FDRA

FOOTWEAR DISTRIBUTORS AND RETAILERS OF AMERICA

Global Footwear Sourcing Assessment

2014

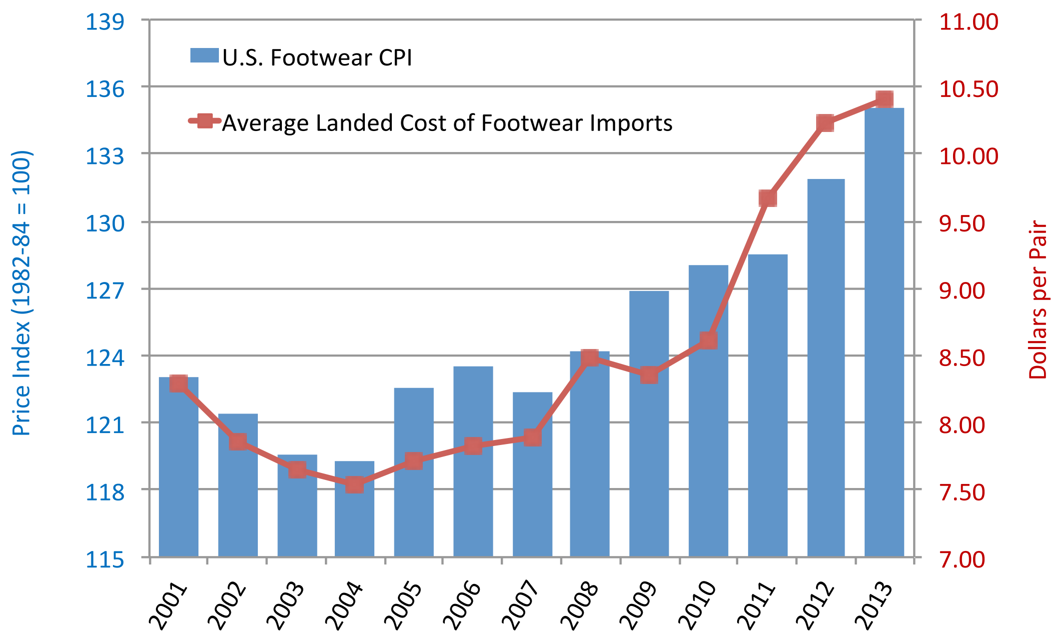
The Current State of Global Footwear Sourcing

Simply put, Americans love shoes. In 2013, 2.3 billion pairs of shoes crossed our borders from all over the world. Mathematically it is easy to see just exactly how much we love our shoes; we imported 7.32 pairs of shoes for every man, woman and child in the United States in 2013! In just one year! Think about that for a second...

Our insatiable appetite for footwear exists in spite of the U.S. Government's insatiable appetite to tax our shoes as they make their way from factory to port to retail outlet. So large was the Government's appetite in 2013 for footwear taxes that it collected $2.5 billion (with a b) in duties on our products ensuring that shoes are more expensive for consumers young and old, rich and poor, urban and rural. With 99% of footwear sold in the U.S. coming from overseas, this regressive tax is becoming even harsher on U.S. consumers as supply chain costs around the world dramatically go up. Higher duty costs have a direct impact on prices consumers pay at the cash register.

Chart 1

Higher Landed Costs of Footwear Imports are Passed on to Consumers

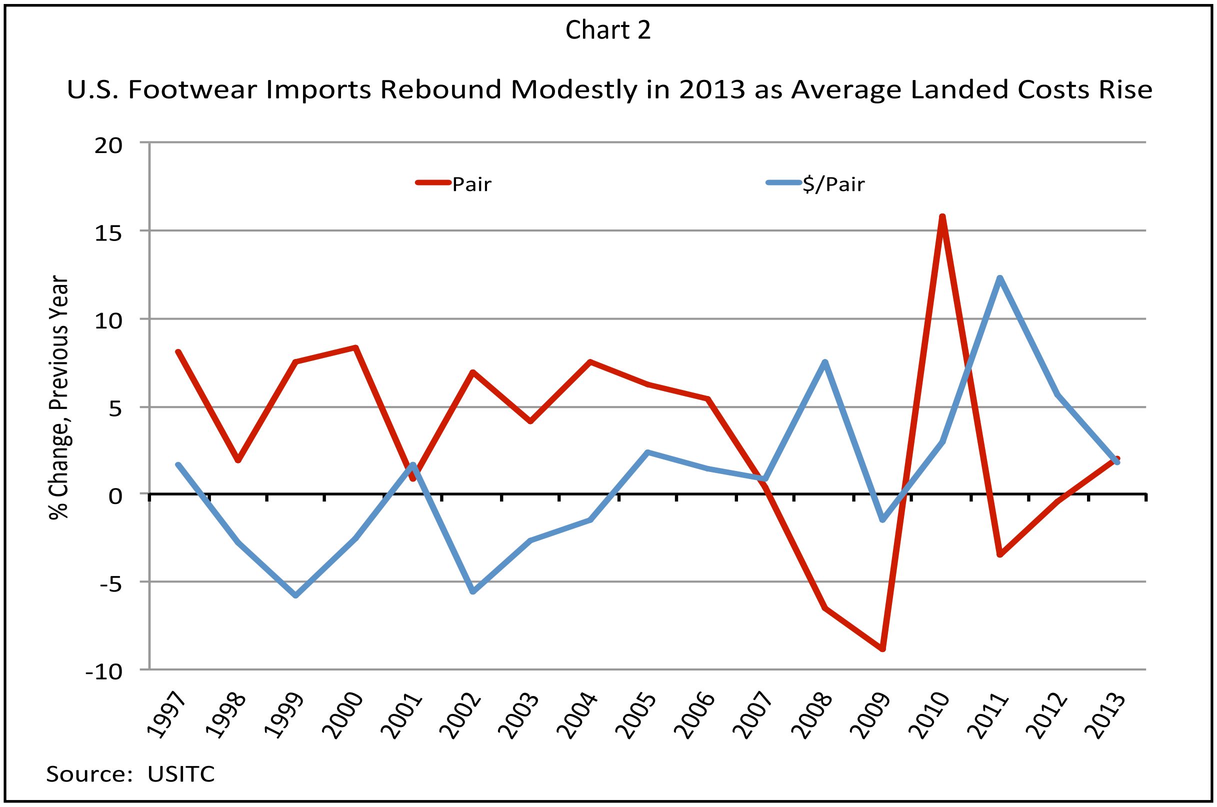


Sources: USITC & BLS

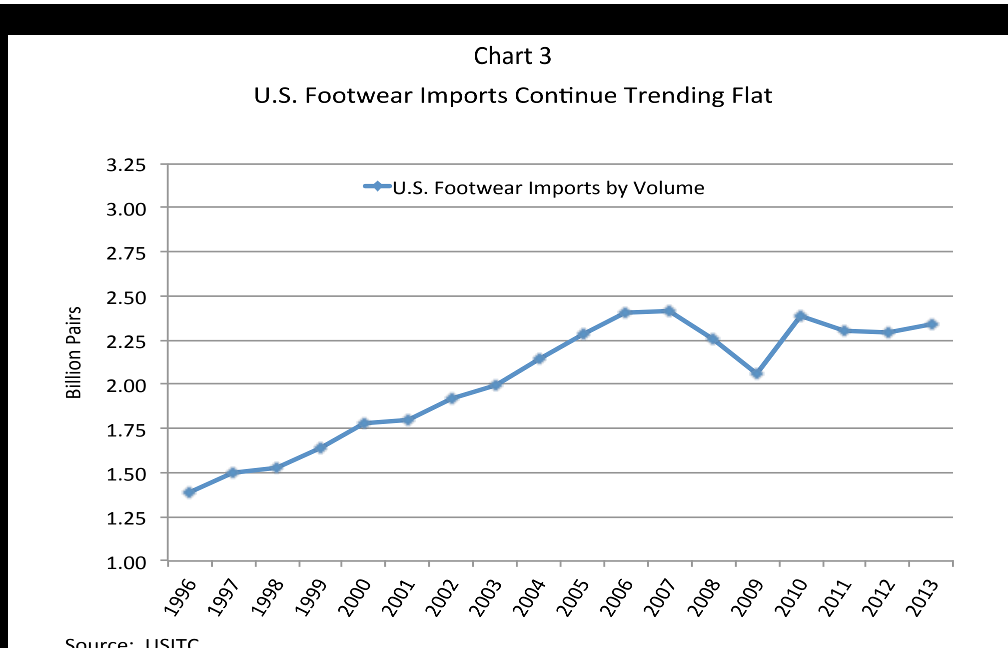
High duties combined with increasing costs of production have a dramatic impact on where footwear is produced and the development of the global footwear supply chain. In the ever-changing world of footwear production and sourcing, the industry finds itself in an era of exploration and uncertainty. Gone are the days of fully relying on one country to supply footwear to consumers worldwide. Increasingly, global footwear conglomerates and privately-held family importers alike are finding themselves continuing their reliance on China as a major source of supply while at the same time discovering and driving the development of production capacity in places like Vietnam, Cambodia, India, Ethiopia and the Americas.

