

FDRA

FOOTWEAR DISTRIBUTORS AND RETAILERS OF AMERICA



2015

Global Footwear Sourcing Assessment



Change is coming fast and furious in the world of global footwear production. Sourcing executives and professionals are faced with rapidly changing challenges all over the world, while at the same time US footwear retailing is dramatically evolving.

The moment you have a grasp on current market place conditions, trends have substantially changed and your sourcing model is stale and out-of-date. These changes require an adept and nimble sourcing operation that tracks changing dynamics and implements on-the-fly alterations. This is the era of change...this is the era of omnisourcing.

About FDRA

Since 1944, the Footwear Distributors Retailers of America (FDRA) has been the footwear industry's voice in Washington, DC. Today, FDRA's voice is stronger and more respected than ever. FDRA has also enhanced its member services and support and is now the industry's intelligence hub. FDRA provides its members valuable business intelligence and expertise on a variety of trends and topics including product safety, customs, sourcing strategies, intellectual property and social compliance. It is also the only association able to provide in-depth sales data and analysis for footwear retailers. In short, FDRA boosts its members business. Visit www.fdra.org to learn why over 80% of the U.S. footwear industry belongs to FDRA.

FDRA forecasting seeks to provide the footwear industry with information and critical thought to better prepare it for global challenges and threats that may impact footwear businesses. All forecasts herein should not be considered legal advice in any way.

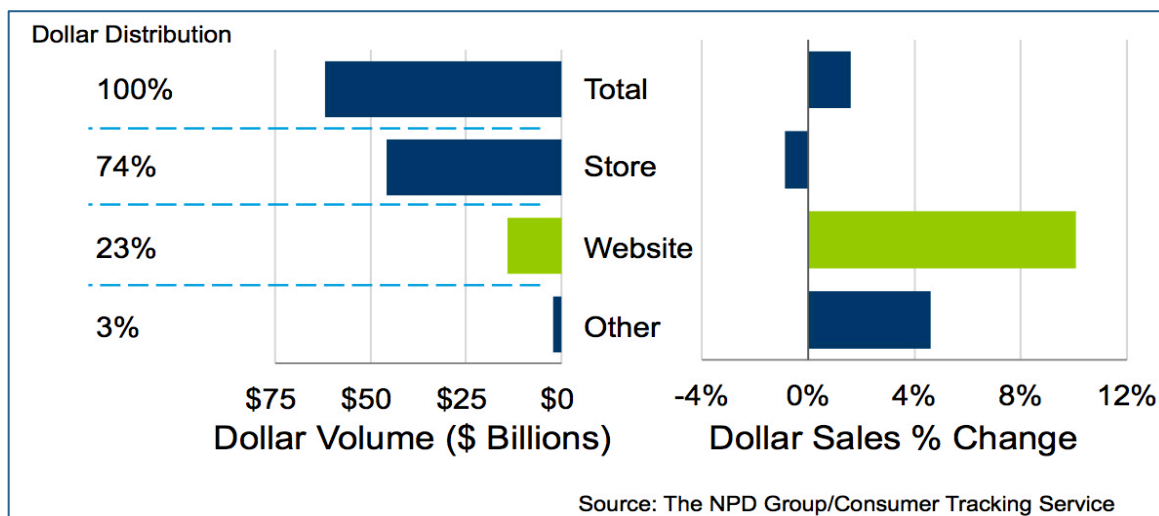
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#OMNIVATION

Is there a more overused term in global footwear retailing today than omnichannel? Or any retail for that matter. The word is everywhere – seminars, workshops, summits and throughout the press. It's absolutely unavoidable! It's also an unavoidable fact that American footwear consumers are shopping, browsing, trying and buying shoes in more ways than ever before. The days of solely relying on department stores and independent retailers for shoe buying are long gone. So much so that according to the NPD Group, 23% of total footwear dollar sales were generated online in 2014 – a 10 percent increase over the prior year. An astounding \$14.2 billion of the \$62 billion in footwear sales in 2014 were generated online.¹ This would have been unheard of just three or four years ago. So, in an effort to capture the rapid evolution of American consumer buying habits, and the multitude of options and tools now available to said consumers, the omnichannel term was born...and used, and used again, and again, and over and over again.



Chart 1



The rampant use of the omnichannel term speaks to the broader phenomenon impacting the global retail landscape. Retailers are rapidly exploring new and innovative ways in which to engage consumers, as consumer buying habits continue to change at a brisk pace. For those retailers that ignore the rapidly changing trends taking place all around us, they do so at their own peril. Innovation is driving change throughout the footwear supply chain – in every aspect of how the industry sources and sells shoes – omninnovation or omnivation, if you will. If a company is not omnivating – innovating in all channels of their business – they will find themselves on the outside looking in on growth and expansion and the selling of more shoes.

Selling shoes is what this industry is all about – it's the core mission of the global footwear supply chain. Finding the right product for the right consumer for the right occasion or activity is the goal. In 2014, the U.S. imported 2,332,737,404² pairs of shoes from all over the world. Even though

¹ Source: The NPD Group, *The U.S. Footwear Industry 2014 Annual Market Drivers*, March 2015

² Source: International Trade Administration (ITA), otexa.trade.gov

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imports in 2014 were flat in comparison with 2013, 2.3 billion pairs of shoes is an astronomical number for 320 million consumers. This is where FDRA normally and predictably provides an astounding ratio of imports per person – such as 7.3 for every man, woman and child in the U.S. – but we will fight the urge and let you use your omni-mathematical skills to calculate that number on your own (don't be shocked if it's close to 7.3).

