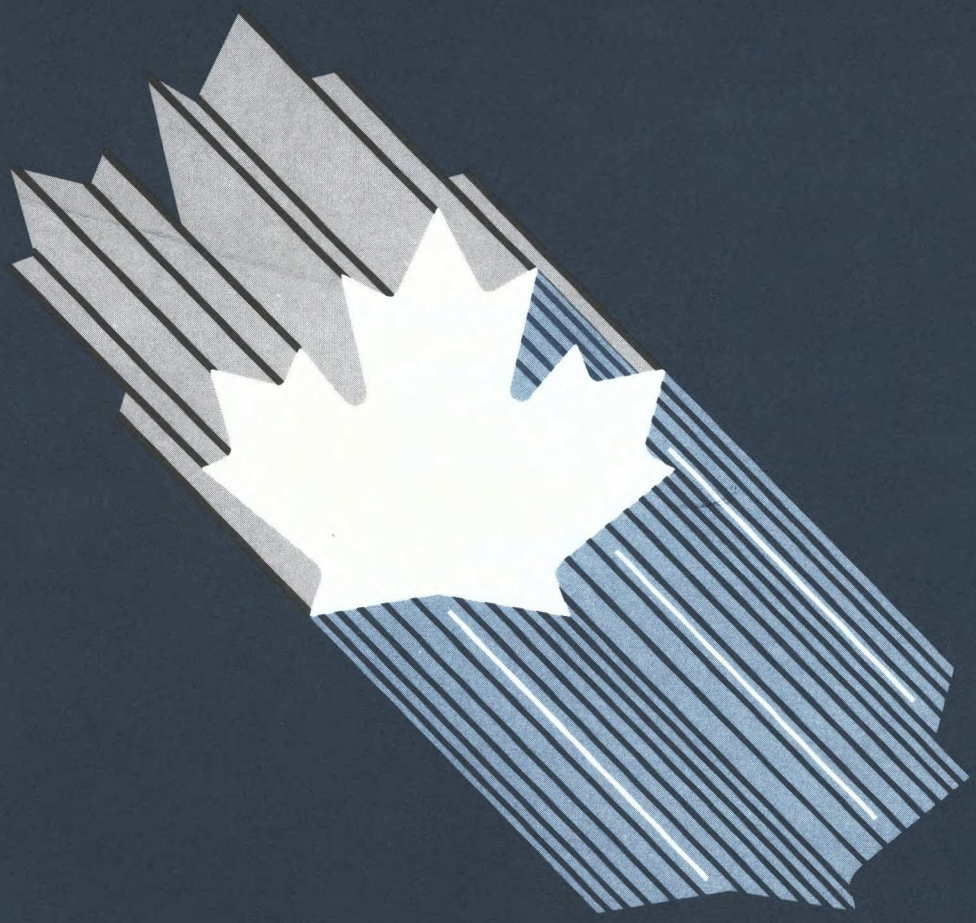
INDUSTRY PROFILE



Industry, Science and Technology Canada
Industrie, Sciences et Technologie Canada

Footwear

Canada

INDUSTRY PROFILE

FOOTWEAR

1988

FOREWORD

In a rapidly changing global trade environment, the international competitiveness of Canadian industry is the key to survival and growth. This Industry Profile is one of a series of papers which assess, in a summary form, the current competitiveness of Canada's industrial sectors, taking into account technological and other key factors, and changes anticipated under the Canada-U.S. Free Trade Agreement. Industry participants were consulted in the preparation of the papers.

The series is being published as steps are being taken to create the new Department of Industry, Science and Technology from the consolidation of the Department of Regional Industrial Expansion and the Ministry of State for Science and Technology. It is my intention that the series will be updated on a regular basis and continue to be a product of the new department. I sincerely hope that these profiles will be informative to those interested in Canadian industrial development and serve as a basis for discussion of industrial trends, prospects and strategic directions.

Robert de Cotret

Minister

Canada

1. Structure and Performance

Structure

The Canadian footwear industry produces all types of footwear available on the world market, but concentrates on leather-uppered boots and shoes for men, women and children in the medium to high-priced range.

In 1986, the industry's 165 establishments and approximately 14 300 employees generated shipments estimated at $830 million in value and exports of $53 million, mainly to the United States. Imports totalled $653 million, of which 42 percent were from Asia and 39 percent from the European Community (E.C.).

