its price segment.

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<sup>83</sup> Nenni, M. E., Giustiniano, L. & Pirolo, L. (2013)

### Service

Felmini's sales representatives coordinate a network of local selling agents, which distribute its products to the right retailers. Therefore the sales representatives are the ones in charge of providing the services required by the retailers.

### Firm Infrastructure

Felmini is based on a functional structure that involves a set of departments – Planning & Production<sup>84</sup>, Account & Finance, Commercial & Marketing<sup>85</sup> and Delivery - that support the work of the whole value-chain. Due to its small dimension, Felmini's board and President closely follow every department. Besides, J. Moreira also control and coordinates the international design teams as well as the Spanish offices.

When the company was restructured, adaptations in terms of the productive area and planning, management, account and in the informatics system were needed. This was mandatory for the company to be flexible to produce both large scale and small batches.

### Human Resource Management

“Human capital has been distinguished as a fundamental component, not only in firms operating in labor-intensive contexts or in the services.” Manufacturing “firms are the ones that have majorly increased the business asset value of human resources.”<sup>86</sup>

Today Felmini counts with 200 employees – from which 149 are blue collar workers - besides the 80 subcontractors the company works with. Contradicting the trends, the

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<sup>84</sup> This department is responsible for the planning and coordination of production orders, as well as the testing of the final products. The coordination of production orders is extremely important, especially considering that Felmini is working at its full capacity since 2004.

<sup>85</sup> It takes care of the design, sales and marketing activities.

<sup>86</sup> Festré, A. & Giustiniano, L. (2011)

company has been hiring blue collar workers, although it's not planning to hire anyone else since it's working on its full capacity.

As the fashion component is very important, the company heavily invests in its team of young designers, which travel in search for new trends and inspiration for their creations. Moreover, good and informal relationships between employees are encouraged, in which 45% of them live outside Felgueiras; thus the company provides a shuttle service to and from nearby areas.

Also, the company never failed to pay the salaries of both its workforce and subcontractors, which are higher than the average of the salaries paid in the footwear industry in Portugal. Furthermore, Felmini follows a policy of slightly increasing its workers' salary every year, to foster a relaxed and motivated working environment. Being a very manual production process, its workforce is essential for the competitiveness of the company and therefore it's important to keep.

Finally, although many footwear companies have shut down, there is still lack of qualified workforce in the industry, compromising the production of the firm. Thus, the company looks for workers on job centers and invests a lot on their training. Besides the training activities provided by the CFPIC, Felmini's internal training is very tacit, therefore it's a learn by seeing based process, in which knowledge is personally transmitted by the older employee to the new one.

### Technological Development

At the time of the restructuration of the company, the productive area was improved with new machinery and methods to work the leather. This was essential to provide the



firm with the equipment needed to allow the materialization of the innovative designs of its collections, which is an important pillar of Felmini's competitiveness. The segment in which Felmini operates implies a high level of specialization and technology. Its success depends on the combination of craftsmanship with the latest technology and high-quality materials.

Therefore, Felmini tests new leathers and working processes every day. Furthermore, since fast response time is crucial, in 2014 Felmini invested in an automated warehouse - of both inputs and finished goods - to speed up the production process.<sup>87</sup>

### Procurement

These activities relate mainly to the source, negotiation and purchasing of components, materials, equipment and services for the production of Felmini's boots, considering products' specifications and quality standards. Betting on the medium-high segment, the company highly invests on the quality of its materials.

Leather is the most important raw material which highly influences the quality and comfort of Felmini's shoes. The firm buys the leather to APIC, which imports 90% of it from Egypt, Brazil and East European countries. The company is very careful in choosing the best quality of pure leather, which will then be worked in-house with unique and unconventional treatments - some of these worked leathers are patented.

The company also buys customized plates to get exclusive printed textures. Finally, Felmini relationships with its 80 subcontractors are very close and long lasting. This allows the firm to fully enjoy the potential of these relations, since the subcontractors

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<sup>87</sup> The finished products are on the warehouse's lower floor. The moulds are on the upper floor to be automatically delivered in the production area. There's also another area reserved for the cuttings.

are aware of the quality standards of Felmini, allowing a lighter training, control and monitoring over their work.

In choosing the best suppliers, the company travels abroad to find the most suitable and exclusive materials and equipment. From these suppliers, 88% are Portuguese and the remaining materials come from Spain and Italy - soles, molds, printing papers, advertising material and applications.

## **8. Recommendations for the industry**

The current main macroeconomic trends are expected to persist: southern European economies' adjustment will continue and emerging ones will improve, the production factors' prices will increase, social and environmental responsibility issues will increase importance, and digital solutions will continue to spread worldwide. With the crisis, taxes are expected to remain high while governments try to control their spending. As a result, exports will persist as a priority for companies.

