

Casual Footwear

**A Global Sources white paper on the industry
in mainland China
January 2005**

Executive Summary

This document offers a ground level view of supplier capabilities and product trends in mainland China's casual footwear export industry, as well as the challenges faced by the country's manufacturers heading into 2005.

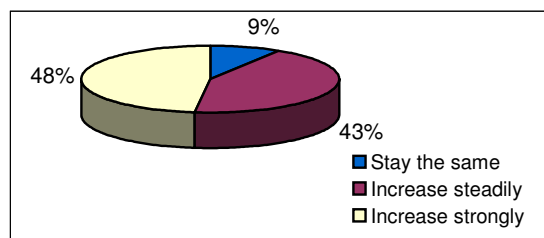
- China is the world's largest producer of casual footwear, accounting for 60 percent of global output; the country exported 6 billion pairs in 2003
- Growth has been steady in recent years, with suppliers registering 15 percent to 30 percent annual export growth. Almost all the companies surveyed for this white paper forecast increased sales in 2005
- A majority of makers have launched plans to boost production capacity by upgrading equipment, increasing factory size or building new plants
- Nearly half of the companies surveyed plan to inflate product prices to maintain profit margins, due to rising material costs and increased plant expenditure
- To have an edge over their competitors, suppliers in China are minimizing their price increases while improving quality and developing value-added designs.

To prepare this white paper, Global Sources surveyed 15 manufacturers, representing a cross-section of mainland China's casual footwear industry. Global Sources toured their factories and spoke with top-level executives who discussed their 2004 performance, and forecasts for 2005.

Industry Overview

China accounts for 60 percent of the world's output of casual footwear; exports reached 6 billion pairs in 2003, worth US\$13 billion. The country has over 4,000 footwear makers, with about 400 exporting directly. Most of these companies are locally owned, and tend to be quick to adapt to market changes and new design trends. Some of these makers are operated by investors from the Taiwan area and Hong Kong SAR, and are mainly based in Guangdong and Fujian province.

Suppliers surveyed report annual export growth of 15 to 30 percent in recent years. Over 90 percent of respondents forecast continued growth in 2005.



Respondents forecasting their 2005 sales

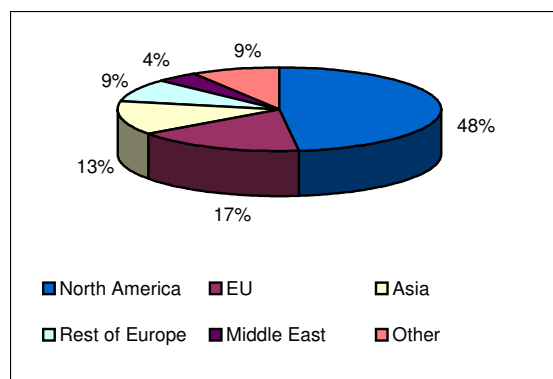
Makers supply mainly low-end to midrange products at low prices (about US\$3 to US\$12 per pair), enabling them to enter export markets. However, there is steady growth in the mid-range export sector, where prices range from US\$18 to US\$55 per pair. Not resting on their laurels, China's manufacturers are moving towards improving the quality of their products in order to stay competitive, not just in relation to other China-based makers but also against rivals in India, Indonesia and Vietnam that offer low-priced footwear.

Product quality is a competitive issue as makers consider raising prices in the coming months due to rising operating costs. The costs of key materials such as PU and leather have gone up as much as 20 percent, and the hikes are set to continue.

China's power infrastructure has had to catch up with the country's rampant industrialization. Power rationing is common, with local governments cutting off power to factories about two days each week on average. Makers have had to purchase backup generators or let their production lines go idle during scheduled blackouts. Labor costs are also rising, as migrant workers return to their home provinces due to improving living conditions. In cities such as Guangzhou and Jinjiang, the labor shortage is as much as 30 percent. Manufacturers have no choice but to offer better wages to attract staff, particularly in the traditionally low-paying footwear industry.

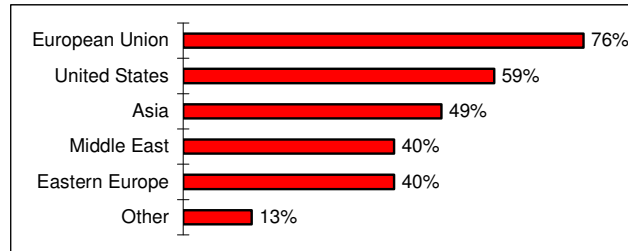
Most surveyed makers say OEM orders account for at least half their output, supplying companies such as Nike, Converse, Diadora, Nautica and Wal-Mart. Makers who produce exclusively for OEM include Paierdun, Shenzhen Smart-in, Pegasus and Nanhai Honghui.