Chart 2

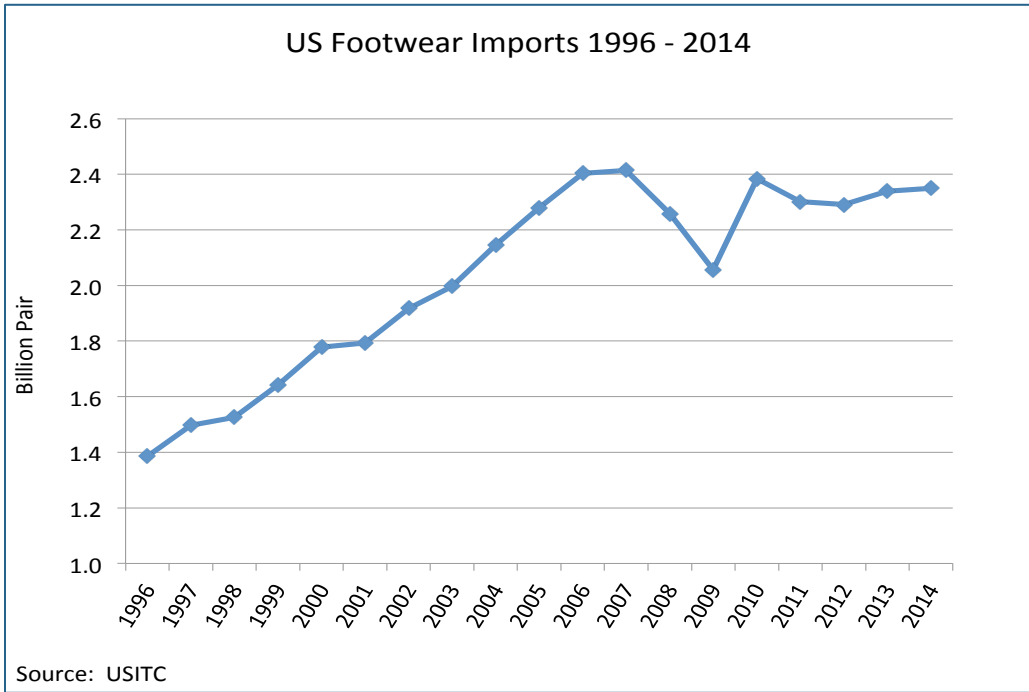
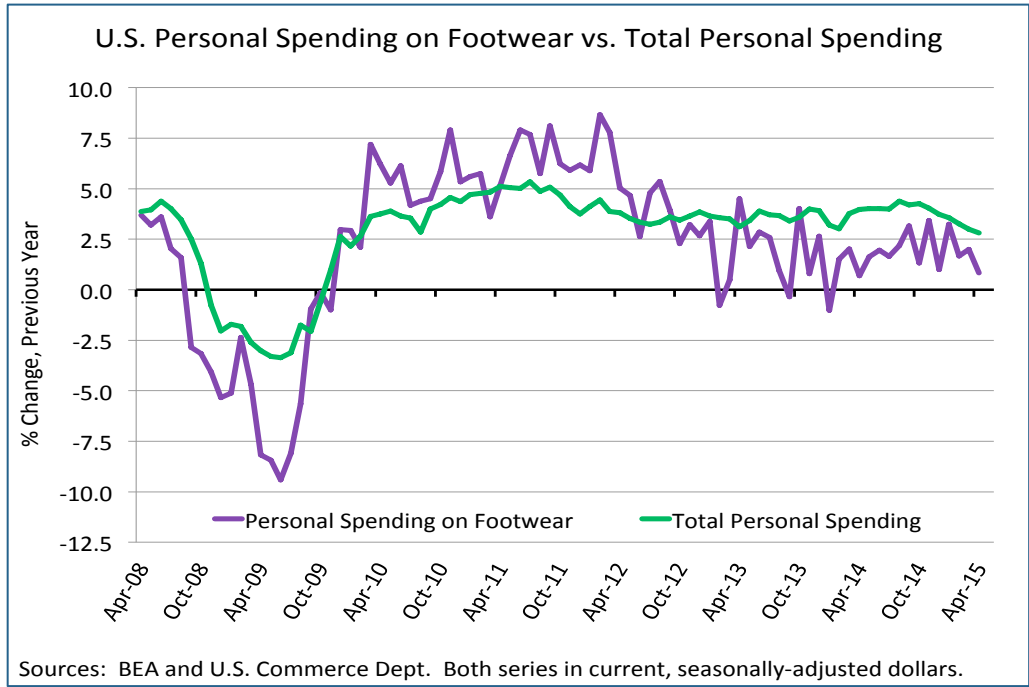


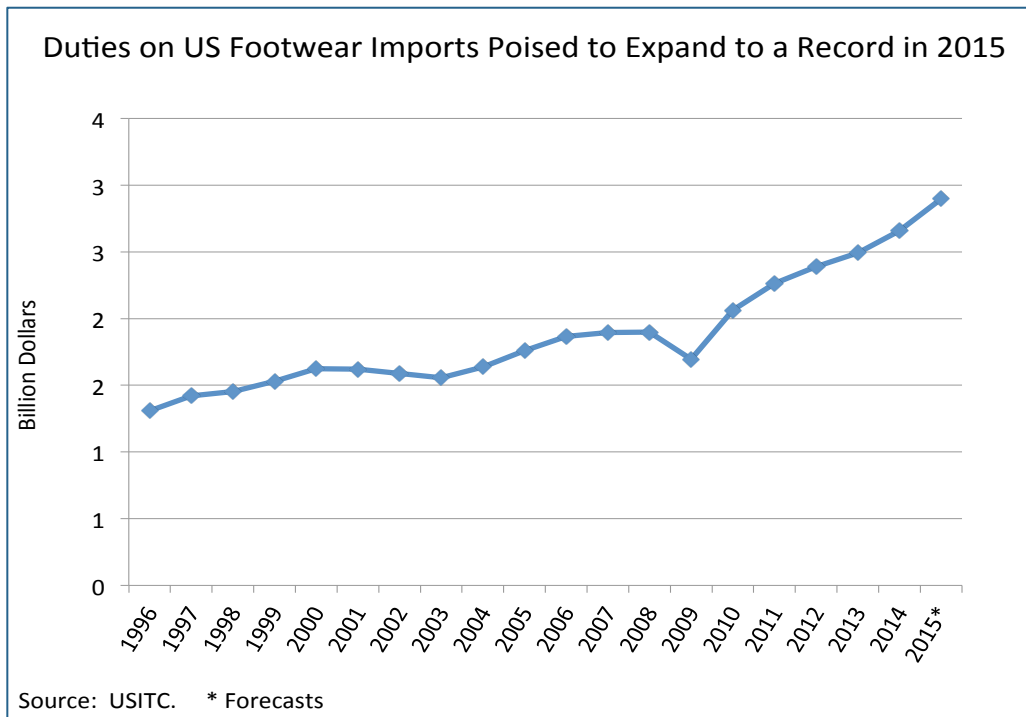
Chart 3



Duties on U.S. footwear imports in 2014 were at record levels reaching \$2,671,841,761. Footwear import duties accounted for 8.2% of all duties collected last year, even though footwear only

accounted for 1.1% of the value of all U.S. imports.³ The increase in footwear duties is not expected to go away any time soon, especially absent of any concerted efforts to reduce duties via trade agreements and preference programs (Chart 3). It is fully expected that total duties collected on footwear imports in 2015 will come close to \$3 billion – another record.