This new era in footwear sourcing is both challenging and exciting. The migration of footwear manufacturing is capital intensive, time consuming and fraught with risk. Nonetheless, footwear companies are reexamining and retooling their supply chains, expanding opportunity and influence in new parts of the world and affecting the ongoing development of U.S. global trade policy. Challenges aside, this new era provides a historic opportunity for the footwear industry not seen in several generations.

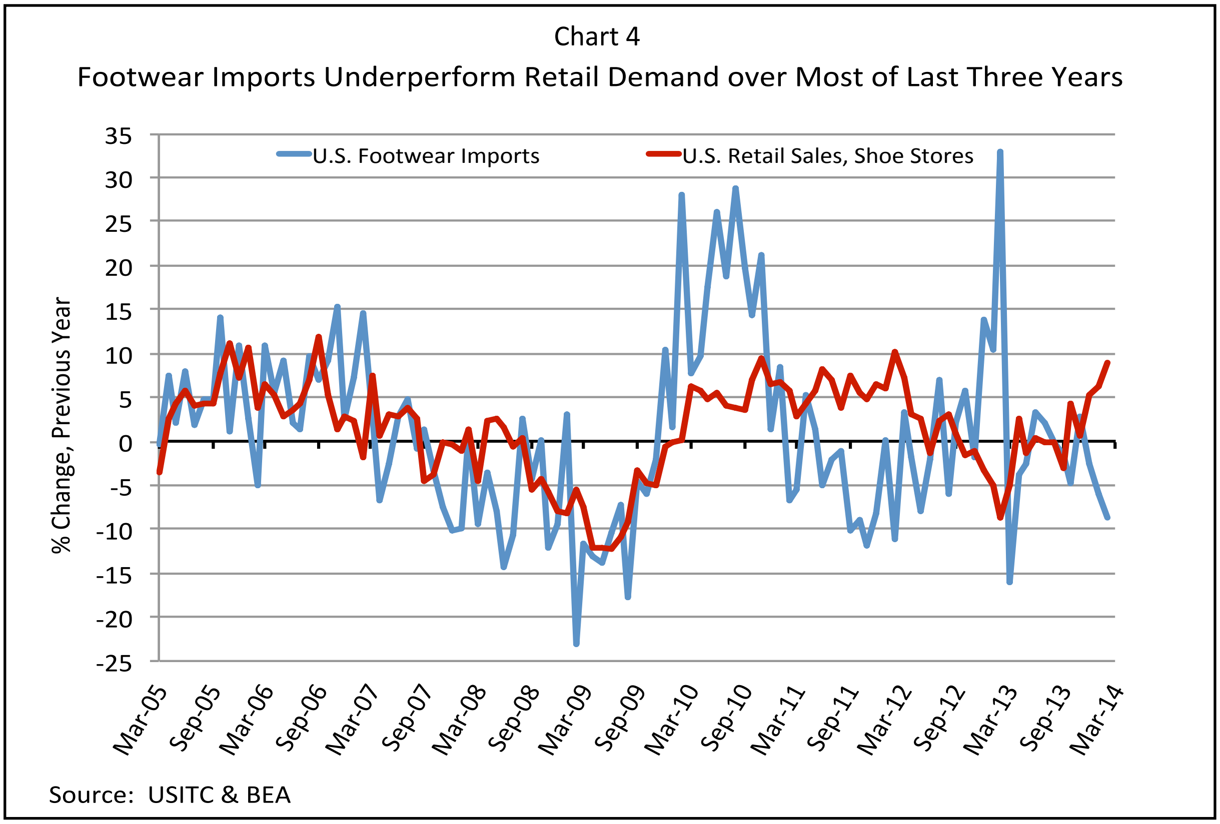
The new dynamic is partially driven by rising costs throughout the footwear supply chain, but also is influenced by the need to contain prices as a result of the continuation of lackluster footwear sales in the United States as seen below.



With nearly 100% import penetration, footwear import data serves as an accurate barometer of the overall health of the U.S. footwear retail marketplace. In 2013, total footwear imports grew at less than 1%, continuing a trend of little to no growth over the past several years.



After the dramatic fall in imports seen leading into the Great Recession, imports quickly and dramatically rebounded in 2010 only to level off over the past three years as imports and inventories more accurately aligned with consumer demand (Chart 4).



> **"This is the most tumultuous sourcing environment I've seen in my 30 years in the business."**
>
> **~ Blake Krueger, Chairman, CEO and President of Wolverine Worldwide**

Decisions, Decisions...

Where to source remains the most important and complex decision for footwear companies. For years, China has been the dominant force in footwear production through the development of a skilled workforce and efficient supply chain. That is beginning to change (see Chart 5 on the following page), even though China still accounted for 81% of all footwear imports into the United States in 2013[1]. Wages in China continue to rise and a new generation of workers is searching for manufacturing jobs up the value chain or outside the manufacturing sector altogether, with more taking jobs in the service industry[2]. This coupled with an aging workforce make it more difficult to find and retain qualified workers in traditional production hubs in China. These demographic shifts and manufacturing shortages mean that production has been pushed out of the Pearl River Delta, leading to longer shipping times and increased logistical challenges.

1 Source: U.S. International Trade Commission (USITC)

2 For further analysis of China's footwear factory base, please see FDRA's 2014 Factory Survey Analysis

FDRA

FOOTWEAR DISTRIBUTORS AND RETAILERS OF AMERICA

Sourcing Strategy Support

Footwear production is shifting.
FDRA provides its members complete sourcing intelligence.
Let us do the same for you.

Data & Analysis

FDRA compiles and analyses global footwear data for its members, helping them to better understand capacity in specific countries. It produces a monthly footwear import report for its members so they can see any production shifts occurring. FDRA also helps its members improve their sourcing strategies through one-on-one private consultations.

Supply Chain Support

Each month FDRA produces a footwear commodities report to help companies understand fluctuations in supply chain costs.

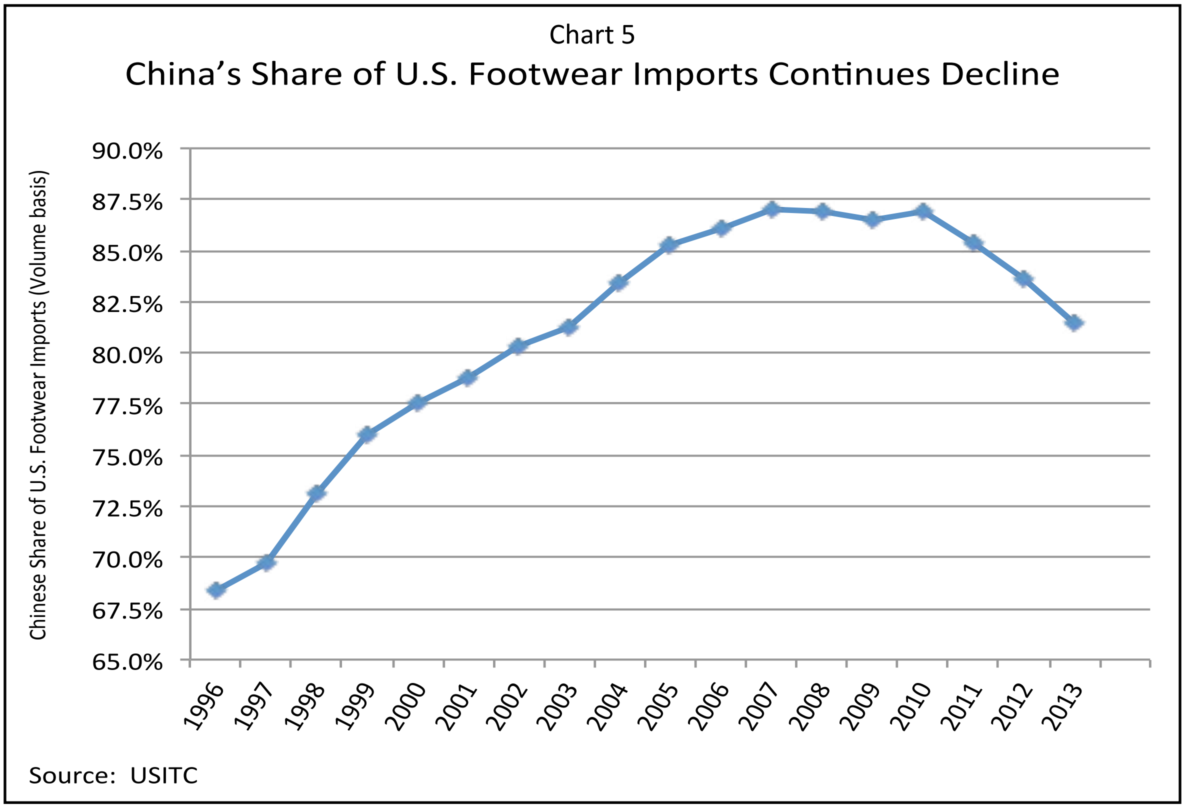
Sourcing Country Profiles

FDRA works to provide its members with in-depth economic, social and political trends in countries where footwear is produced. This helps footwear sourcing professionals get a more complete picture of current and potential issues impacting production.