European footwear firms are aware that competing on cost is not sufficient and more needs to be done to sustain their competitiveness. Both the Portuguese and the Italian footwear clusters benefit from great flexibility and quick response times. However, gaining market share on more distant countries calls the need for firms to develop stronger competitive sources. For instance, footwear firms could develop joint collections with other players from the fashion industry, such as apparel, jewellery, etc.

To expand exports will remain an imperative for companies. Although APICCAPS has been effective in helping firms to export, Assocalzaturifici should reinforce its assistance by asking EU funding to help Italian footwear brands to attend to more

international trade fairs. Additionally, provide more training in export, marketing and sales management in both countries since the future will require increasingly innovative approaches, as the e-commerce.

Being a driver of the Portuguese and Italian footwear industry's success, innovation must be a priority in terms of the entire scope of the business, instead of products only – leather textures, colors, etc. Therefore, R&D activities should focus on customer service and marketing, which are unlikely to receive support from other sources. These refer to activities such as customers' service platforms, online selling, customized ordering, special editions, telephone applications, etc.

Associations might continue to promote effective partnerships on products' innovation, for example through joint programs between research centers and universities in which footwear firms inform about their main needs, for the outcome to be relevant. In addition, training in innovation development<sup>88</sup> would enhance firms' managers and employees' skills; as well as internships on international footwear firms.<sup>89</sup>

Social and environmental responsibility will reinforce the importance of aspects such as sustainability as a source of competitiveness. Therefore, firms' environmental friendly processes should be stimulated, focusing on recycling, energy efficiency, "green" marketing campaigns<sup>90</sup> and certification of products and processes.

The emerging countries, besides increasing competition, also bring opportunities from the arising of new elites of very high economic power that value the Portuguese and Italian footwear production. However, in expanding to these markets, firms need to

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<sup>88</sup> In fields such as design, modelling, prototyping, equipment maintenance, etc.

<sup>89</sup> For example, for designers to acknowledge new cultures, styles and practices.

<sup>90</sup> Such as the collection and redistribution of second hand, high quality shoes for lower income people.

consider adapting their business models. Although Europe will maintain as a world's trend setter, the economic and population growth in emerging countries predicts an increasing demand for higher quality footwear.

Furthermore, the European population ageing will make features like comfort and impact on health stronger sources of competitiveness. So firms - especially those exploring niche markets of specialized footwear - may develop more functional skills.

The development of emerging countries pressures the prices of raw materials up, and consequently the prices of most of the Portuguese and Italian footwear. This may stimulate the exploitation of new materials and technologies to substitute the leather.

Also, since innovation is central to address competition, the troubles in accessing finance must be faced. Greater efforts should be made by associations to negotiate with governments for further support through tax benefits on investments.

The counterfeiting is a big barrier and reforms on the EU patent system weren't made.<sup>91</sup> Therefore industry associations and governments should provide administrative and financial support for the protection of innovations and designs to overcome the problem of piracy and stimulate companies to invest in their footwear's features.

The workers' aging and the trouble in attracting young people are fostering skill shortages in the footwear industry. These clusters need to attract young qualified people and qualify the existing workforce, as a way to ensure generational transition of firms and bring innovative ideas. Also, firms and universities could develop design contests destined to freelance and aspiring designers, to together develop "limited collections".

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<sup>91</sup> Requiring a patent is a very costly, slow and difficult process.

On the companies' management level, it's important to reinforce management and soft skills programs<sup>92</sup>, since these people generally entered in the business early and are likely to lack this type of qualifications.

Digital solutions should be adopted by companies for activities related to marketing and sales<sup>93</sup>, as well as to facilitate relationships within their value chain, especially since distant markets are the most promising, being important to easily reach them. Although both countries' heavily invest in promotion, Italy's reputation still exceeds Portugal's, which may work harder and use the digital solutions to upgrade its image, both on the industry and firms' level.

Individual firm's advertisement and promotion should be encouraged, through assistance in the development of communication plans with specialized agencies. Also, APICCAPS and Assocalzaturifici could increase training in the field - specially directed to the power of social media marketing which importance is poorly recognized by many companies, particularly among the Portuguese ones.

These activities should be aligned with the existing support for the presence on trade fairs. Moreover, links between manufacturers and fashion and music events, as well as public figures should be strengthen - for example by the participation on fashion week's catwalks, photo shoots, show-rooms, fashion magazines' events<sup>94</sup> and music festivals.

## 9. Conclusions

Felmini is an example of a Portuguese brand that was successful in the review of its value chain to face competition from Asian countries.

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<sup>92</sup> Communication, language courses, social and environmental responsibility, HR management, etc.