Chart 4



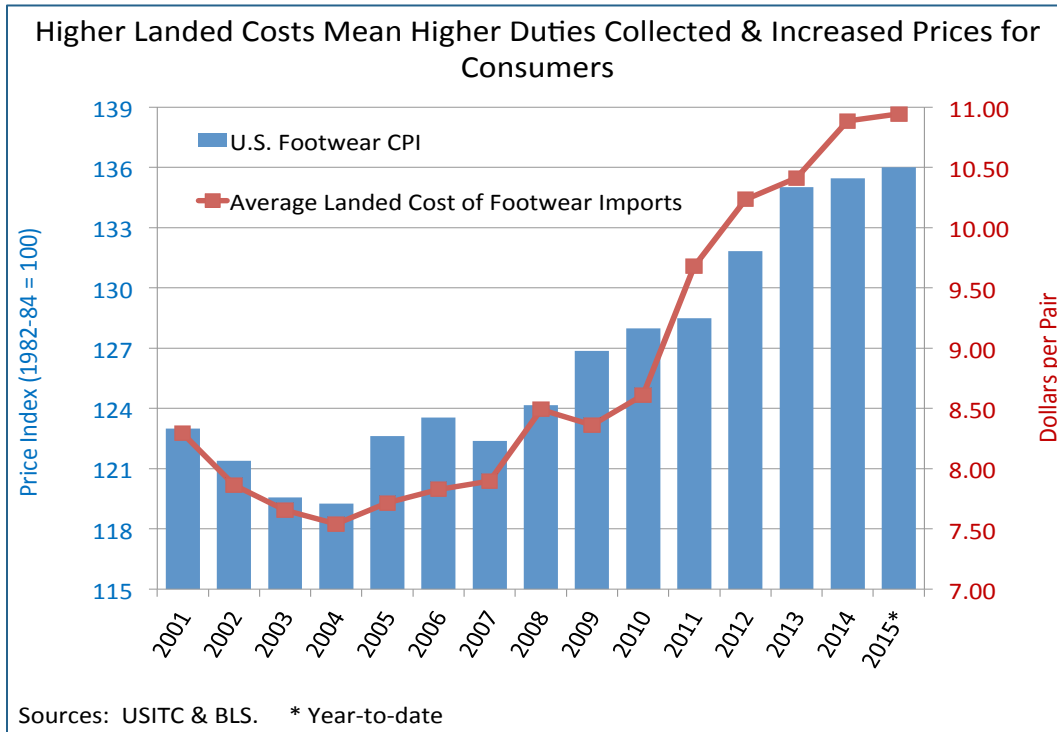
Footwear duties are a percentage calculated against the price of the shoes as they cross the U.S. border. The higher the freight on board or FOB price of the shoes, the higher the amount of duties by value that are charged to the footwear when imported and declared by the importer of record. Since prices continue to rise, and have been doing so on average 5% every year from 2011 to 2015, the amount of duties collected on footwear imports have also increased. In fact, in 2011, the average price on imported footwear increased an astonishing 12%. That same year, the overall inflation for all consumer goods was 3.16% or slightly above the historical average annual increase of 2.94%⁴. Increases in the cost of shoes have a direct impact on consumers purchasing shoes as seen in Chart 4 – particularly those consumers purchasing shoes that fall under higher duty rates

Duties on U.S. footwear imports in 2014 were at record levels reaching \$2,671,841,761.

³ Source: International Trade Commission (ITC)

⁴ Source: Consumer Price Index 2011, Bureau of Labor Statistics (BLS)

Chart 5

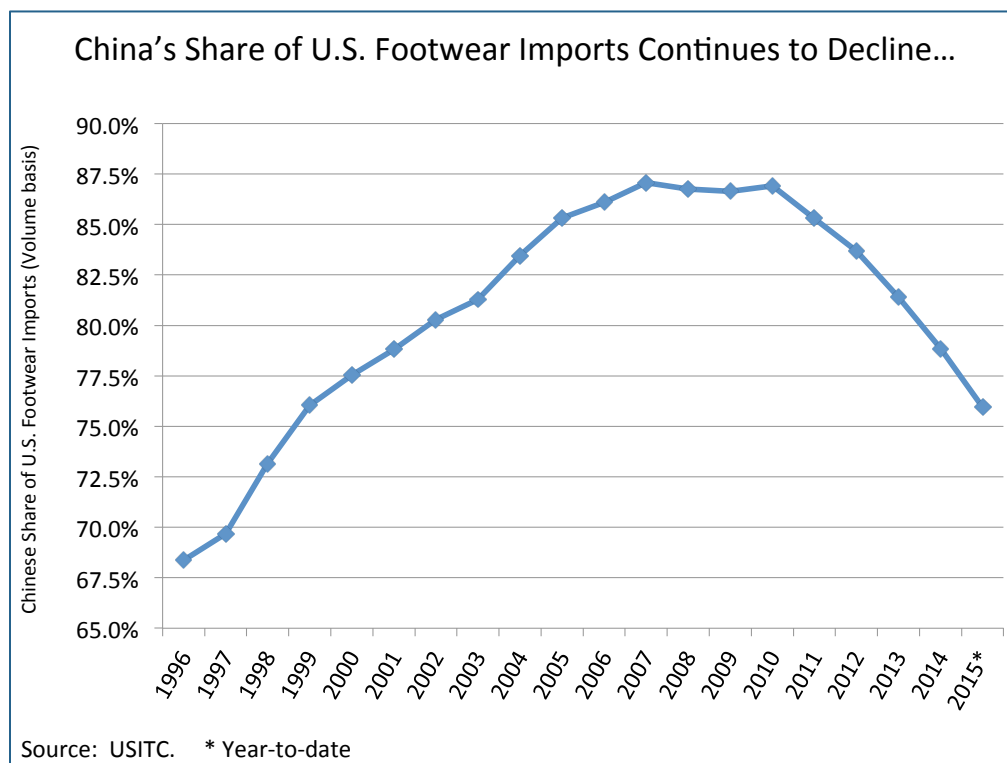


#OMNISOURCING

With the lightning pace at which footwear retailing is changing it is important to understand that footwear sourcing has also continued its unprecedented era of change. Continuing with our theme of attaching omni to just about any word we can get our hands on, we now find the industry in the era of omnisourcing. For years, footwear was almost singularly sourced from one country, or at the most from China plus one additional secondary supplier. With the exception of some premier athletic footwear brands who were a bit more diversified than the average footwear company, China has been the dominant supplier of footwear for what seems like ages. In 2007, China's market share of U.S. footwear imports peaked at 87%, with even 97% of some footwear types being sourced from the major footwear powerhouse. Those days are long gone with the continued and rapid decline of China's share of U.S. footwear imports. China now accounts for 79% of U.S. footwear imports and FDRA clearly expects that number to drop to close to 75% by the end of 2015.