North America is mainland China's biggest export market, followed by the EU and Asia. The US alone absorbed US\$5 billion worth of exports, according to China Customs statistics from May 2003 to April 2004.



China's main export markets

Regarding future growth, 76 percent of respondents see Europe with the most potential in 2005, as quotas are eased on imported footwear priced under US\$10 per pair (see chart, next page). Footwear sold in Europe must comply with restrictions on azo dyes and toxic glues; however, mainland China makers eager to secure orders from the continent are not hindered by these requirements.

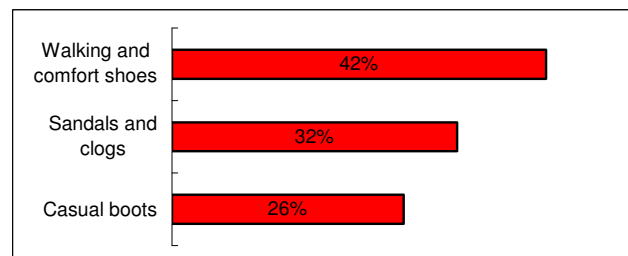


Export markets with greatest growth potential

Companies surveyed also see strong sales to continue in traditional markets such as the US (59 percent of respondents) and Asia (49 percent of respondents). Eastern Europe and the Middle East were cited as having potential for increased sales; suppliers will target these markets with their modestly priced midrange designs.

Product Overview

Casual footwear can be classified into walking and comfort shoes, casual boots, sandals and clogs. Most of the suppliers surveyed can offer products in these three types, with walking and comfort shoes accounting for the largest product line.

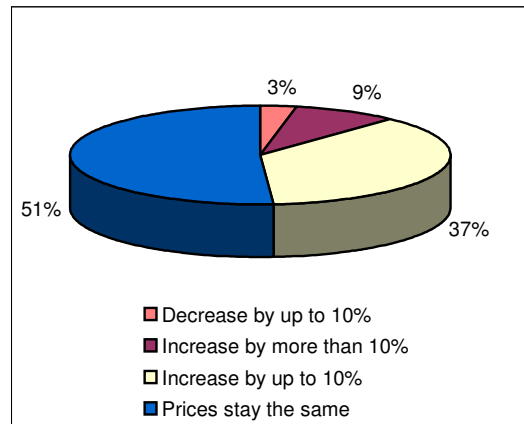


Product export percentages among respondents

Footwear price range

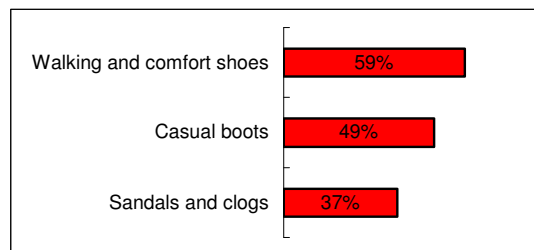
	Walking/comfort shoes	Sandals and clogs	Casual boots
Low end	US\$3 to US\$10	US\$3 to US\$7	US\$6 to US\$12
Midrange	US\$11 to US\$20	US\$8 to US\$17	US\$16 to US\$25
High end	US\$21 to US\$40	US\$18 to US\$36	US\$26 to US\$55

While 46 percent of respondents plan to raise prices in 2005 due to higher material and operating costs, about half of respondents intend to maintain current price levels. These suppliers do not want to risk losing their competitiveness and are willing to accept smaller profit margins.



Pricing trends among respondents for 2005

Fifty-nine percent of suppliers surveyed see walking and comfort shoes as having the best growth potential in 2005, followed by casual boots, and sandals and clogs. China's price advantage largely drives export growth.



Products with most potential among respondents

Walking and casual shoes

Suppliers offer walking and comfort shoes in a range of men's and women's styles, including flats, loafers, moccasins, Mary Janes, oxfords and deck shoes.

Low-end models usually have canvas or regular PVC uppers, though some designs in this price range are made of PVC leather. Rubber is the standard sole material. Most low-end shoes are vulcanized, meaning that a chemically treated rubber sole is "welded" onto the upper. Vulcanized models typically do not have midsoles.