<sup>93</sup> Social media marketing – Facebook, Twitter, fashion blogs, pinterest, etc. – and e-commerce.

<sup>94</sup> Like “Vogue Fashion Night Out” which happens in several cities.

The Portuguese and Italian footwear industry are considered as top leaders in the production of footwear for the upper market segment. To achieve this position, factors as high quality, innovation, technology and rapid response time were vital. But these characteristics are only possible due to a network system of companies, located in specialized areas that agglomerate footwear manufactures, related firms and services, and industry associations that Michael Porter defines as clusters.

Both Portuguese and Italian footwear companies used to work as subcontractors for international brands. However, the liberalization of the world trade changed the competitive environment of the sector and proved that the basis of their competitiveness wasn't sustainable anymore. When competition is based on prices, firms with higher costs have to find new sources of differentiation to survive in the market.

Therefore, many Italian and Portuguese firms moved to higher quality segments, taking advantage of their long tradition and expertise in the production of leather made shoes. In doing so, some invested in the creation of their own brands to increase the control over their value chain and margins – which is the case of Felmini.

The small size of these firms provided them with a higher flexibility. The vertical cooperation among them allows the specialization in different phases of the production chain, providing them with increased efficiency and quick access to high quality materials and equipment. These features are considered as one of the key sources of success of the Portuguese and Italian footwear industry.

However, being agglomerated into clusters also increases horizontal competition among firms, which gives them an incentive for being more innovative and efficient.

Portuguese companies are almost completely exported oriented, while the Italians' still have a strong home market which helps in faster understanding market trends and customer's needs. The European countries are the main exports destinations. In this matter, both the Portuguese and Italian manufacturers hold a relative advantage in quickly understanding and responding to the dynamics of the markets trends.

The Italian cluster is stronger than the Portuguese because the cooperation among manufacturers and related industries is stronger. In Portugal, almost no niche segments are explored; firms lack of pro-active marketing strategies and are still dependent on foreign suppliers. However, the Portuguese cluster has been improving its business network, and going towards a stronger and more interrelated cluster, like the Italian.

By selling directly to retailers under their own brand, Felmini went from an almost bankrupt firm to the most successful Portuguese company in such a challenging and demanding market as the Italian. Its competitive advantage stands on factors as innovative design, high quality and exclusive materials, a production process that combines technology with craftsmanship and a quick response to new trends.

Knowing the market trends and customers' needs is crucial in a fashion industry, so the company exports for 30 countries through a network of 28 agents that develop close relationships with the retailers and provide them with the services that best fit them.

In the future, footwear firms will need to develop stronger competitive sources to deal with the effects of the increasing competition of emerging countries and the growth constraints of the markets they are focused on.

Emerging markets will require adaptations from firms in two dimensions. First, firms will have to deal with the increase in prices of production factors, due to emerging economies' development. Then, these markets also represent an opportunity, but their distribution model will have to be adapted to the infrastructure of the emerging markets.

The importance of innovative approaches will be fostered by increasing joint actions between firms, research centers, universities and industry associations; R&D and training on other dimensions beside features directly related to products.

### **9.1. Limitations**

Felmini was very prompted in providing me the relevant information to develop my thesis. However, the other players both from the Portuguese and Italian industry were more difficult to reach. Therefore, it may have limited the rigor of the SWOT analysis and of the recommendations, which are based on my own analysis of the market and considering Felmini's data. As a result, it may affect the impartiality of the analysis.

Furthermore, it could be useful to develop a market research focused on both the existing and potential customers of Felmini, to better understand what motivates their choice in doing business with Felmini (or not), as well as the brand's main strengths and possible improvements.

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## 11. Appendixes

Appendix 1 – Real GDP growth rate 1996-2012, % (Source: Eurostat and INE – Contas Nacionais Anuais)

	1996	2000	2002	2004	2006	2008	2009	2010	2011	2012
Portugal	3.4%	3.4%	0.8%	1.0%	1.1%	-0.1%	-3.0%	1.9%	-1.1%	-2.8%
Italy	1.1%	3.6%	0.1%	0.7%	1.6%	-1.9%	-6.1%	1.2%	0.1%	-2.8%
EU 27	1.7%	3.6%	1.0%	2.1%	2.9%	-0.1%	-4.8%	1.7%	1.4%	-0.7%

Appendix 2 – Annual average Unemployment rate 2005-2013, % (Source: Eurostat)

	2005	2006	2007	2008	2009	2010	2011	2012	2013
<b>Portugal</b>	8.6%	8.6%	8.9%	8.5%	10.6%	12.0%	12.9%	15.9%	16.5%
<b>Italy</b>	7.7%	6.8%	6.1%	6.7%	7.8%	8.4%	8.4%	10.7%	12.2%
<b>EU 27</b>	9.1%	8.3%	7.2%	7.1%	9.0%	9.7%	9.7%	10.5%	10.9%