Chart 6



The reasons for China’s decline as a supplier of footwear are well documented and accepted at this point in time. Countless reports, studies, assessments and FDRA publications have chronicled the social and economic changes taking place in China’s coastal provinces, which have long housed a vast majority of footwear manufacturing facilities in China. These changes have resulted in higher wages, increased living costs, a growing middle class and a stronger desire for factory workers to find production jobs in higher valued manufacturing or jobs in the service industry. This is the new reality of China. So much so, that only 25% of respondents to FDRA’s 2015 Factory Survey indicated that the labor shortage was a significant business challenge – down significantly from prior FDRA factory surveys.⁵

On the rise

Minimum wage per month (US\$)

Effective date

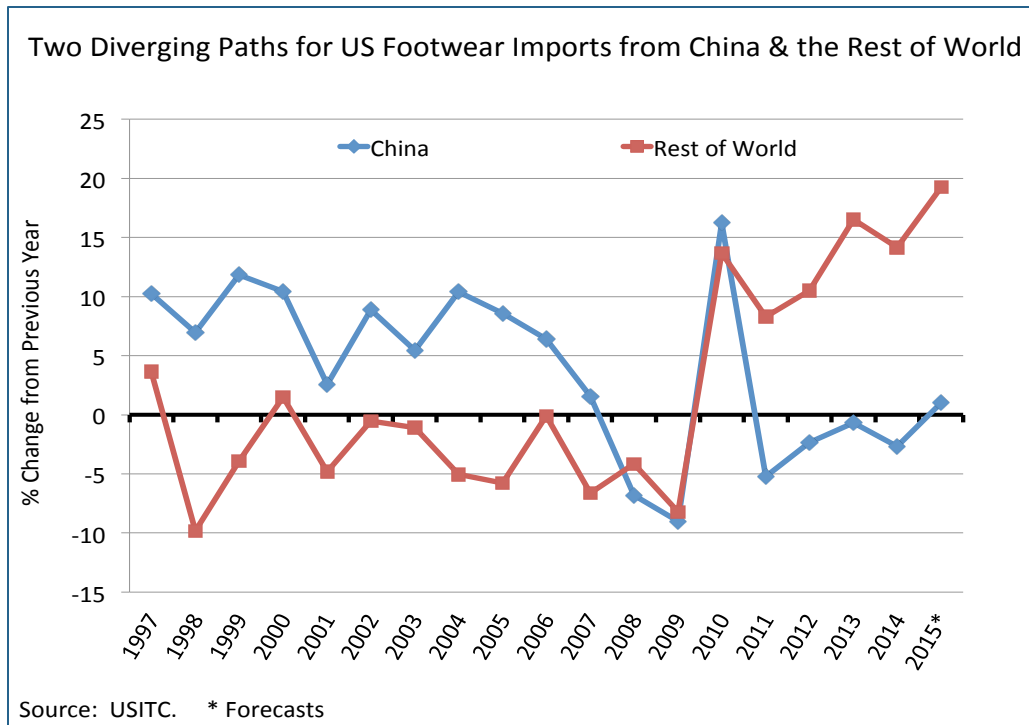
China

Shanghai	291.8	April 1, 2014
Dongguan	290.19	April 1, 2014
Shenzhen	289.87	Feb 1, 2014

⁵ Source: 2015 FDRA Factory Survey Analysis

This new reality is no longer new but is no less a reality for the changing global footwear production landscape. Export growth is growing more substantially in markets other than China – a trend that began in earnest in 2011 as seen in Chart 7.

Chart 7



The Race to Vietnam

2015 will go down in history as a year when trade liberalization advanced in two substantive ways. First and foremost, after an eight-year hiatus, Trade Promotion Authority (TPA) was renewed in the summer of 2015 for President Barack Obama. Every president since Franklin Delano Roosevelt has enjoyed Trade Promotion Authority (TPA) as a tool to negotiate free trade agreements with other nations and send those agreements to Capitol Hill for an up or down vote by Congress without amendment. Often controversial, the authority expired in 2007 when TPA ran out on then President George W. Bush. Passing TPA is seen as critical to finalizing and advancing the Trans-Pacific Partnership (TPP) before President Obama leaves office in January 2017.

The second major advancement in footwear trade liberalization is the anticipated completion of all negotiations surrounding TPP. Since its launch in 2009, TPP negotiators from all 12 nations have been working around the clock to find consensus on a number of politically difficult issues. With the passage of TPA it is widely expected that the negotiators will finalize the agreement sometime this summer, closing out the remaining points yet to be finalized, including the treatment of footwear under TPP. At the time of the writing of this report, FDRA





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expects that of the 120 harmonized tariff system (HTS) lines covering footwear at the eight digit level, 103 of those lines will be duty free on day one of the agreement. The remaining 17 lines that have historically been considered politically sensitive, will see an up front duty cut in the range of 30 to 40% with the remaining duties coming off 12 years after the implementation of TPP. These lines will include athletic footwear with an FOB price over \$12 and protective and specialty footwear.

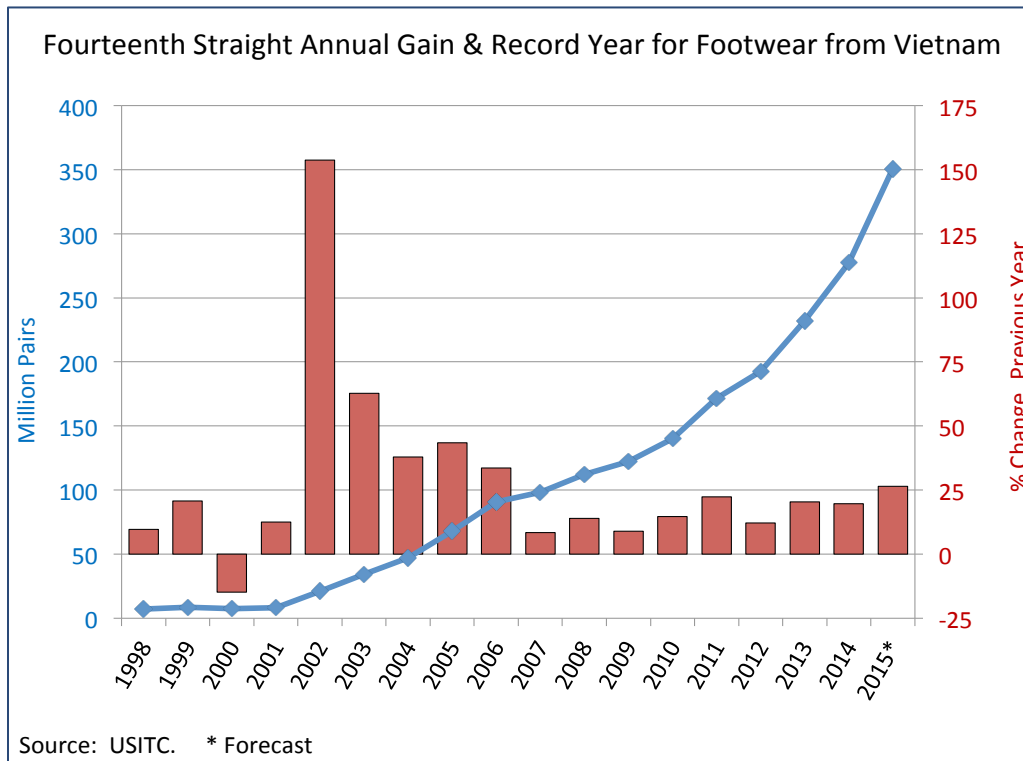


Even after the agreement is agreed to by all nations involved, it will take significant political will to pass the implementing legislation that implements TPP both here in the United States and in the other participating countries. There will be no lack of political and economic will both here at FDRA and throughout the industry. Vietnam continues to grow as a supplier to the U.S. market place at an impressive rate. In 2014, footwear exports from Vietnam to the United States grew a robust rate of 19% over 2013. These growth rates were preceded by increases of 20%, 13%, 22%, and 12% in 2013, 2012, 2011, and 2010 respectively (Chart 8). And in 2015, increases in Vietnamese footwear exports to the US have grown even more rapidly as US Vietnamese footwear imports are up 26% through April 2015.⁶

In 2014, \$448,941,403 in duties was collected on US footwear imports from Brunei, Japan, Chile, Peru, Mexico, Canada, New Zealand, Malaysia, Australia, Singapore, and Vietnam...