Midrange designs have uppers made of regular PU or PU leather, the latter closely resembling the look and texture of genuine leather, and can come in a wide range of colors. Well-made PU leather looks identical to genuine leather even when held up close. However, it costs five times as much as PVC materials.

The midsoles of midrange shoes can be made of phylon, a material that is lightweight yet shock-absorbent. However, phylon shoes are 20 percent more expensive than models with midsoles made from other materials. Another popular material is TPR, which is flexible and enhances shoe comfort. Some companies offer shoes with cork midsoles for a special look. China makers use PU, TPR, TR and rubber for outsoles of midrange designs.

Makers use genuine leather to produce high-end walking and comfort shoes. Most of these designs are handmade, with better stitching than less expensive models. They might also have special interior structures to enhance comfort, such as enlarged toe boxes or more spacious heel areas. Embossing is another feature that sets high-end designs apart.

Most China suppliers that produce genuine leather designs also make shoes in other materials. At such makers, the genuine leather line usually accounts for no more than one-third of production. As genuine leather is the most expensive footwear material, it forces products into the high end, where buyers' quality requirements are also high. The shoes usually have to be made by hand to meet quality standards, meaning that production is slower and output lower than for walking and comfort shoes made from materials such as canvas, PVC or PU. Interested in high volume, many China suppliers avoid genuine leather; however, the country also has suppliers that specialize in genuine leather walking and comfort shoes.

Sandals and clogs

Most China suppliers that produce walking and comfort shoes also make sandals and clogs as a sideline. Production in this line usually takes up between 5 percent and 30 percent of a maker's total output. However, there are makers in China that emphasize the line more heavily; sandals and clogs account for 100 percent of output at Shantou SEZ and Shantou Yidaxing. Large-scale supplier Pegasus produces 220,000 pairs of sandals and clogs monthly, or 40 percent of total output.

Sandals and clogs require an emphasis on comfort and color perhaps more than any other type of casual footwear. For this reason, most China makers are using PU as their main sole material, because it is highly flexible and accepts a wide range of colors. TPR and EVA are also commonly used but PU is even more resilient and lightweight. PVC is another choice for sole material, but only on the least expensive of low-end models.

China suppliers use polyester, vinyl, PVC and PVC leather for the vamp and straps of low-end models. Soles are generally made from rubber and TPR. Midrange designs mostly come with PU leather vamps, but some genuine leather models are also priced for this category. EVA is sometimes used as well. To accommodate tight budgets, makers can use nylon fabric straps instead of leather ones on sandals.

PU, TPR, Texon, Modal and EVA are common sole materials on midrange designs, and phylon is gaining popularity for the more expensive midrange models because of its lighter weight and greater flexibility. One new launch by Pegasus is a sandal with woven nylon strap, EVA back, and rubber EVA/phylon sole.

Where midrange sandals and clogs would have denser stitching than low-end models, high-end designs go further with double- or even triple-stitching. High-end sandals and clogs from China have genuine leather vamps and straps.

The most expensive designs use top-grain or full-grain cowhide, calf hide and sheepskin, as these materials are the most lustrous and durable. Action leather, which is cow split covered with a layer of PU, is popular as the most breathable type of leather. Makers also offer genuine leather with nubuck and napa surface treatments. Phylon is a favorite material for the soles of high-end designs. China suppliers are producing models with special features. These include printed fabric uppers that give models more eye appeal, waterproof uppers and slip-proof models.

Casual boots

Around one-third of China's casual footwear suppliers produce boots, and these account for 5 to 30 percent of a supplier's total output. Only one company among the respondents – China Feiqin Shoes Industry – manufactures boots exclusively.

China suppliers offer casual boots in light, mid- and heavy weights, and ankle, midcalf and calf lengths. Men's and women's designs are offered. Lightweight models, featuring mostly fashion boots for social or office wear, emphasize comfort and style but are less durable due to using thinner materials. Midweight designs have thicker materials but less breathability. These models are made generally for daily wear but some could also handle hiking trails.

Heavyweight models are made of sturdier materials, and target hikers and street fashions. Such designs provide the most support but are less comfortable and breathable. They have a high degree of ankle and foot protection and waterproofing.

Casual boots are made from either synthetic or genuine leather, sometimes in combination with mesh fabric when enhanced breathability is required. PVC leather is used for low-end designs. Midrange designs are made largely from PU leather, which costs about 60 percent more than PVC leather.