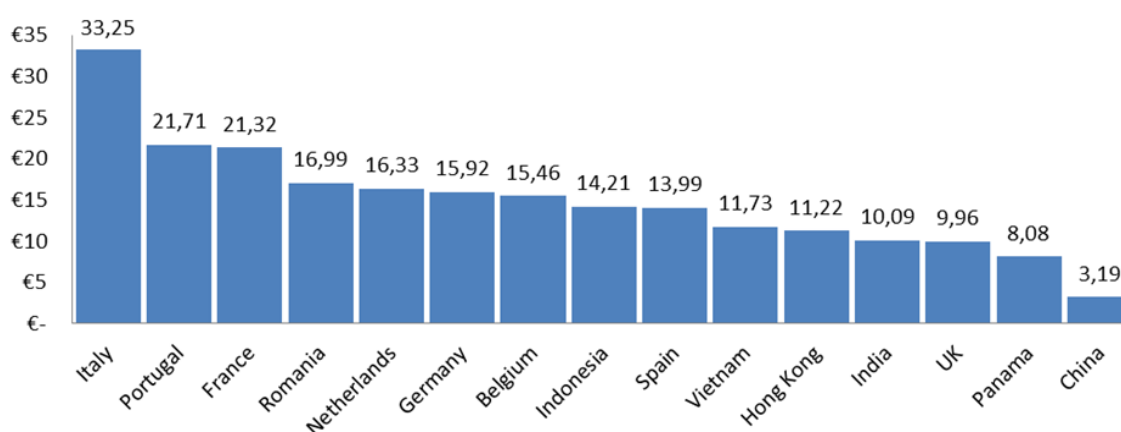
Appendix 3 – Top 10 Footwear Producers and Consumers (Volume) 2012 (Source: APICCAPS)

Production			Consumption		
#	Country	World Share	#	Country	World Share
1	China	63.1%	1	China	17.3%
2	India	10.4%	2	India	11.9%
3	Brazil	4.1%	3	USA	11.8%
4	Vietnam	3.2%	4	Brazil	4.2%
5	Indonesia	3.2%	5	Japan	3.6%
6	Pakistan	1.7%	6	Indonesia	2.8%
7	Bangladesh	1.4%	7	UK	2.4%
8	Turkey	1.2%	8	Russian Fed.	2.3%
9	Mexico	1.2%	9	Germany	2.1%
10	Italy	0.9%	10	France	2.0%

Appendix 4 – World Top 10 Footwear Exporters and Imports (Value) 2012 (Source: APICCAPS)

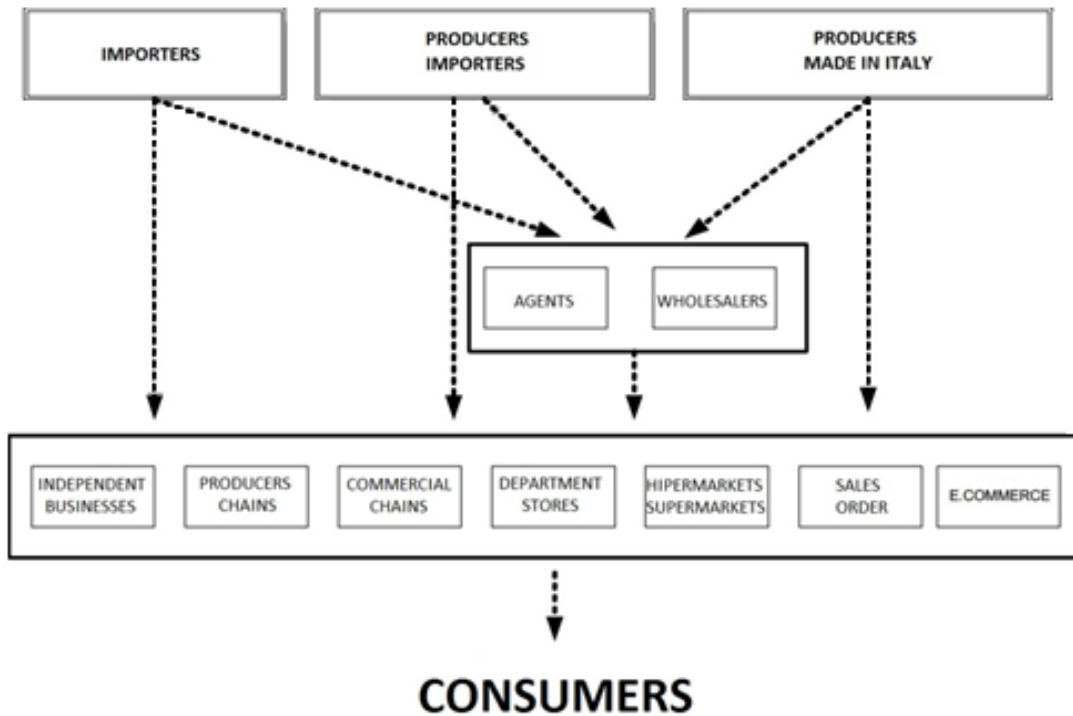
Exports				Imports			
#	Country	World Share	Average Price	#	Country	World Share	Average Price
1	China	39.9%	3.19€	1	Usa	22.6%	7.72€
2	Italy	8.8%	33.25€	2	Germany	7.5%	10.85€
3	Vietnam	8.2%	11.73€	3	France	5.8%	10.44€
4	Hong Kong	4.4%	11.22€	4	UK	5.5%	7.57€
5	Belgium	3.9%	15.46€	5	Japan	5.1%	5.90€
6	Germany	3.5%	15.92€	6	Italy	4.6%	11.86€
7	Indonesia	3.1%	14.21€	7	Hong Kong	4.2%	8.65€
8	Netherlands	2.7%	16.33€	8	Russian Fed.	3.7%	8.78€
9	Spain	2.4%	13.99€	9	Netherlands	3.2%	12.19€
10	France	2.3%	21.32€	10	Belgium	2.8%	9.23€