⁶ Source: International Trade Administration (ITA), U.S. Department of Commerce, <http://otexa.trade.gov/FLT/imports/cat10.htm>

Chart 8



With growth in footwear exports to the American market come increased duty collections on said exports. Duties are up significantly on US footwear imports from TPP countries over the past several years. Vietnam has historically produced an assortment of footwear, most notably athletic shoes, that fall under higher US duty classifications than those of China, so a simple comparison of duty rates between the two countries will review a higher per-pair duty collected on shoes from Vietnam. Beyond this comparison, it is easy to see that the average growth rate on duties paid is increasing more significantly for TPP countries, from which most are from Vietnam. In 2014, \$448,941,403 in duties was collected on US footwear imports from Brunei, Japan, Chile, Peru,

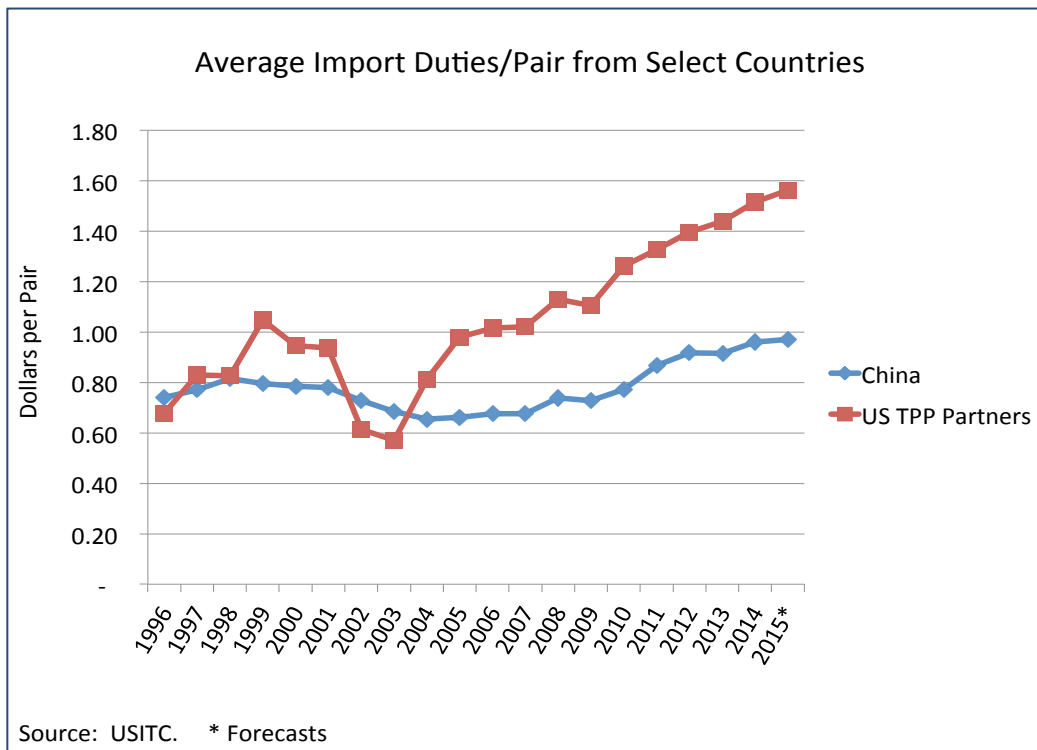


Mexico, Canada, New Zealand, Malaysia, Australia, Singapore, and Vietnam – America’s 11 TPP trading partners. Vietnam’s share of these duties was \$446,027,853 or 99.3%.⁷

No matter what the reason behind Vietnam’s growth – price pressures and labor shortages in China or anticipation over duty free under TPP – the economic importance of passing TPP grows with each passing day. This is to say that TPP is more valuable to the footwear industry now than it was just last year or the year before. Growth has brought on additional opportunities for exporters while at the same time increased the urgency and need for an agreement that will significantly reduce, and ultimately eliminate, high duty costs on footwear from TPP countries. This is why passing the Trans-Pacific Partnership is a once-in-a-generation opportunity to drive significant and dramatic cost savings throughout the global footwear supply chain – creating jobs, lowering costs and increasing innovation in this era of change.

⁷ Source: International Trade Commission (ITC)

Chart 9



In fact, there is even concern that with increased demand brought on by the prospects and final conclusion of TPP, prices will dramatically increase in Vietnam driven by a rush to secure capacity in footwear factories. Nevertheless, until TPP is a reality and due in large part to the ongoing price pressures seen in China, Vietnam will continue to see growth and in turn drive capacity growth to its neighbors in the region.

Cambodia Surge Continues

As noted in the 2014 FDRA Sourcing Intelligence Assessment, one of the beneficiaries of Vietnam's

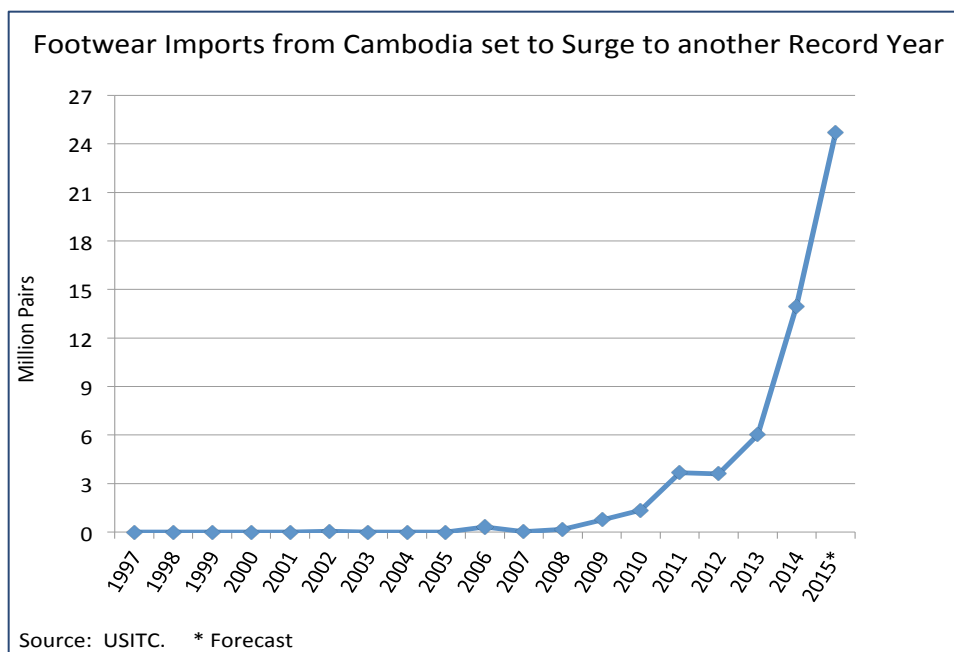


growth is its immediate neighbor to the West, Cambodia. Cambodia is seeing impressive growth in exports to the United States. This development is sticking to the age-old truth that when an industry grows and develops, neighboring states and countries often grow in the same sector soon thereafter. In addition, Cambodia has implemented the International Labor Organization's (ILO) Better Work program, providing enhanced factory compliance and additional assurances to companies sourcing footwear from its factories. In 2014, Cambodian footwear exports to the