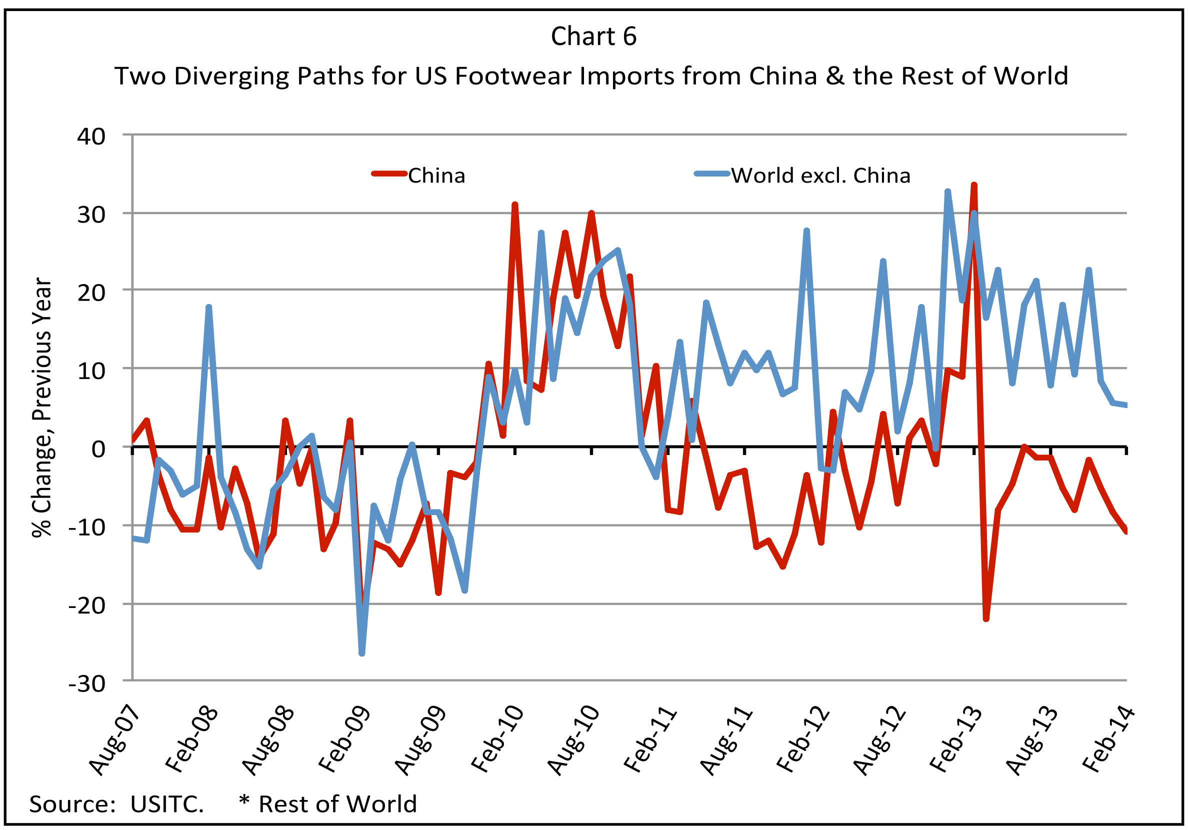
Reports and Forecasts

FDRA produces a monthly sourcing newsletter focused on helping its members understand trends, the impact of current and potential trade deals, as well as interviews with leading sourcing experts to provide on the ground footwear production analysis. FDRA also publishes key sourcing, factory and geopolitical reports throughout the year. These groundbreaking reports, which are always free for members, help businesses better understand the issues impacting our industry from factory to retail.

FDRA is the largest and only U.S. footwear association focused solely on footwear sourcing challenges and solutions. Email info@fdra.org for more information on how FDRA can help you.



Because of these changes, and China's continued push for more advanced manufacturing up the value chain, many firms are looking at other options to either supplement or fully supplant their Chinese production. U.S. footwear import numbers are continuing to demonstrate the dramatic change taking place in footwear sourcing today as seen in Chart 6.



Some suppliers like Vietnam are growing for a combination of reasons, particularly the availability of capacity and a skilled workforce, along with the anticipation of duty-free access to the United States via the Trans-Pacific Partnership (TPP) free trade agreement (FTA) negotiations. Other countries such as Indonesia have grown impressively as the government stabilized and the country has reconstituted much of the production capacity that was available prior to the Asian Financial Crisis and Indonesian riots of 1998. While other countries such as Ethiopia, the Dominican Republic and Mexico are growing because of duty-free access to the American market already available under free trade agreements (FTAs) such as the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA) and the North American Free Trade Agreement (NAFTA), or trade preference programs like the African Growth and Opportunity Act (AGOA).

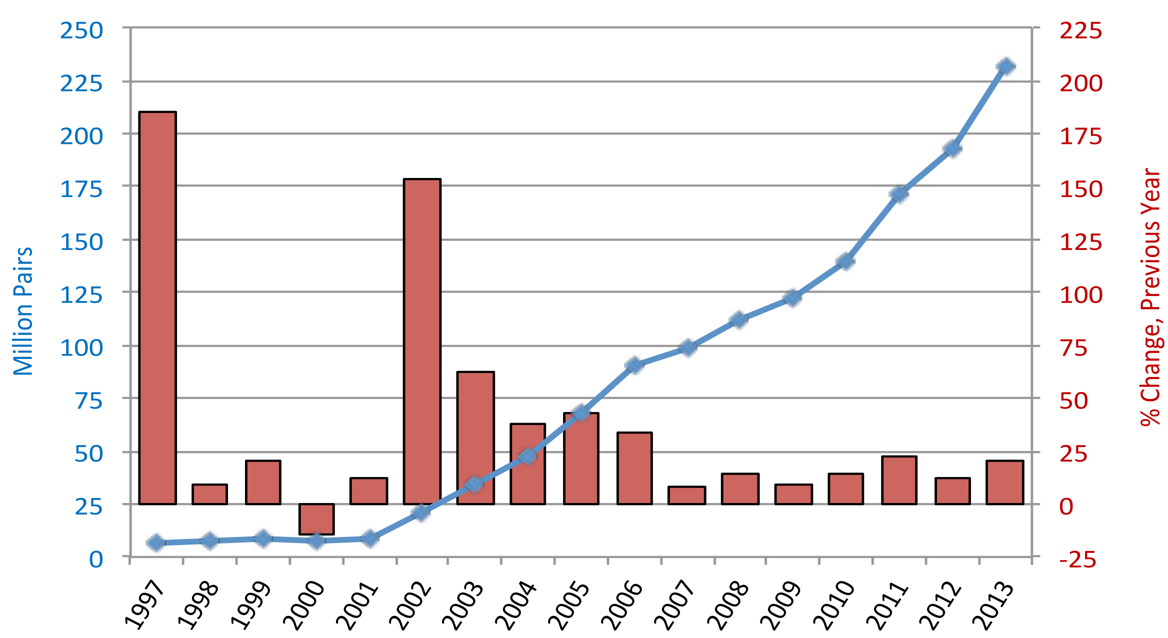
Changing Factories, Changing Trade Policy?

The anticipation surrounding the completion of TPP negotiations cannot be overstated. Currently only about 1.2% of volume from America's top 10 footwear suppliers enter under a free trade agreement. Historically, the footwear industry has not been able to utilize trade preferences because, for the most part, the United States has not negotiated free trade agreements with major footwear countries, or when it has, such as the case with Mexico under NAFTA, the rules of origin were far too rigid to allow for the development of significant footwear production for the U.S. market. That may all change under TPP.

When completed, TPP will provide Vietnam, the second largest supplier to the U.S. market (and rapidly growing), with significant advantages. Many categories of shoes will likely see duty-free access immediately, increasing the lure of sourcing footwear from the growing Southeast Asian nation. The U.S. Government levied an astounding $361 million[3] in duties on Vietnamese footwear imports in 2013. Eliminating or reducing a significant amount of this burden will provide a substantive incentive to attract production investment into Vietnam.