Genuine leather dominates the high-end. It is also used for some midrange models, particularly in combination with mesh for reduced cost. Genuine leather has a natural water resistance but costs up to 30 percent more than synthetic materials. China footwear suppliers are producing boots in full-grain, split-grain, suede, napa and embossed genuine leather. Makers are using cowhide, pigskin and sheepskin. Among the latest releases, Nanhai Saturday is offering a women's midcalf model with combined cowhide and sheepskin upper accented by buckle straps.

Two drawbacks of real leather are that it is much heavier and far less breathable than synthetic leather and other materials. Some new releases feature genuine leather combined with nylon mesh for reduced weight and increased airflow. The technique is used on midrange and high-end boots. Suppliers are targeting leather/nylon boots at warm climates. Besides being lightweight and breathable, these models are more comfortable than full-leather designs. The use of nylon can also reduce the cost of a leather boot by 40 percent.

Microfiber is another alternative material gaining popularity for midrange and high-end designs. Much lighter in weight than genuine and even synthetic leather, microfiber is made from yarn with a fineness of less than one denier. However, this new material is more expensive than PU leather, as most of it has to be imported. Makers can apply various kinds of waterproofing treatments. Some makers are approved to use Gore-Tex materials, but most apply other types of waterproofing. Rubber, PU, TPR and TR are used for boot soles.

Top exporters among respondents

Walking and comfort shoes:

1. 400,000 pairs/month: Qingdao Over-World Group
2. 300,000 pairs/month: Nanhai Honghui
3. 275,000 pairs/month: Pegasus

Sandals and clogs:

1. 400,000 pairs/month: Qingdao Over-World Group
2. 250,000 pairs/month: Xiaoshan Friends Shoes
3. 220,000 pairs/month: Pegasus

Casual boots:

1. 270,000 pairs/month: Shenzhen Art Star
2. 210,000 pairs/month: Hanbee Shoe
3. 200,000 pairs/month: Wanbang Shoes

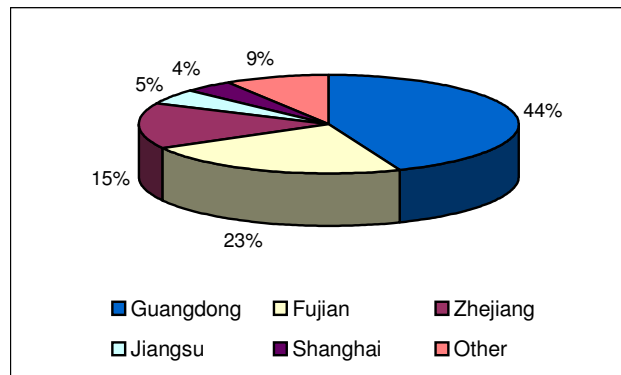
Surveyed suppliers with top annual export revenues:

1. Hanbee Shoe Co.: US\$70 million
2. Pegasus International Holdings: US\$70 million
3. Fuguiniao Group Footwear Marketing Management: US\$31.5 million
4. Nanhai Honghui Footwear: US\$23 million

5. Nanhai Saturday Shoes: US\$6 million

Manufacturing

China's major production centers



Casual footwear supplier demographics for China

Guangdong province accounts for 44 percent of China's casual footwear exports, totaling 3 billion pairs annually. Suppliers in Guangdong focus on midrange and high-end models, the majority of which are handmade from genuine leather. The emphasis on quality means leather designs made in Guangdong cost 20 percent more than those made elsewhere on automated machines. Guangdong's main production centers include Guangzhou, Huizhou and Foshan.

Fujian province is the second largest source of casual footwear. The province's makers focus on midrange models, priced at US\$6 to US\$18 per pair. Fujian and Guangdong are the major investment areas for shoe manufacturers based in the Hong Kong SAR and Taiwan area.

Zhejiang province is the main hub for low-end to midrange designs. Prices go as low as US\$3 per pair. Suppliers here specialize in synthetic leather designs; the cities of Wenzhou and Jiaying are major production centers of PU and PVC leather in mainland China, with Wenzhou accounting for about half the national output.

Sichuan province's shoe makers specialize in women's footwear. Many suppliers focus on the emerging market in Russia. Jiangsu and Shanghai are other minor production centers for China's footwear sector.