Ontario employed approximately 8300 persons and accounted for 48 percent of the establishments in the industry, while Quebec employed 5600 and accounted for 39 percent of the establishments. A further 400 workers were employed primarily in Newfoundland, New Brunswick, Manitoba and British Columbia. The principal footwear producing centres are close to major markets and include Québec City, Montréal, Toronto and the Kitchener-Cambridge area of Ontario.

The main footwear manufacturing operations involve the cutting out of components for shoe uppers and linings; assembling or stitching these components to form the shoe upper; lasting, which involves the drawing of the completed upper over a "foot-like form" and attaching the insoles; attaching the outer sole to the upper, stitching or moulding; and, finally, preparing the shoe for sale and distribution.

Statistics Canada data for 1985* show that the 20 largest establishments (with 200 or more employees) accounted for 48 percent of industry employment, a concentration that was increasing gradually through further acquisitions in 1986 and 1987. Thirty-three medium-sized firms (100 to 199 employees) accounted for 28 percent of employment, while the remaining 116 firms (less than 100 employees) accounted for 24 percent. Plants with 150 or more employees are generally considered to be at the threshold of efficiency and are comparable in size to their counterparts in other countries. There are a few very large establishments, particularly in the Far East, which realize additional economies by specializing in one or two non-leather product lines for the world market.

Four footwear manufacturing firms in Canada, including Florsheim Inc., are foreign owned (three percent). They are generally larger than the average of 95 to 100 employees per establishment, and account for approximately 10 percent of industry employment. Three of these firms, as well as a few Canadian firms producing a range of footwear, including Bata Industries Limited, own a number of retail stores in Canada which provide them with brand recognition and feedback on consumer preferences. This type of vertical integration has also taken place in the United States and other developed countries.

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* *The footwear industry annual census (Standard Industrial Classification — SIC 1712) published by Statistics Canada.*

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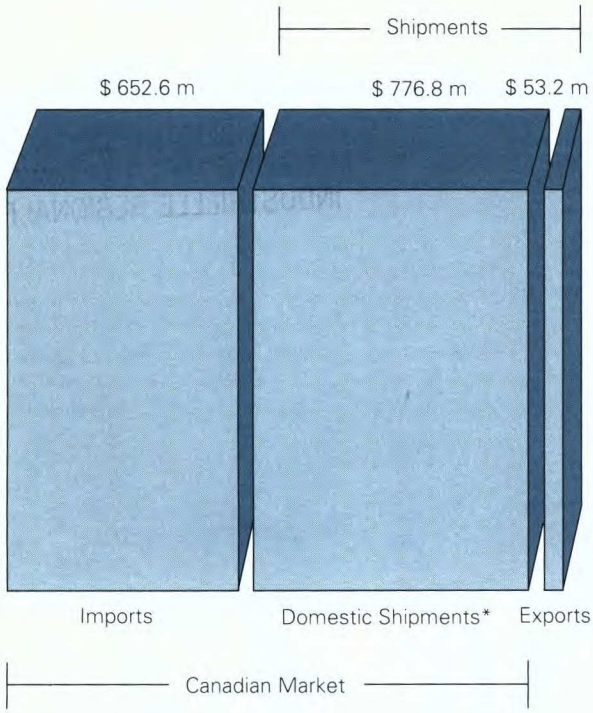


Imports, Exports and Domestic Shipments 1986

** Estimate*

Footwear firms are the major customers of the domestic tanning industry (60 percent of tanning industry output in terms of value) and the shoe findings industry (laces, heels, etc.). They are also important users of coated and other fabrics purchased from the textile industry. The tanning industry employs approximately 2200 pesons, while the shoe findings industry employs an estimated 1000.

The footwear industry is domestically oriented. Its customers are small shoe retailers, department and chain stores and shoe specialty stores. Smaller shoe retailers generally carry a higher proportion of domestic shoes in their inventory than do the larger distributors. Most Canadian firms are not actively involved or well known in international markets. Bata Industries Limited, however, is the largest footwear company in the world. It is a Canadian-owned multinational with an estimated total of 79 000 employees (800 footwear workers in Canada), operating in 91 countries with 97 plants and 6000 retail stores.