Chart 7

Thirteenth Straight Annual Gain & Record Year for Footwear from Vietnam



Source: USITC

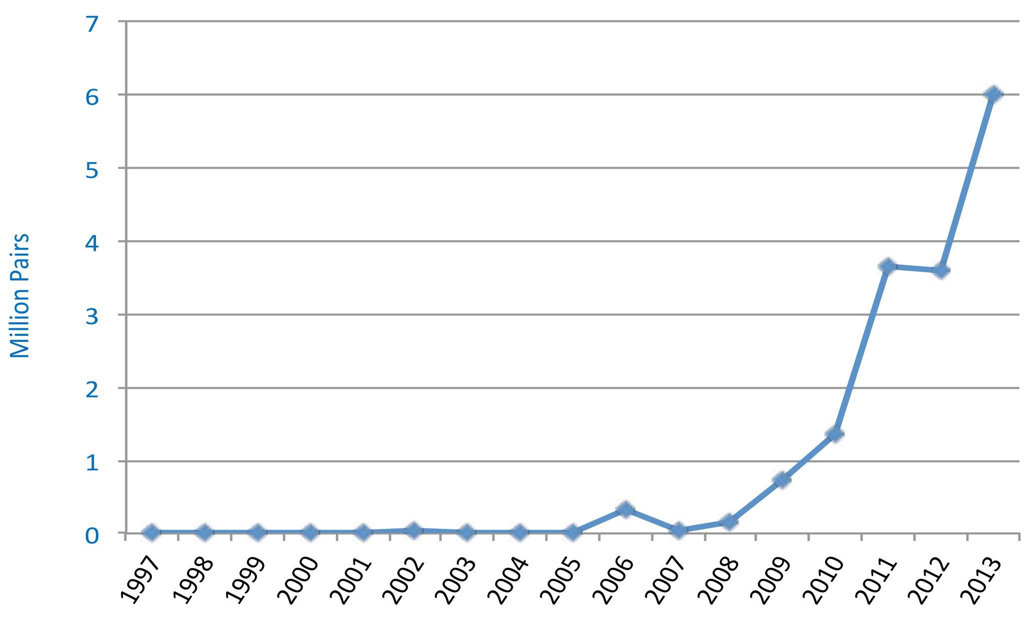
3 Source: U.S. International Trade Commission (USITC)

The labor unrest in Vietnam in early 2014, spurred by regional conflict with China in the South China Sea[4], has not dampened the enthusiasm for the opportunity TPP promises to bring to Vietnam. Foreign Direct Investment (FDI) has continued from places like Mainland China and Taiwan as many firms look to launch or enhance already established supply chains ahead of TPP's conclusion. 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. While we await completion of the TPP negotiations, ongoing price pressures in China will continue to spur growth in Vietnam and more broadly Southeast Asia's footwear sector.

One of the beneficiaries of Vietnam's growth is its immediate neighbor to the West, Cambodia, whose exports to the United States are growing impressively. This development confirms the age-old adage that when an industry in one country develops, neighboring 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. As of May 2014, Cambodian footwear exports to the United States were up an impressive 162%.

Chart 8

Footwear Imports from Cambodia Surge to a Record



Source: USITC

GSP as a New Sourcing Benefit

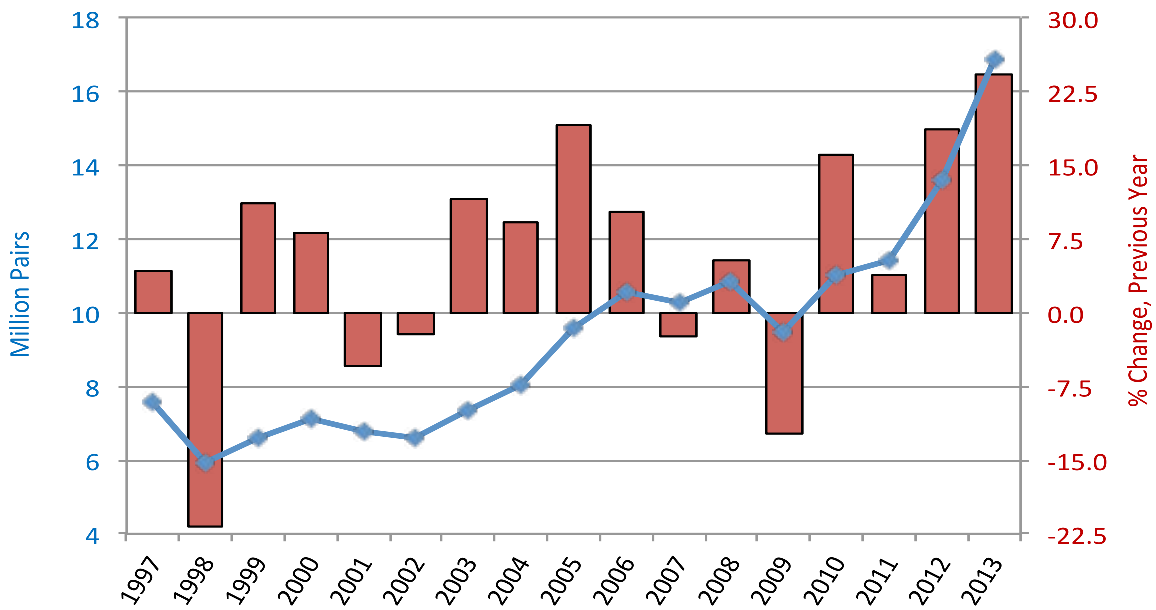
With the diversification of global sourcing, FDRA continues to push for the inclusion of footwear in the Generalized System of Preferences (GSP) program. Historically, the GSP program has provided duty-free access for hundreds of products to the U.S. market for lesser-developed countries including India, Cambodia, Bangladesh and others. In addition, Myanmar (Burma) and Laos have pending applications before the U.S. Government to participate in the GSP program. Inclusion of footwear under GSP could help eliminate upwards of $208 million in duties levied against exports of footwear from GSP beneficiary countries to the U.S. market, and facilitate the development of the industry in countries such as Myanmar. The GSP program lapsed on July 31, 2013 as Congress failed to pass an extension. There is hope that the program will be extended by the end of 2014.

4 For further analysis, please see FDRA's Special Geopolitical Report: What Conflict in the South China Sea Would Mean for the Footwear Industry

2013 saw India continue its footwear export growth trajectory, increasing its exports to the United States an impressive 21%. 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 2013[5]. Year-to-date Indian exports as of May 2014 continue to growth, pushing India to overtake Italy as the fourth largest supplier of footwear to the U.S. market. This growth is in spite of ongoing concerns amongst sourcing professionals about India's slow infrastructure development, production difficulties and inefficiencies in transporting and shipping to the U.S.

Chart 9

2013 Footwear Imports from India Stretch to a Record



Source: USITC

Beyond Asia

Some U.S. companies are looking beyond Asia to take advantage of capacity and trade preference programs granted to other footwear producing countries. Since 2000, the African Growth and Opportunity Act (AGOA) trade preference program has been in place, providing duty-free access for some products including footwear from Sub-Saharan Africa. Until recently, AGOA was on a long list of programs and agreements not utilized by the footwear industry. This narrative is changing as Ethiopia is starting to realize its potential, growing footwear exports 1,871% from 2011 to 2013[6]. FDRA expects continued growth out of the African nation in the coming years, if and only if, the AGOA program is extended before it is set to expire on September 30, 2015.

Policymakers in Africa and the United States are focused on ensuring that the program continues for an yet to be determined amount of time, with the hopes that one day a permanent free trade agreement will be passed, providing certainty to those companies sourcing footwear out of Africa. In the meantime, capacity development continues as Chinese investment pours into Ethiopia helping to establish additional footwear production capacity and infrastructure development.