Typical production profile

These figures are the median for data gathered from interviewed suppliers:

- Monthly production capacity: 200,000 units
- Monthly production output: 150,000 units
- Capacity utilized: 81 percent
- Monthly exports: 80,000 units
- Export percentage: 78 percent
- Number of products or models: 100
- Production lines: 5

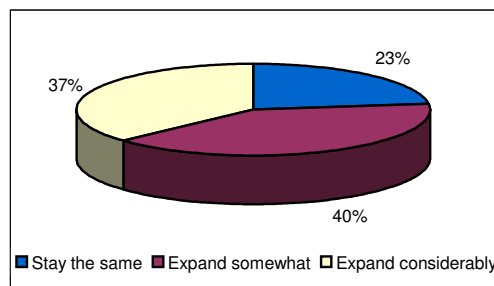
A number of large and small companies have been in business for more than 10 years, particularly those that employ more than 1,000 workers.

Respondents leading in monthly capacity:

1. 2 million pairs: Qingdao Over-World Group
2. 650,000 pairs: Guangdong Jinhan Group
3. 650,000 pairs: Jiangxi Gofar Industrial

Foshan Nanhai Dexing has a monthly capacity of 27,000 pairs, the lowest among the companies surveyed. Capacity utilization is generally high, and is not related to the company's size; Foshan Nanhai Dexing (a small company) and Pegasus (a large company) both use their entire production capacity.

A majority of respondents plan to expand their production capacity in 2005 to meet rising demand. Expansion includes building new factories or adding new production lines to existing plants.



Companies with expansion plans for 2005

Suppliers surveyed leading in monthly output:

1. 2 million pairs: Qingdao Over-World
2. 550,000 pairs: Pegasus
3. 500,000 pairs: Wanbang Shoes and Xiaoshan Friends Shoes

OEM remains the core business for most suppliers, accounting for the entire export production of makers such as Pegasus, Paierdun, Shenzhen Smart-in and Nanhai Honghui. Most of the other companies say OEM accounts for at least half of their output. However, a growing number of small to midsize companies are focusing on ODM work and in-house labels as a way of finding their niche in the market. In-house designs and ODM can account for up to 100 percent of production for some of these manufacturers. Respondents that mainly rely on ODM work and in-house designs include Fenghao Leather Goods, Nanhai Saturday and Wenzhou Anjili.

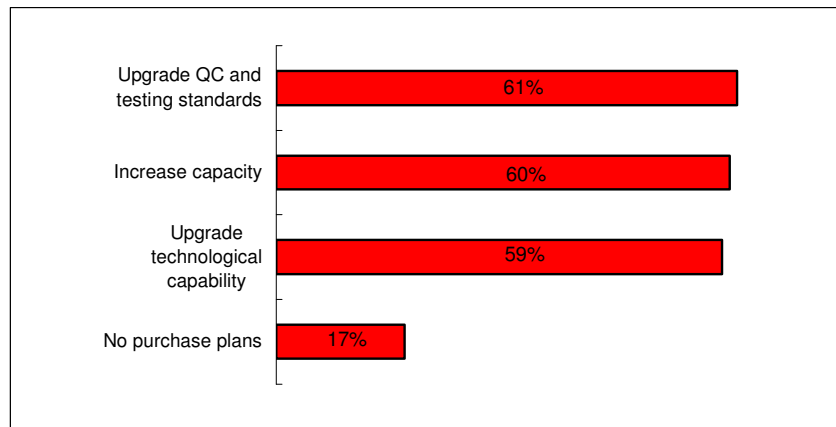
A supplier for the most part offers the same delivery time for the different segments of his catalog (e.g., 30 days for casual boots, 30 days for sandals). While a majority of the companies surveyed offer 30-day delivery time, several makers can deliver in a shorter period. Jiedeng Shoes has the fastest delivery time: seven days.

Key manufacturing processes

Cementing and vulcanizing are the two main processes for attaching uppers to soles. Cemented construction involves gluing the outsole, midsole and upper in a thermal bonding process, and is applied more towards midrange and high-end shoes. Vulcanizing construction is for low-end products, and is a forming process by which the rubber sole is treated chemically to intensify its hardness, then “welded” to the upper under high heat.

The majority of the companies visited for this report use cemented rather than vulcanizing construction processes. While makers still use toxic glues for cemented construction, they can use nontoxic glue upon request. Nontoxic glue is sourced from Japan or the Taiwan area and costs about US\$1.20 per kilogram, 30 percent more than traditional adhesives. Suppliers tend to use nontoxic glue in high-end products. The majority of makers also outsource their midsoles and outsoles, rather than investing in injection molding equipment. Of the 15 interviewed suppliers, only Pegasus, Aide Bao, Wenzhou Guoding and Hengfa (Fujian) Light Industry produce their own soles. Other processes that many footwear companies usually subcontract are computerized embroidering, embossing and silk-screen printing.