United States were up an impressive 134%. Through April of 2015, Cambodia has increased its exports an additional 73%. This growth is absent any true duty incentive as Cambodia is not a party to the Trans-Pacific Partnership nor does it receive duty free benefit on programs such as the Generalized System of Preferences (GSP) where footwear is not covered even though Cambodia is a

beneficiary. In a short amount of time Cambodia has risen from footwear production obscurity to a competing with India as a top second tier footwear supplier to the US market behind only China, Vietnam and Indonesia.

Chart 10



India on the Move

2014 saw India continue its footwear export growth trajectory, increasing its exports to the United States a strong 10%. A vast majority of India’s exports are leather footwear, for which a majority of its leather footwear is men’s leather footwear. However, India is starting to increase production of non-leather, rubber/plastic footwear having over doubled (114%) its exports in this category from 2012 to 2013⁸. India’s advance in 2014 pushed it to overtake Italy as the fourth largest supplier of footwear to the U.S. market. Expectations are high as Indian Primer Minister Narendra Modi



announced his “Make in India” initiative in 2014 to enhance manufacturing in India and significantly grow exports.⁹ The full power of the Indian Federal Government is behind this initiative and footwear production is of particular focus as producers look to grow their exports to the United States. Only time and future US import statistics will tell if Prime Minister Modi’s initiative drives substantial footwear export growth in India,

although a peak at 2015 year-to-date numbers show trends in a positive direction.

⁸ Source: U.S. Department of Commerce, Office of Textiles and Apparel
⁹ Source: <http://www.makeinindia.com>



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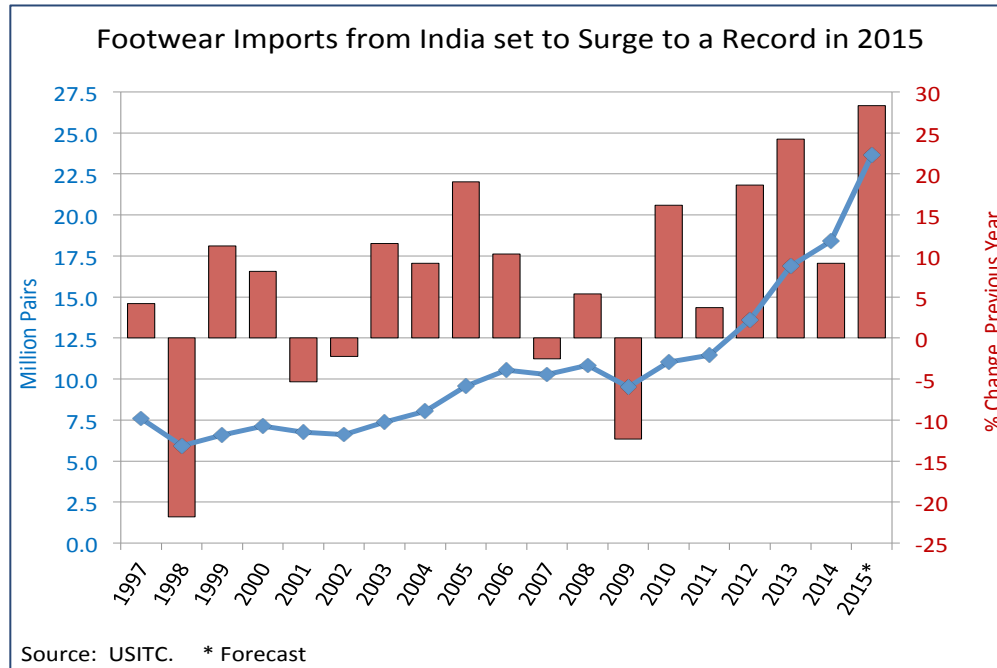


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Chart 11



Western Hemisphere in Focus

In the Americas, the Dominican Republic, Brazil and Mexico are the only US footwear suppliers in the top ten located in the Western Hemisphere. Each of these countries have had varying degrees of success exporting to the US market, with the Dominican Republic continuing to show solid export growth. The DR enjoys duty free access to the US market via the Dominican Republic – Central America Free Trade Agreement (DR-CAFTA) and has used its status as a permanent trading partner with the US to grow 18% through April 2015. If this trend continues, Dominican producers will be driving its country's exports to the United States to a 17-year record, with almost continuous growth since DR-CAFTA entered into force between the United States and the Dominican Republic in 2007.

As a member of the Trans-Pacific Partnership (TPP) negotiations, Mexico has the potential to liberalize its rule of origin providing added flexibilities and incentives to footwear companies considering Mexico as a potential sourcing partner. Currently, under the North American Free Trade Agreement (NAFTA), Mexican exports to the United States only receive duty free treatment if it meets a 55% regional value content (RVC) rule and the upper originates in Mexico, the United States or Canada. Such a restrictive rule has restricted the development of footwear production and assembly in Mexico for non-leather footwear. Since NAFTA, footwear rules of origin in FTAs have become more flexible, so it is expected that the TPP rule of origin will be more flexible and provide more Mexican footwear exports to the U.S. duty-free treatment once the agreement goes into effect.