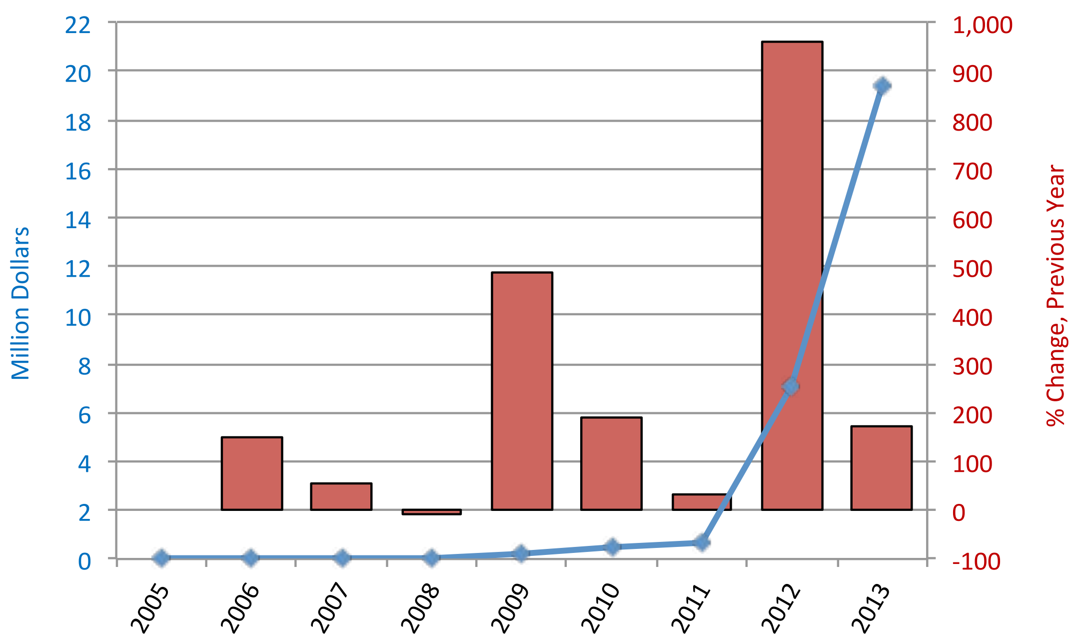
5 Source: U.S. Department of Commerce, Office of Textiles and Apparel

6 Source: U.S. Department of Commerce, Office of Textiles and Apparel

The Mieso-Dire Dawa–Dewanle railway project connecting Addis Ababa with the Port of Djibouti is just one example of infrastructure developments underway in Ethiopia, easing the movement of goods[7]. Expected to be completed by 2015, this new railway being constructed by China Civil Engineering Construction Corporation will provide expedited access for freight to the port, alleviating delays and enhancing Ethiopia's ability to produce and ship goods. Duty free access to the United States and an improving logistical profile will only enhance Ethiopia's attractiveness as a potential footwear supplier in the years to come.

Chart 10

Fifth Straight Annual Gain & A Record High for Footwear from Ethiopia

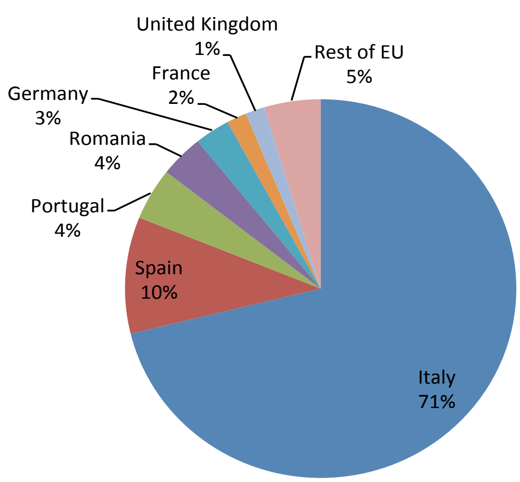


Source: USITC

Chart 11

2013 US Footwear Imports from European Union

2013 Import Value from EU: $1.9 Billion



Source: USITC

A Snapshot of European Exports

Europe continues to produce high-end, high-value footwear for U.S. consumers with Italy as the top European supplier and Spain a distant second. Leather footwear dominates exports to the U.S. from Europe, benefiting from quality hides as well as relatively low duty rates on leather footwear. Tariffs on footwear from Europe could be eliminated altogether through the Trans-Atlantic Trade and Investment Partnership (TTIP), an FTA currently being negotiated. TTIP discussions are ongoing but are not expected to bear fruit for several more years. TTIP has the potential to increase footwear exports from Europe, once implemented as duties drop to zero.

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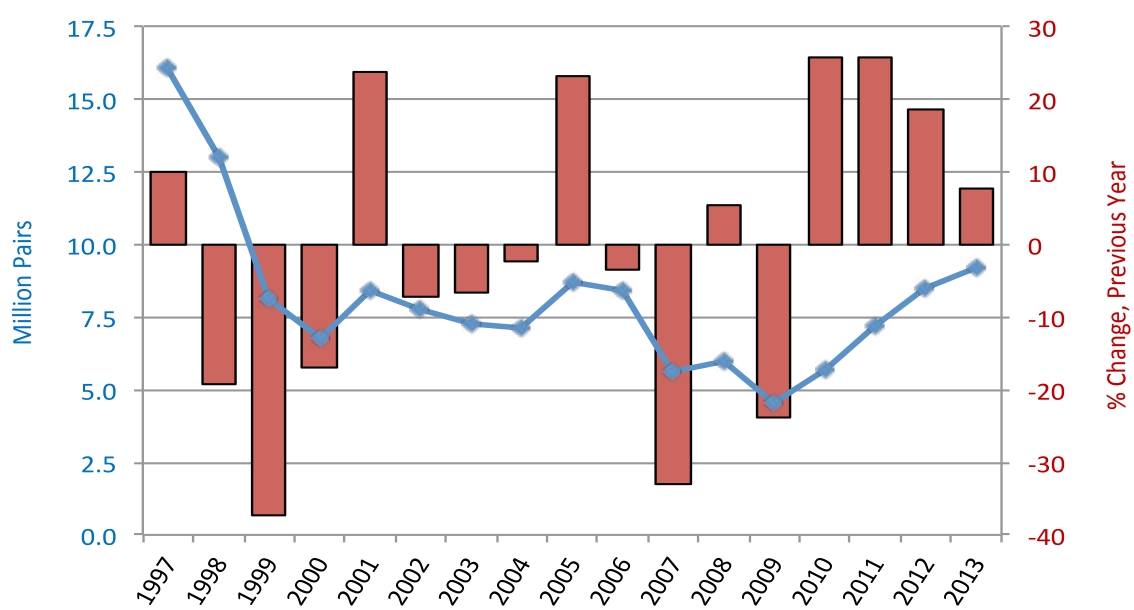
7 Source: Construction Review Online, May 19, 2014 - http://constructionreviewonline.com/2014/05/19/ethiopia-builds-us4b-electric-railway/

In the Americas, the Dominican Republic and Mexico grew their 2013 footwear exports to the United States 4% and 3% respectively[8]. A majority of this growth, as with Ethiopia, was in leather footwear due to the fact that leather footwear has preferential treatment under U.S. trade policy over footwear made of rubber, plastic and/or canvas. Without added flexibilities granted to the rules of origin required to qualify for preferential treatment, there is very limited potential for these countries to develop and maintain the capacity and inputs needed for non-leather footwear production.

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 stymied 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

2013 Footwear from Dominican Republic Stretch to a Sixteen-Year High



Source: USITC

Chart 13

Top 15 Footwear Exporters to the U.S. in 2013

By Country and Total Volume

China	1,893,720,218	India	16,389,800	Taiwan	4,886,669
Vietnam	229,744,300	Brazil	10,707,535	Hong Kong	4,240,563
Indonesia	85,226,073	Dominican Republic	9,058,172	Spain	3,453,605
Mexico	19,456,402	Thailand	7,413,875	Canada	2,609,604
Italy	16,480,580	Cambodia	5,823,091	Bangladesh	1,657,576

8 Source: U.S. Department of Commerce, Office of Textiles and Apparel

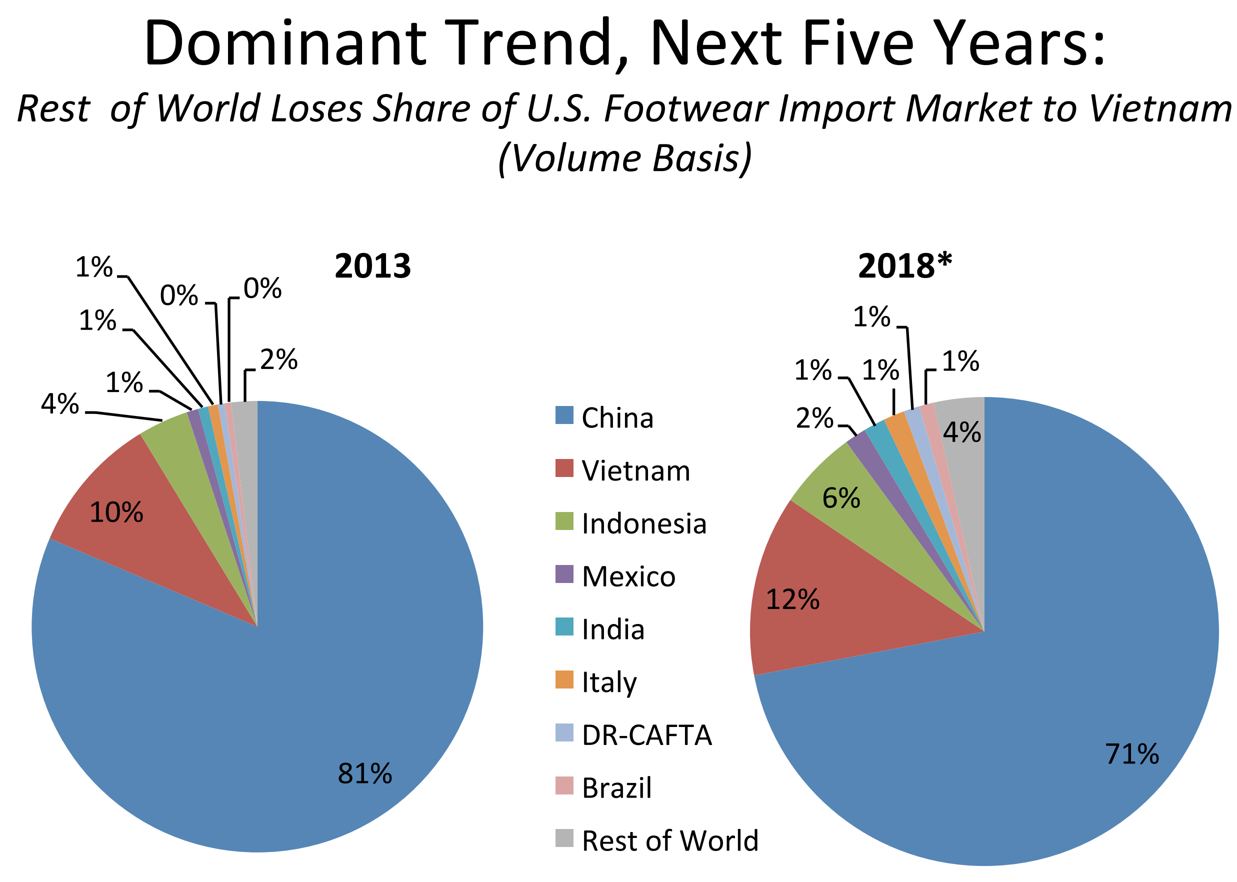
What Next? To 2018 and Beyond!