Appendix 5 – Average Export Price among Top 15 Exporters, 2013 (Source: APICCAPS)

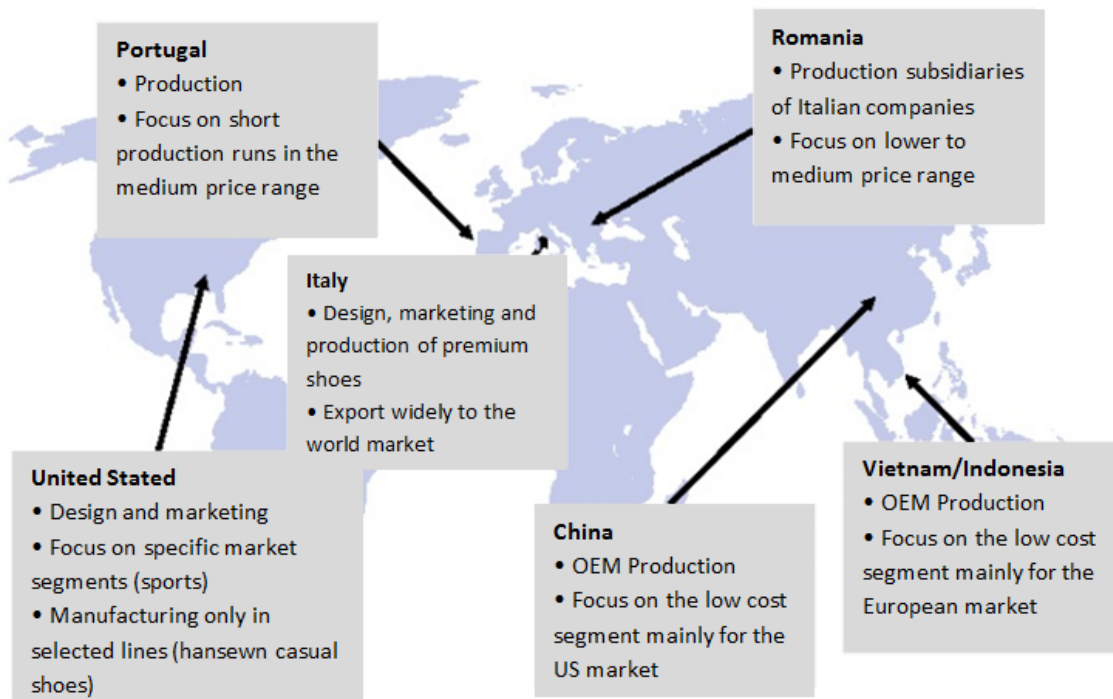




Appendix 6 – Example of the Italian footwear distribution network



Appendix 7 – Leading footwear clusters, 2002 (Source: Michael Porter, research by HBS student)





Appendix 11 – Main Trading Partners (Volume and Value) 2012 (Source: APICCAPS)