Chart 12

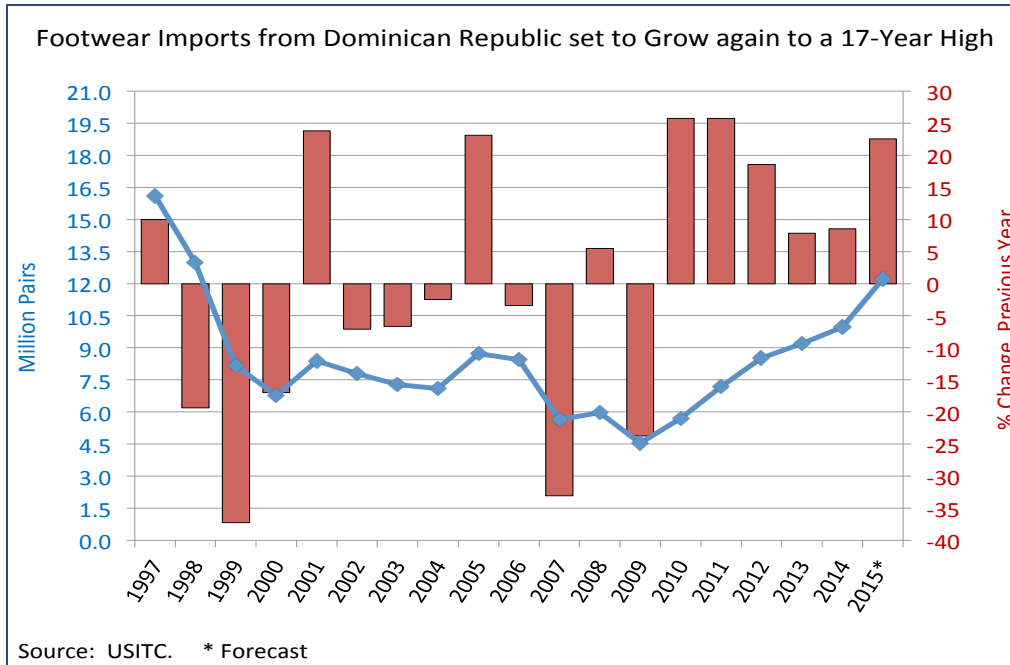
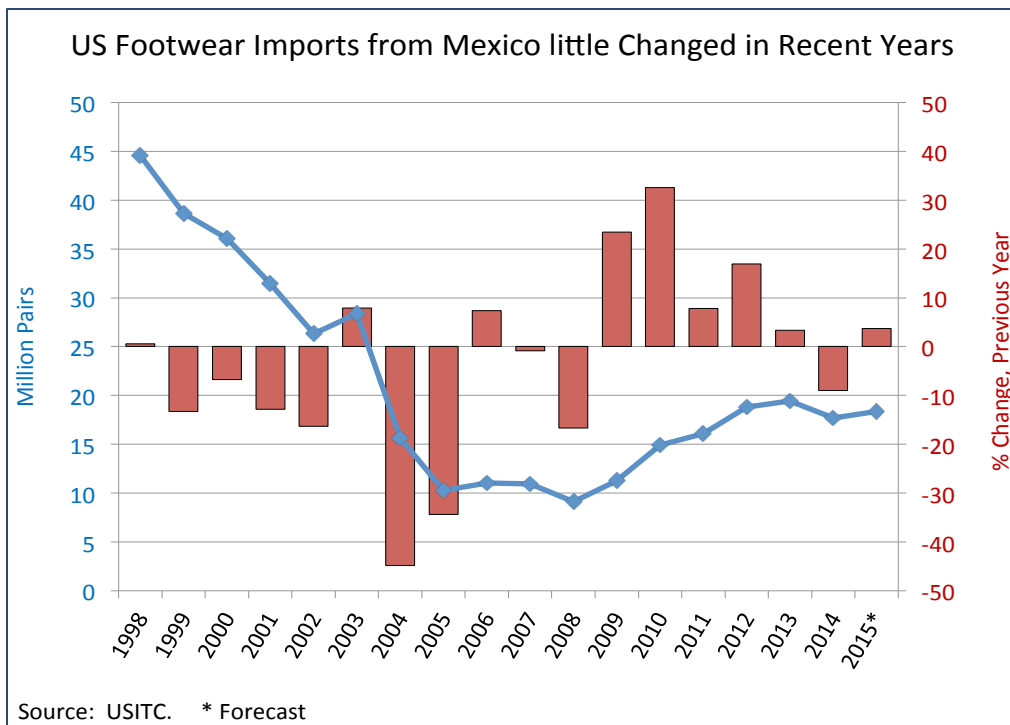


Chart 13



Considering this new opportunity to attract investment, Mexico has implemented new barriers to trade hoping to keep out increased import competition from TPP nations such as Vietnam. These barriers have included reference prices, added import documentation and increased restrictions to designated ports of entry. These measures do nothing more than to restrict legitimate trade and reduce competition, weakening the domestic footwear industry in Mexico in the name of perceived protection. In this era of omnisourcing, when countries are fighting for footwear production market

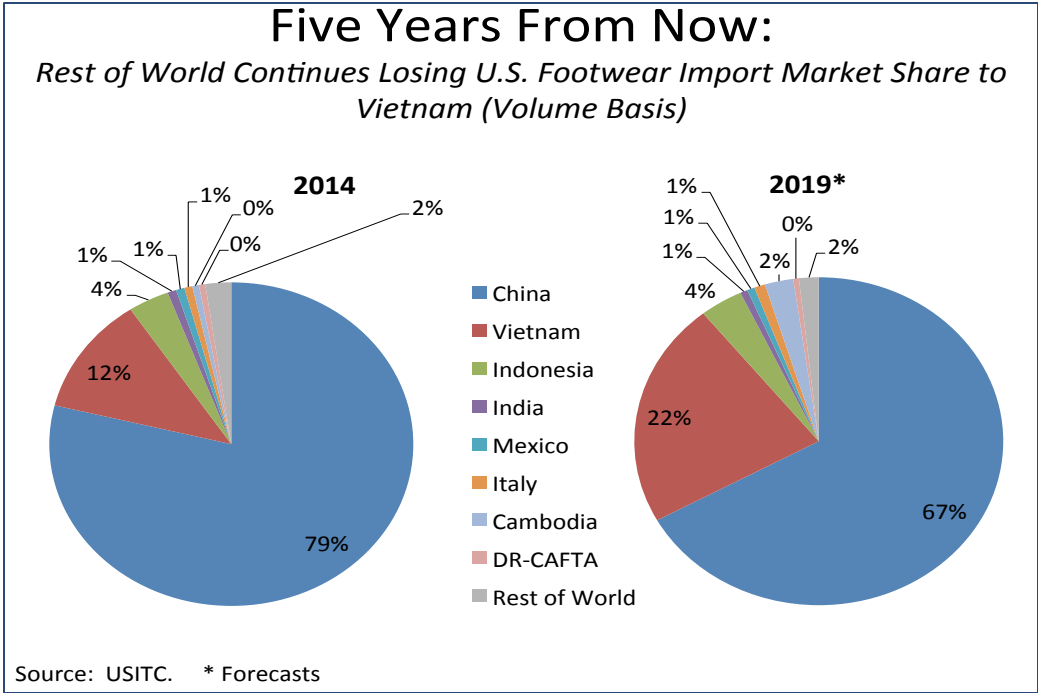
share being shed by China, a country like Mexico – adjacently located next to the United States with duty free access – should be growing and increasing its exports to its neighbor to the North. Unfortunately, in 2014, Mexico footwear exports to the United States declined 9% and have declined 2% through April of this year. It’s easy to see how Mexico’s actions can be attributed to a lost opportunity in an era of great change and growth.

As we Approach 2020...

Since 2012, FDRA has attempted to provide the industry with a snapshot of sourcing trends and how those trends might impact the global footwear supply chain in the coming five years. Knowing full well the unstable and treacherous foundation of sourcing predictions, we have always provided more than enough disclaimers to cover our predictions as any of the declarations contained in our sourcing reports were based on current import data and a lion’s share of assumptions. In 2014, the report was actually even renamed from a sourcing forecast to an assessment to help assuage any fears that the forecast generates in this rapidly changing world. This year’s report is no different as FDRA looks to “assess” the current state of global footwear production and yet we continue to provide our best forecasts for the coming five years as well.