And herein lies the predicament in which the footwear industry finds itself **– as the industry stares across the horizon, ready to explore and develop the next great footwear frontier, U.S. trade policy is laging behind, failing to help with such an ambitious global initiative.** In spite of the oft-cited goals of politicians and policymakers to drive manufacturing diversification, U.S. trade policy continues to develop rules of origin that are restrictive (forcing participants to source locally in the region even when such inputs are unavailable) or promulgate a list of "sensitive" footwear that is no longer made in the United States or is assembled primarily from Chinese –origin components.

All of this, driven by special interests and to the detriment of American consumers, creates an environment not conducive to taking advantage of America's FTAs and preference programs, which would ultimately diversify production in significant ways at a time when it's needed most. FDRA is working hard to have government policy catch-up to market realities. We will be persistent, and we will prevail.

Vietnam continues to show impressive growth, even without the benefit of a permanent FTA. As in previous editions of this assessment, FDRA envisions Vietnam gaining a majority of the market share shed by China. Vietnam's growth will spill over into neighboring countries and footwear companies will also continue exploring sourcing possibilities outside of Asia. But in the end, despite its ongoing loss of market share, China will continue to produce over 70% of all footwear sold in the U.S. even five years from now as illustrated below.

Chart 12

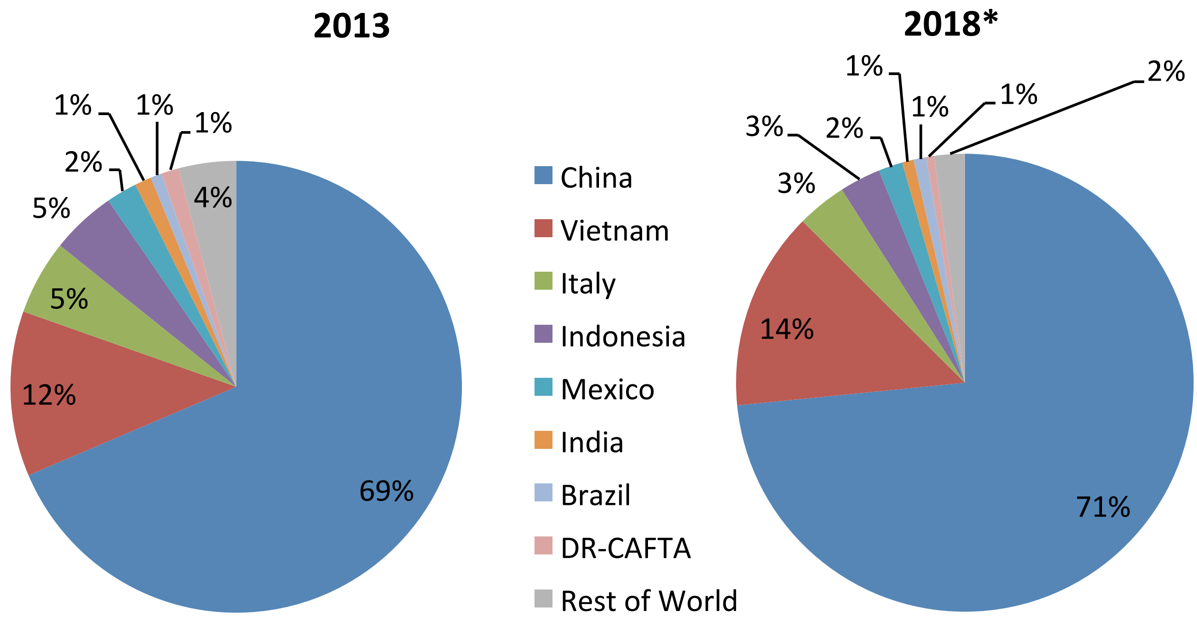


Source: USITC. * FDRA forecasts

Chart 15

Dominant Trend, Next Five Years:

Rest of World Loses Share of U.S. Footwear Import Market to Vietnam ($ basis)



Source: USITC. * FDRA Forecasts

By 2018, FDRA also believes that footwear companies who have been producing exclusively in China for decades will begin to source a small portion of footwear in Southeast Asia, while those who have already diversified production will push further into regions like Africa and possibly the Americas. Further, as technologies like 3D printing and customization advance we could see a slight increase of footwear produced in the United States by 2018. All things considered, China will remain the dominant supplier by volume and value for years to come. Although China's loss of market share is not precipitous, it has launched a new era in the history of global footwear sourcing ensuring that change and exploration will be constant in the years to come.

Ultimately, the American footwear industry, with all of its brands, retailers, merchants, importers, distributors, and marketers, will do what it does best - address sourcing challenges and drive global change through the ongoing development of its supply chain, the exportation of best corporate social responsibly practices, and the constant design of innovative and fashionable footwear for consumers all over the world, thus mapping its own course one factory, one country, one consumer at a time.

As trade policy evolves and sourcing challenges morph, FDRA will continue to be there every step of the way for its members through its special sourcing and compliance program. This program has been built to ensure companies both large and small see and understand trends as they occur. As part of the sourcing program, FDRA members receive monthly footwear import and input/commodity price reports and its monthly Footwear Sourcing and Compliance Bulletin. FDRA also partners with experts to provide in-depth webinars and innovative conferences to help the industry understand sourcing challenges and find practical solutions.

2014 FOOTWEAR PRODUCTION PROFILES

China - Vietnam - Indonesia - Cambodia - Bangladesh - India - Ethiopia

FDRA *Intelligence to Act*

FOOTWEAR DISTRIBUTORS AND RETAILERS OF AMERICA

China

China remains the global footwear manufacturing powerhouse, but its footwear production market share continues to erode. Chief obstacles in China are an aging, more expensive labor force and increased supply chain costs. While likely to remain a major player for years to come, it is clear that China has become a more complicated sourcing option for a variety of reasons. In 2013, China exported 1.89 billion pairs of shoes to the U.S., or over 81 percent of all U.S. footwear imports. FDRA members reported that many of these problems were pushing production to other destinations.

A polling of FDRA members identified the following issues and recent developments that affect production in China:

- Low worker return rates post Chinese New Year, now at 70-75% according to FDRA members, is down from 85-90% in years past. Wages continue to rise, with FDRA members estimating that wages have increased by an annual rate of 15 percent.
- While wages rise, the number of available workers age 16-39 is decreasing as China's demographics continue to shift to an older population.
- Capacity in China is shrinking. Factories are closing down lines, dropping smaller brands and pushing orders to Cambodia and Vietnam.
- Recent strikes highlighted the lack of social insurance compliance in some factories. The costs to comply with social insurance could increase production costs 5-15% depending on a factory's initial compliance level. Social insurance rates of 100% are required in the Shanghai area and 40% in other areas.
- FDRA members report that transportation times have increased as production shifts inland away from the Pearl River Delta.
- Capacity is currently shrinking, but remains the largest in Asia. The Chinese government has prioritized job creation in its interior provinces over the next decade, which, as infrastructure develops, may increase factory capacity and reduce worker turnover.