Country	Portugal					Italy					
	Exports		Imports			Exports			Imports		
	% Total Volume	% Total Value	Country	% Total Volume	% Total Value	Country	% Total Volume	% Total Value	Country	% Total Volume	% Total Value
France	23.8%	26.4%	Spain	38.3%	43.7%	France	19.4%	16.5%	China	40.9%	20.1%
Spain	18.2%	10.1%	China	27.7%	8.6%	Germany	14.7%	10.7%	Romania	8.9%	12.0%
Germany	16.4%	18.4%	Belgium	6.1%	14.4%	USA	6.0%	9.6%	Belgium	4.6%	8.4%
Netherlands	11.5%	12.5%	France	5.8%	7.4%	Switzerland	5.2%	8.5%	Netherlands	2.8%	7.3%
UK	7.7%	7.5%	Italy	4.3%	10.3%	Russian Fed.	3.8%	8.2%	France	3.4%	5.9%

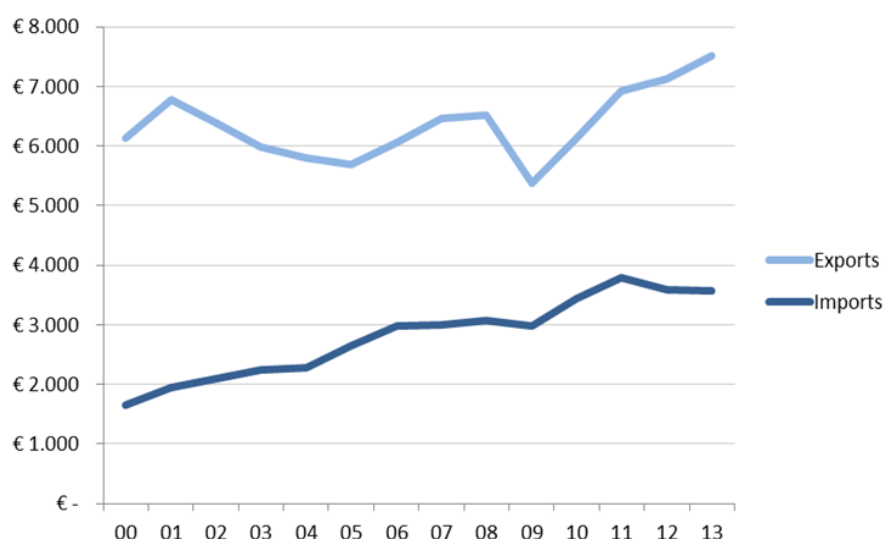
Appendix 12 – Share of exports in production (%) and Trade Balance (volume) in Portugal, 1994 -2012 (Source: APICCAPS)

	1994	2004	2006	2008	2009 <sup>22</sup>	2010	2011	2012
% exports in Production	79.3%	86.5%	87.1%	92.4%	87.1%	101.0%	102.0%	89.5%
Trade Balance (thousand pairs)	74.362	42.005	22.575	13.751	8.927	3.023	14.691	22.369

Appendix 13 – Share of exports in production (%) and Trade Balance (value) in Italy, 1970 -2012 (Source: ANCI)

	1970	1985	1995	2005	2007	2009	2010	2011	2012
% exports in Production	63%	83%	84%	82.3%	82.4%	80.9%	82.6%	83.8%	84%
Trade Balance (Million €)	213.4	3454.8	5209.5	3215.6	3678.2	2631.3	2908.3	3386.6	3806.6

Appendix 14 - Evolution of Exports and Imports of Italian footwear sector (Million €), 2000-2013 (Source: ANCI)



## Appendix 15 – Overview of the Italian footwear districts

### Veneto

In 2002, this region alone exported more than Greece and Portugal together, was responsible for 70% of Italy's production of sports shoes and 65% of the world production of ski boots. Actually, 91% of its sales are destined for export.

It also exports shoe components, while outsourcing a part of the assembling operations<sup>95</sup>, mainly to Romania.

Its three main industrial footwear districts are: Riviera del Brenta - specializing in woman shoes; Verona – classic shoes - and Montebelluna - sports footwear:

- Riviera del Brenta – it's responsible for the design, manufacture and marketing of almost all the most well-known footwear brands in the world. In 2003, around 90% of its shoes were medium-high and luxury women's shoes with an average price of 58€. <sup>96</sup> It produces mainly to Germany, France and UK. The district has an agreement with Barletta to outsource its lower value-added activities.
- Verona - In the 1950's, firms were predominantly working as subcontractors for German companies. Nowadays, it's responsible for almost 49% of total production in Veneto and 10% of Italian production. Although being very innovative, the district typically uses “low-tech” machines and equipment. Given its moderate quality, it doesn't hold a very competitive position, being heavily affected by Asian countries competition. Therefore, the district has been in decline over the last decade. As a result only 38% of its production is for

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<sup>95</sup> Verona and Montebelluna imported more than 4.4 million and 700000 pairs of finished shoes in 2001, respectively.

<sup>96</sup> Rabellotti, R. (2004)

export. Finally, Verona bets considerably on outsourcing because the quality of components isn't significant for the quality of the finished goods.