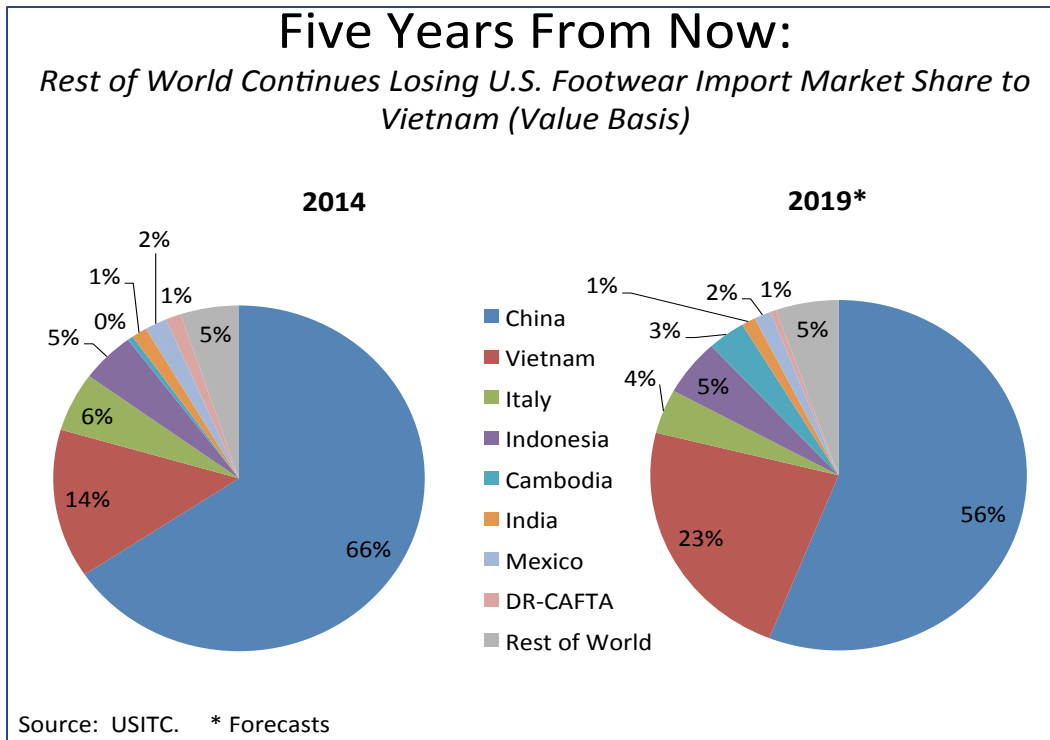
In the inaugural report published in 2012, we predicted by the year 2016 that China would account for 80% of all US footwear imports by volume and 67% by value. As with the 2015 assessment, the 2012 report indicated that Vietnam would be the biggest beneficiary to China’s decline moving from 7% of volume in 2012 to 13% in 2016, accounting for 15% of value, up from 9%. As we assess the 2012 prediction and with China now sitting at 79% of volume and Vietnam at 12%, it is clear that we may have been off one year in our forecast, as change has come more quickly than anticipated. At the time of the publication of the 2012 report, several detractors scoffed at the notion that Vietnam would have the capacity to take on such rapid growth in production, but the global footwear production marketplace has a tendency to find capacity when needed. And it has done so in Vietnam and will continue to do so as 2020 fast approaches.

Chart 14



So, five years from now, in 2019, China will have shed another 12 percentage points off of its share of the market and Vietnam will stand to benefit, hitting 22% of US footwear imports. Change might even come more quickly for Vietnam as the TPP should be passed and implemented during this time. But the narrative will continue to be China's losses are Vietnam's gains because as they say, the more things change the more they stay the same.

Chart 15



Change is coming fast and furious in the world of global footwear production. Sourcing executives and professionals are faced with rapidly changing challenges all over the world, while at the same time US footwear retailing is dramatically evolving. The moment you have a grasp on current market place conditions, trends have substantially changed and your sourcing model is stale and out-of-date. These changes require an adept and nimble sourcing operation that tracks changing dynamics and implements on-the-fly alterations. This is the era of change...this is the era of omnisourcing.

#Sourcing Sound Bites in the Social Media Age

#Footwear Executives Sound Off on Sourcing in 140 Characters or less

Production in #China

“Getting workers is a challenge, putting pressure on LOP. Banks refuse to extend loans, social benefits continue to increase, less import as a source country.”

“Strike in GuangDong province is likely to surge as workers continue to demand better wages and employee benefits mandated by China laws.”

“Where’s the LEAN? Drive manufacturing excellence and streamline supply chain.”

“In the attempt to overcome wage increase and labor shortages in the coastal regions, factory owners in Guangdong and other coastal provinces have started setting up their own production facilities in non coastal regions.”

#Currency & Fx Issues

“Strong U.S. #dollar plays in our favor, most, if not all, source country #currencies depreciated against the U.S. dollar, driving local currency comment of FOB down.”

“Challenging environment for fully understanding #input costs. FDRA’s monthly #Commodities report is helpful.”

The #Future of #Production?

#Bangladesh: “Large workforce available, long lead times due to material import and challenged #logistics. Stable labor situation, fewer disputes and political unrest.”

#India: “Should be more important, but plagued by delays and #quality issues, plus long lead times. Less sophisticated factory leadership, and limited material infrastructure.”

#Dominican Republic: “Beginning to show importance as primary near shore manufacturer, short lead times, better material infrastructure and good skilled work force. Bank #financing a problem.”

Footwear #Trade

“Hooray for June in DC! Bring on #TPP. Our industry’s influence still woefully underrepresented compared to our size & impact on the economy.”

“Vietnam will soon account for 20+% of all imports, TPP is crucial to lowering import #duties.”

Production in #Vietnam

“Second largest source country, but getting close to maxed out. Relative stable work force, LOP under control. #Materials #infrastructure improving.”

“No strategy yet, too late. Not easy & must be done. Elevate capabilities and materials supply. Beware the “wild west” TPP #capacity wars.”

#Compliance Issues

“Table stakes foundational requirement. Much more we can do if we work #collaboratively as an industry. Kudos to @FDRA for their work here!”

“#Compliance at all levels, SEC, IT, Retail Transactions, Product, IP, Health & Safety, #CSR, #RSL plays increasing important role in our operations, governance and processes.”

“Factory #training a must. Concerns over new challenges outside China: new #cultures new issues?”

“@FDRA helpful here, RSL and online factory training website. Everyone should join the Factory #CodeofConduct.”



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1319 F Street, NW, Suite 700

Washington, DC 20002

202.737-5660

(F) 202.638.2615

info@fdra.org

www.fdra.org