"China remains the biggest part of the sourcing puzzle for all segments of the footwear market. But problems are beginning to become more pronounced. Costs are rising across the board – labor, compliance, and materials are all rising. In addition, the move from the Pearl River Delta has added another logistical hurdle. While China will remain the biggest kid on the block, companies are beginning to actively look at sourcing alternatives."

- Tony Liao, Owner, Bright Jade Shoes Co.

Due to a number of ongoing challenges, China's footwear production has shed market share over the last three years. A trend that is expected to continue.

Vietnam

Already the second largest supplier of footwear to the United States, Vietnam stands to greatly improve its market position once the ongoing Trans-Pacific Partnership (TPP) free trade agreement (FTA) negotiations are complete. While TPP is still under negotiation, the potential duty-free access for certain types of footwear makes this country a sourcing priority.

A polling of FDRA members identified the following issues and recent developments that affect production in Vietnam:

- Significant labor unrest occurred after a dispute between Vietnam and China over drilling rights in the disputed area of the South China Sea. The shutdown cost tens of millions of dollars, resulted in canceled orders and expedited freight costs. For further analysis of the South China Seas conflict, read [FDRA's Special Geopolitical Report: What Conflict in the South China Sea Would Mean for the Footwear Industry.]
- While its industry is expanding and the labor force growing, Vietnam remains roughly 85% as efficient as China. Vietnamese labor costs are no more competitive than in China.
- The reliance on imported Chinese components continues to add significant lead time to production.
- The possibility of tariff savings through TPP has made Vietnam a target for brands selling into the U.S.
- Vietnam will not overtake China as the world's largest footwear producer due to an insufficient number of workers. FDRA members look to Vietnam becoming a "good, core country" for footwear sourcing.

Cascade Asia's Political, Economic, and Social Outlook on Vietnam:

Vietnam is at a political crossroads as it seeks to balance Chinese infringement on territorial sovereignty—a historically touchy subject—with heavy economic dependence. The signing of TPP will provide alternatives to Chinese inputs for Vietnamese industries, further boosting the position of the pro-U.S. faction in Hanoi.

In spite of recent tensions with China, Cascade Asia expects GDP growth to show modest improvement in 2014 as fundamentals continue to improve and inflation remains contained. The government, however, will need to work faster at reforming the banking sector and improving foreign investor access.

For all the stability that Vietnam offers in the context of regional turbulence, there are real social risks to production operations. Recent rioting and looting of Chinese-run firms (as well as Taiwanese firms perceived to be Chinese-run) exposed the volatility of the workforce and illustrated just how quickly things can spiral out of control.

"Vietnam has probably garnered more attention than any other sourcing alternative this year, for good and bad reasons. On the positive side, the possibility of duty-free access under the Trans-Pacific Partnership (TPP) means most companies will take a serious look at Vietnam. This potential and a steady stream of labor has led to Vietnam consistently ramping up production in the past year. On the negative side, a recent work shutdown, including damage to Taiwanese-owned facilities, over a dispute with China, has given some potential investors pause. However, the lure of duty free treatment will overwhelm that in the long term."

- Lev Gelfand, Footwear Sourcing Executive

India
Vietnam

CascadeAsia
Advisors

China
Indonesia
Bangladesh
Cambodia
Sri Lanka

Forward-looking Risk Solutions Across Asia for Footwear

Cascade Asia helps businesses anticipate labor, political and regulatory shifts before they happen. Our offering within this practice includes:

- Labor/Social Risk Early Warning System
- Political Risk Monitoring & Analysis
- Regulatory Monitoring & Analysis
- Financial & Reputational Due Diligence
- Stakeholder Engagement

For more information, please visit www.cascadeasia.com or contact us at +1.360.358.3094 or info@cascadeasia.com.

Indonesia

Photo Credit: Crack Palinggi/Landov, 2007

Indonesia is an up-and-coming sourcing option for FDRA members, viewed in part as a viable alternative to Bangladesh.

A polling of FDRA members identified the following issues and recent developments that affect production in Indonesia now and into the future:

- The large workforce, quality infrastructure and ports are attracting increased interest from FDRA members.
- Looking for alternatives due to labor compliance problems and other issues in Bangladesh, companies are looking at Indonesia to hedge sourcing options.
- While Indonesia footwear exports are growing, challenges remain, including heightened wage pressure resulting from strikes in 2013, which led to several local governments raising the minimum wage.
- Availability of raw materials is another major issue facing the footwear sector in Indonesia. Raw materials are largely imported from a variety of sources, including China, Korea, South America, India, Europe and the U.S.
- Indonesia's currency, the rupiah, has also appreciated against the dollar - over 6% in 2013. While this has helped retailers selling in the Indonesian domestic market, it has increased the cost of exports.
- Though capacity has grown, the capabilities of factories varies greatly. As one FDRA member pointed out, factories will vary from 1,000 pairs per day production capacity up to 15,000 pairs per day. The ability and desire to expand varies from factory to factory, type of shoes manufactured, and availability of investment.

"Indonesia has been an obvious sourcing option for a few years, and many companies are in the market. That being said, wages are rising and Indonesia's currency has seen some appreciation in the last year. This has raised costs, but investment continues. I see the Indonesia market remaining a real option in the years to come.

- Susan Cochran, President, Blackstone Shoes

Cascade Asia's Political, Economic, and Social Outlook on Indonesia:

Indonesia's Election Commission announced that Joko "Jokowi" Widodo has won the July 9 presidential election by a 6 percent margin. Gerindra Party presidential candidate Prabowo Subianto's camp has sent conflicting messages following the loss and it is unclear at this stage whether or not he will concede the race or appeal to the Constitutional Court. If an appeal is filed and accepted by the court, Cascade Asia does not expect the outcome to be overturned.

Fuel subsidies continue to loom as the largest single-expenditure item in the national budget and the biggest hurdle to sustained economic growth. President-elect Jokowi pledged on the campaign trail to cut fuel subsidies in his first 100 days in office. Cascade Asia is of the opinion that a second cut is likely to follow in 2015. Such structural reforms would substantially free-up Indonesia's budget to focus on infrastructure development and education, further fueling prospects for medium-term growth.

Outgoing administration officials are drafting a Government Regulation (RPP) on Wages that would decentralize wage-setting to the company level and extend the time interval for adjusting wages to every two years. Jokowi oversaw a 50 percent aggregate minimum wage increase in the capital during his tenure as governor and, if the draft regulation is derailed for any reason, would support raising minimum wages. Cascade Asia expects the draft law to be ratified before President-elect Jokowi is sworn in at the end of October.

Cambodia

Cambodia's lack of infrastructure creates significant challenges, yet it continues to benefit from a shift in sourcing from China.

A polling of FDRA members identified the following issues and recent developments that affect production in Cambodia:

- Taiwanese shoe manufacturers have invested heavily in Cambodia after the industry was pushed out of China's Pearl River Delta.
- These manufacturers are already seeing stiff competition for available workers. Productivity among workers is low, exacerbated by low education levels and the need to operate in three languages: English, Chinese, and Cambodian.
- Cambodia is lacking in infrastructure investment, with no highway system, no commercial rail, and one deep-water port. Factories add 6 additional weeks to production cycles in production planning to account for the difficulty in importing inputs and then exporting finished product.
- Additionally, most materials, tooling, and components are sourced from China, a "considerable problem" according to one FDRA executive, due to the lack of infrastructure.

"Cambodia has benefited from China losing some of its sourcing luster. As additional investment has flowed into the country, driven by Taiwan-owned factories, Cambodia is becoming a larger part of the sourcing conversation. However, several problems need to be addressed. These include low productivity due to a lack of skilled workers and generally low education levels, and a serious lack of infrastructure within the country, including no highway or commercial rail systems. With one deep water port, Cambodia will need to address these logistical issues to reach its full potential."

- Peter Hohensee, Senior Director of Product Development and Logistics, Rack Room Shoes

Cascade Asia's Political, Economic, and Social Outlook on Cambodia:

Ending a year-long stalemate, Cambodia's opposition (CNRP) agreed in late-July to drop its parliamentary boycott and take up their seats in the National Assembly. The move comes in exchange for an overhaul of the National Election Committee and greater parliamentary clout, including a deputy speaker position. Cascade Asia is cautiously optimistic about the agreement as an ultimate end to the deadlock will hinge on how the two parties address the details of these reforms in the coming weeks.

Economic fundamentals remain strong and generally on trend though Cascade Asia expects a modest down tick in GDP growth in 2014 resulting from political uncertainty, labor unrest and softening demand from China. Against the backdrop of an improved political situation, foreign direct investment and tourism—both of which cooled during peak months of political and labor protests—are expected to return to near normal growth rates.