- Montebelluna - It is one of the most important places for the production of technical mountain shoes, après ski boots, ski boots, motorbike footwear, and "in-line skates".<sup>97</sup> It has an extraordinary innovation capability and technology regarding both processes and the production of high quality sports footwear and clothing. "Made in Montebelluna" expresses the quality of a successful cluster. Being focused in a very technical niche, most companies own R&D departments and many patents.

### **Puglia**

Barletta is one of the main footwear areas in Puglia, and it's specialized in the low-priced leisure and sports segment. Its production is based on big highly standardized batches and great usage of plastic raw materials. Its competitiveness is based on low production costs, on-time delivery and production flexibility.<sup>98</sup>

Since companies couldn't individually satisfy the demand for huge quantities of standardized products, firms act collectively to achieve the capacity needed. Therefore, local firms are extremely homogenized.

However, Barletta has been losing its competitiveness,<sup>99</sup> hence companies massively outsource to Albania.

### **Marche**

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<sup>97</sup> By exploiting a niche segment, this cluster benefits from a position of quasi-monopoly. Almost all the largest sports brands have operated in Montebelluna, such as Nordica, Dolomite, Nike, and Lotto.

<sup>98</sup> D'Ercole, M. (2000)

<sup>99</sup> Parolini, C. & Visconti, F. (2003)

It focuses mainly on the medium-high quality footwear production and it's very exports oriented. Its main areas are Ascoli Piceno and Fermano-Maceratese. Nowadays, Fermano-Maceratese is the largest footwear district in Italy. Due to its richness on natural resources, the area is considered an important center for leather tanning.

Its business system is organized through a limited number of business leaders who delegate the stages of the production process to a several small subcontractors. To guarantee the shoe's quality, it only outsources the assembly operations to Romania, Bulgaria and Hungary.

### **Campania**

Aversa's firms work mostly as subcontractors and are focused on the middle segment. The districts lacks of integration among companies, mainly due to strong differences and low entrepreneurial spirit. Therefore, small efforts are made towards integration and innovation, and there's poor availability of common infrastructures. As a result, most firms operate abroad through their independent brands.

### **Emilia Romagna**

San Mauro Pascoli is famous for the production of high quality fashion shoes. Here are produced some of the most famous luxury brands.<sup>100</sup> This district wasn't specially affected by Asian countries production since the high-end production processes are hard to be reproduced, both in terms of quality of materials, craftsmanship and design.

### **Lombardia**

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<sup>100</sup> Such as Gucci, Louis Vuitton, Chanel, Prada, Fendi, Vivienne Westwood, Christian Louboutin, etc.

Vigevano is a traditional footwear cluster that also houses CIMAC - The Italian Centre for Footwear Application Materials<sup>101</sup> – and the International Footwear Museum of Vigevano.

The district was specialized both on sports and low-quality products. It has been affected by the Eastern European and Asian countries competition; therefore it went through a downsizing process. Nowadays it focuses in the production of machinery for the sector, being a global leader in the field.

### **Toscana**

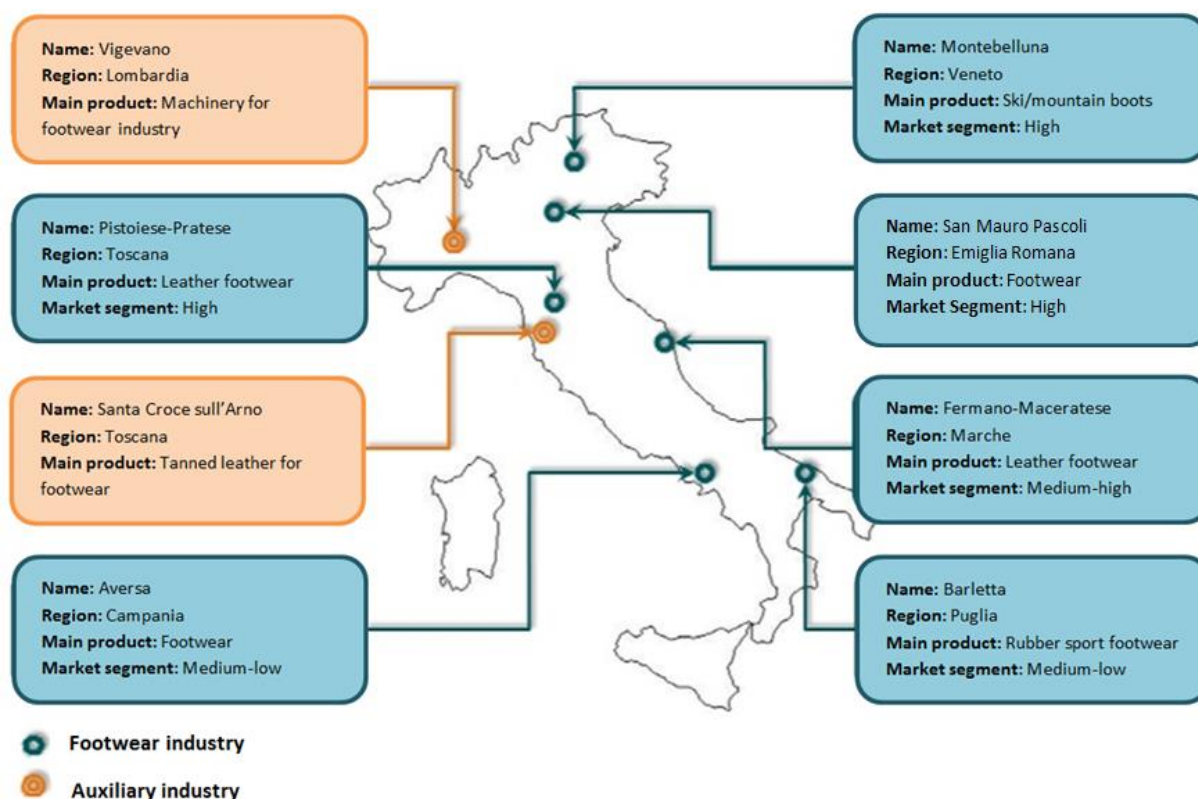
The district of Santa Croce sull'Arno focuses on the medium-high classic shoes segment, some companies work exclusively for big distributors and others have their own brands.