Popular machine brands makers source from include Taiwan's Golden Wheel and Chee Siang, as well as Japan's Mitsubishi and Brother. While most makers use Brother zigzag machines for special tasks, others purchased less expensive systems from domestic suppliers, mainly those based in Zhejiang province. The bigger the company, the more equipment it will have: large makers have 500 to 1,000 sewing machines, for instance. Most respondents plan to acquire new equipment over the next 12 months to improve their quality, capacity and capability.



Equipment purchase plans of respondents

Sixty-one percent of firms surveyed plan to upgrade product quality by acquiring new QC and testing systems. Improvements will range from small (e.g., purchasing metal detectors to make sure sewing needles are not left in shoes) to major investments (e.g., setting up a fully equipped in-house testing lab). Sixty percent of respondents will buy new equipment to increase their production capacity. Fifty-nine percent of respondents will acquire software and hardware for the purpose of upgrading technological capability.

Most surveyed companies have in-house QC departments. Nine of the 15 manufacturers surveyed are certified to an ISO standard.

Research and development

The general trend within the industry is towards improved quality and product features, as makers seek to add to their low-price advantage. The size of an R&D team depends on the company's output and emphasis on in-house designs:

- Large-scale makers: an average of 100 staff, US\$2 million annual R&D budget
- Midsize makers: about 50 R&D staff, US\$200,000 for their R&D budget
- Small-scale makers: might have just 10 staff, US\$75,000 annual R&D budget

The manufacturers who invest the highest percentage of their sales in R&D are:

1. Nanhai Hongui Footwear Co. Ltd: 7.8%
2. Paierdun Light Industry Co. Ltd: 4.9%
3. Pegasus International Holdings Ltd: 4.6%
4. Aide Bao Shoes Development Co. Ltd: 4.2%
5. Fenghao Leather Goods Co. Ltd and Fuyi Shoes Co. Ltd: 3.8%

About 72 percent of companies surveyed indicated they would increase R&D spending in 2005.

Midsized makers release 300 to 500 new designs annually. Large makers such as Fuguiniao and Nanhai Hongui roll out up to 1,000 new models each year. Design work is done manually and through the use of computer systems. Makers usually draft ideas on paper first, then flesh them out using AutoCAD, 3D Studio Max, CorelDraw and Photoshop software. It takes six to 12 months for a new concept to go from draft to prototype to mass production.

R&D trends include creating sole structures that reduce shock and distribute pressure more evenly, as well as making shoes lighter. Another trend is the use of new materials that are more durable and environment-friendly. For example, Texon and microfiber are becoming popular alternative materials for midsoles and uppers, respectively. Companies are also mixing materials to cut costs, such as combining leather with meshed fabric on uppers.

For casual shoes and boots, makers will release designs in 2005 that are lighter in weight and more comfortable to wear. To facilitate these features, new models will feature split-grain leather mixed with nylon, or fabric combined with synthetic leather. However, these designs are not as water-resistant as full leather models. For this reason, classic designs in genuine leather will remain the major line.

Designs for sandals and clogs emphasize color and comfort. For this reason, most suppliers use PU as their sole material. TPR and EVA are also commonly used, but PU is more resilient and lightweight. Trends for sandals and clogs include printed fabric uppers to make models more attractive, uppers that are waterproof, and product designs that are lightweight and slip-proof.

Companies surveyed

Aide Bao Shoes Development Co. Ltd
Fenghao Leather Goods Co. Ltd
Forworld Shoes Co. Ltd
Foshan Nanhai Dexing Shoes Habilmente Co. Ltd
Fuguiniao Group Footwear Marketing Management Co
Fuyi Shoes Co. Ltd
Hengfa (Fujian) Light Industry Co. Ltd
Nanhai Honghui Footwear Co. Ltd
Nanhai Saturday Shoes Co. Ltd
Paierdun Light Industry Co. Ltd
Pegasus International Holdings Ltd
Shenzhen Smart-In Ind. Co. Ltd
Wenzhou Anjili Shoes Co. Ltd
Wenzhou Aojue Shoes Co. Ltd
Wenzhou Guoding Shoes Industry Co. Ltd