An end to the CNRP's boycott of parliament augurs well for a resolution to the labor crisis, where a hung political situation has been a facilitating factor. However, trade unions are taking issue with a draft union law and are sticking to their calls for a new US$160 monthly minimum wage to take effect in October. Labor strikes are unlikely to resume between now and October and only then, if wages posed by the tri-partite Labor Advisory Committee are seen as unreasonable.

Bangladesh

Corporate social responsibility and compliance costs are the key issues facing Bangladesh following the Rana Plaza apparel factory tragedy. Larger factories that can more easily adapt to safety regulations will continue to attract significant business, but the shift in production will cause some short-term problems.

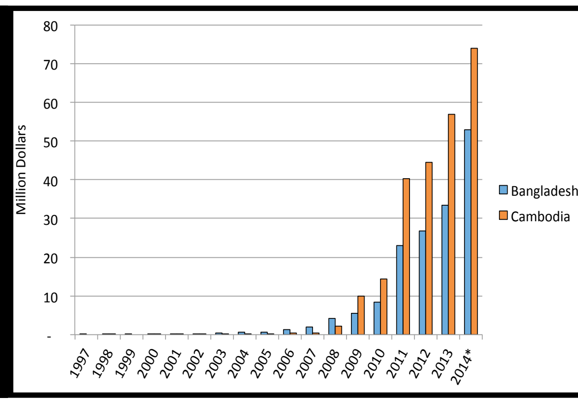
A polling of FDRA members identified the following issues and recent developments that affect production in Bangladesh:

- 2013 saw increased investments from Taiwan, which combined with improved quality at many factories led to an increased level of production. This investment showed that interest in Bangladesh as a sourcing platform outweighed the political fallout from the Rana Plaza tragedy.
- Following Bangladesh's removal from the Generalized System of Preferences (GSP) program, there is a high sensitivity to improving factory conditions and worker safety.
- The industry continues to struggle with implementing more stringent compliance and safety standards which have been promulgated following the Rana Plaza tragedy. These changes are expected to further favor larger, more compliant factories over their smaller, less regulated counterparts, causing short-term volatility in the supply of trained labor.
- Newly formed worker unions and rising wages are issues to watch over the next year.

Since the Rana Plaza tragedy, Bangladesh has seen an increase in corporate social responsibility and government activity to protect worker safety. Larger, established manufacturers are the most likely to be able to meet these new facts of life in the Bangladesh market, adding some volatility. Despite the negative attention from the Rana Plaza tragedy, investment has continued to flow into the footwear market.

- Mike Jeppesen, President of Global Operations, Wolverine Worldwide

As Footwear Production Grows in Cambodia, Bangladesh Continues to Benefit from its Spillover.



Cascade Asia's Political, Economic, and Social Outlook on Bangladesh:

Embroiled in a political stalemate resulting from disputes over the fairness of January's parliamentary election, the current gridlock has set the stage for political instability, continued violence and an incohesive legislative process.

Economic growth in 2014 is being tempered by the clouded political outlook, weakening domestic demand and lost trade privileges with the US and EU due to slower than expected workplace safety improvements in the wake of the Rana Plaza tragedy. However, Bangladesh's economy has weathered other political storms with remarkable resiliency and, so far, sound macroeconomic fundamentals appear to be safeguarding the country's economic position.

Demands for sweeping compliance and safety reforms by the international community have driven monthly wages up by 80 percent in last 7 months. Some 190 new labor unions have been registered and an estimated 80,000 workers are out of work due to non-compliant factory closings. Combined with some resistance by government and industry associations to these reforms and friction with the newly emerging unions, Cascade Asia sees continued volatility while the industry absorbs and adapts to its new landscape.

India

India is a key sourcing country for leather products which has naturally evolved into a robust footwear industry. Non-leather footwear manufacturing has started to take hold as India puts more incentives in place to attract that segment of the market.

A polling of FDRA members identified the following issues and recent developments that affect production in India:

- Traditionally focused on Europe, India has begun to turn its view towards the U.S. market as India's government aims to significantly boost exports by 2017. A major focus of that push will come from footwear and leather goods.
- India has a huge raw material base and the Indian shoe industry has its origins in the leather industry. This gives India a huge advantage in all leather footwear production.
- Leather footwear has been concentrated in Chennai, Agra, and Delhi.
- India has grants and investment subsidy programs in place to attract non-leather footwear producers, but availability of raw materials is currently lacking.
- Non-leather footwear producers should look to previously untapped areas of the country, including central India, which has not seen prior footwear investment but has seen other significant investment.
- With close to 2.2 billion pairs sold annually and a young middle class with increasing disposable income, India will also be a growing retail market for years. With 70 percent of the population under 30 years of age, many brands see the Indian market as a phenomenal opportunity to expand global footwear sales.

"India's footwear sector naturally evolved out of its mature leather goods sector. India is a current leader in leather footwear production thanks to an available source of raw materials. While pushing to grow non-leather production, India does not currently produce the inputs needed for athletic footwear at anything close to its leather production. That being said, the government has targeted footwear as a key export industry, and is offering incentives to achieve growth. For companies that look beyond current production bases to the middle of the country, there is serious potential in India. Demographically, India is a young country that is growing younger, making it a tremendous opportunity for brands looking to grow sales.

- N. Mohan, Global Head of Footwear Business at Tata International

India's Footwear Exports to the U.S.

2011	2012	2013
10,771,799	13,511,148	16,389,800

India's footwear production grew 21%, by volume, in 2013.

Ethiopia

With duty-free access for major markets, including the United States through the African Growth and Opportunity Act (AGOA), Ethiopia is attracting foreign investment in the footwear sector. As a result, its footwear exports are rapidly growing, leading some U.S. brands to explore Ethiopia as a source of supply for some of their product lines.

A polling of FDRA members identified the following issues and recent developments that affect production in Ethiopia.

- The global demand for leather continued to grow in 2013 resulting in more Ethiopian tanneries exporting to Europe and Asia. This growth has fueled in-country leather capacity.
- Capacity remains relatively modest in Ethiopia. However, Chinese, Italian, and Taiwan-based companies are all considering investments in the near term.
- Expansion will be slow and dependent on international investment to build factories and associated infrastructure.
- AGOA is due to expire on September 30, 2015. While FDRA anticipates that the U.S. Congress will extend the program, uncertainty may affect the overall timing of investments.

Quick Facts

- Ethiopia's footwear exports to the U.S. grew 1871% from 2011 - 2013.
- The majority of footwear produced for the U.S. market was women's leather footwear.
- By 2015, the Ethio-Djibouti Railway project will be completed. This will allow footwear to transit from Addis Ababa to the port of Djibouti in half the current time.
- Transit security has improved drastically in the last decade. Djibouti is home to America's largest military base in Africa with 4,000 troops to fight Al-Shabaab and ensure regional stability. America, France, Italy, England and China also base naval ships in Djibouti as part of fighting piracy and protecting cargo ships.

"Ethiopia is a growing source for leather footwear, thanks in large part to duty-free access under the African Growth and Opportunity Act. This sourcing option will require patience – workers will need to be trained, and infrastructure is lacking, certainly compared to many Asian options. But if a company is willing to look beyond those possible hiccups, Ethiopia is a solid sourcing choice."

Clay Jenkins, SVP, Global Sourcing, Compliance and New Business Development, Brown Shoe

Sourcing Insight: The African Growth and Opportunity Act (AGOA) Is Boosting Footwear Production

The AGOA footwear rule of origin (ROO) requires a minimum regional value content (RVC) of 35%, which must consist of the sum of the cost or value of the materials produced in any one or a combination of AGOA countries, plus the direct costs of processing operations performed in any one or a combination of AGOA countries. There are no restrictions on the use of imported uppers. No more than 15% of the total value of the footwear can come from the United States. Nonetheless, the AGOA footwear ROO is more stringent than U.S. free trade agreements such as CAFTA-DR and Korea (KORUS), which have a simple tariff shift rule for the vast majority of footwear products.

FDRA is committed to working with Congress to extend AGOA and to simplify the ROO to align with the more flexible CAFTA-DR and KORUS free trade agreements.

*FDRA's 2013 Footwear Production Rising Star

Acknowledgements

For the fourth time in as many years FDRA has set out to provide a comprehensive footwear sourcing snapshot to its members and the industry at large. Utilizing current footwear import data, FDRA attempted to provide some insights as to where footwear production and sourcing is trending and how those trends will impact our industry.

This year's report is the most robust and informative to date. FDRA could not have published the 2014 Global Footwear Sourcing Assessment without the help and input from so many of its members and supporters. More specifically, FDRA would like to thank the following individuals and firms for their contributions:

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For additional information on this report or any of FDRA's services, please contact us at info@fdra.org or 202.737.5660.

FDRA *Intelligence to Act*
FOOTWEAR DISTRIBUTORS AND RETAILERS OF AMERICA

About FDRA — 70 Years of Excellence

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. Over the past year, FDRA has 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.

70 years FDRA
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