It also produces tanning machinery, accounting for 30% of the national production. The district is particularly sensitive to environmental issues; so it heavily invests in green technologies. To assure quality, the district mainly outsources to other Italian districts.

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<sup>101</sup> Assocalzaturifici's research institute.

## Appendix 16 – Examples of Italian footwear districts



## Appendix 17 – The delocalization of some Italian footwear firms

Most of shoemakers serve both the national and international markets. Due to the globalization, improved transport links and Asian competition, Italian firms started to offshore<sup>102</sup> part of their production chain, mainly to Eastern European countries. In 2007, Italy was the country with the highest number of foreign firms in Romania.<sup>103</sup>

There are two main outsourcing strategies: the subcontracting of intermediate phases – as did the districts of Barletta and Salento - and the subcontracting of assembling and

<sup>102</sup> “Offshoring occurs when the outsourced business functions are done in another country, typically where costs of resources are low.”

<sup>103</sup> Mariotti, J. & Montagnana, S. (2008)



final processing phases.<sup>104</sup> According to Mariotti (2003), Italian firms use these soft forms of internationalization in order to minimize its risks and sunk costs.

Italy is a relatively high labor costs country and the cost of workforce represents a significant part of the total production costs. Following a cost-reducing strategy, companies keep in Italy the most knowledge intensive phases - product design, prototyping, R&D, specialized components production, markets analysis, marketing and distribution. The low-value added and standardized activities - like the shoe assembling – were delocalized into lower costs countries.<sup>105</sup>

Outsourcing only part of the production-chain allows clusters to take advantage of costs differences among countries, while avoiding the desertification of the districts.<sup>106</sup> The decision on which phases to outsource depends to the market segment companies are focused in.

Firms focused on the lower-price segment - such as Barletta - outsource a lot of their production phases and import parts from foreign subcontractors. Some districts also outsourced assembling operations or transferred all their production process. By reducing their costs, firms could face the price competition from emerging countries.

Therefore, these firms adopt a massive delocalization strategy and target the low-priced domestic market, because they cannot compete internationally. However, this strategy isn't sustainable in the long run to face competition from Asian producers.

On the contrary, aiming to guarantee the high quality of its products, footwear districts such as Veneto and the Marche produce locally and outsource mainly the final phases of the production chain – as the assembly phase - rather than intermediate processing.

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<sup>104</sup> Italian companies export intermediate products to foreign subcontractors who processed them into finished products and export them back to Italy.

<sup>105</sup> This strategy is called outward processing (OP) and it's the most common followed strategy in the Italian footwear sector.

<sup>106</sup> Jones, R. & Kierzkowski, H. (2000)

In this case, the decentralization of low-value added activities while focusing on the capital or skill intensive operations – as design and sales – can be worthy and assure the high quality standards of products.

Actually, some believe that the Italian clusters have seen the benefits of its clusters weakening. As stated by Rodolfo Helg<sup>107</sup>, outsourcing abroad is a sign that firms are losing competitiveness, weakening networks on which clusters are built on. So, for clusters to remain successful, they may adapt their structure to the new competitive environment.

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