Smaller Canadian firms active outside Canada include Natural Footwear Limited (Roots) with retail stores worldwide. Kaufman Footwear, Susan Shoe Industries Limited, Bastien Inc. and Genfoot Inc. also have strong market identification in the United States. With the modest cost of basic technology and the availability of the more expensive machinery on a rental basis, barriers to entry into and exit from the industry are almost non-existent. Historically, the industry has operated at about 65 percent to 75 percent of capacity.

Canadian footwear production is concentrated on leather dress and casual footwear. It competes mainly with footwear imports from Italy, Spain, the United States and Brazil. Collectively, these countries exported 10.3 million pairs of shoes to Canada in 1987, accounting for 67 percent of the imports.

Performance

Between 1974 and 1977, after-tax profits, averaging 6.1 percent on capital employed in the industry, were lower than the all-manufacturing average of 8.3 percent. After the imposition of footwear quotas in 1977, the situation was reversed, with industry profits averaging 11.1 percent as compared to the manufacturing average of 7.3 percent. In 1984, industry profits again fell below the all-manufacturing average. The lower profits in 1984 could be attributable, in part, to higher input costs, particularly those for leather.

Since the late 1960s, the domestic industry has faced growing import competition, particularly from low-cost countries. In 1977, imports totalled 46.4 million pairs. This represents 55.5 percent of the apparent Canadian market, and an increase of 6.5 million pairs, or 16 percent, over 1973. In 1977, the government introduced a three-year global quota on non-rubber footwear, after a finding of injury by the Anti-Dumping Tribunal. The major factor quoted by the tribunal to explain increased foreign penetration was the competitive advantage of imports made possible by lower labour costs. Following their introduction in 1977, footwear import quotas remained in effect, in one form or another, until November 1985. With the exception of women's and girls' footwear, all quotas were discontinued following a recommendation of the Tribunal in June 1985. The remaining quotas expired in November 1988.

The protective environment, created by the 1977 quotas, allowed the industry to maintain the restructuring efforts it had begun in 1974. It gradually upgraded its product lines by reducing production of non-leather footwear, such as sandals and jogging-type shoes, which compete directly with low-cost imports. Instead, it has concentrated on the manufacture of more fashionable and higher-quality leather footwear in the dress and casual categories. In the process, the labour cost, as a percentage of the total value of the product, has been reduced in spite of the additional labour required per pair, due to the increased value of the final product.

The result of this restructuring was relatively stable employment, averaging 15 588 between 1978 to 1985, with a low of 14 400 during the 1982 recession year. In 1985, employment was estimated at 15 800. However, after the partial removal of quotas in November 1985, imports of pairs of shoes increased by 34 percent in 1986 and employment in the industry dropped. Most of the new imports were from low-cost countries which increased their 1986 exports to Canada by 42 percent, in volume, over 1985. The rate of increase moderated to 17 percent in 1987, mainly as a result of consultations with the major exporting countries in this group. These consultations were designed to seek an orderly transition to the post-quota environment by encouraging exporting countries to exercise restraint in their export plans.

However, Taiwan, the People's Republic of China and the Republic of Korea all have increased their leather footwear exports substantially, particularly in the athletic category, ever since quotas were removed on footwear imports (except for women's and girls') on November 30, 1985. The export thrust of Taiwan and the Republic of Korea is also evident in the U.S. market.

Yet another trend in the industry has been the decline in the share of leather footwear in Canada's total footwear market (and, indeed, around the world). Leather footwear now accounts for less than one-half of all footwear sold worldwide. This market shift to non-leather footwear has weakened the competitiveness of footwear firms in all developed countries, including Canada, as the use of less expensive materials has effectively increased the proportional cost of labour.

For many years, Canada has exported from six to seven percent of its footwear production (in pairage terms), with the largest share going to the U.S. market. Canadian exports to the United States, however, have shown only marginal gains in recent years, at least partly because of changes in the exchange rate, particularly since 1984. For the same reason, Canada's exports to Europe have declined as the exchange rate became less advantageous. Exchange rate trends strongly influence the long-term marketing strategies of the industry.

The Canadian industry has traditionally maintained a trade surplus with the United States (an estimated $6 million in 1986). The surplus is due to such factors as exchange rates, global quotas on imports of footwear since 1977, and Canada's reputation as a producer of quality and fashionable, specialized footwear (e.g., winter boots). A complete reversal of this situation occurred in 1987 however, with the industry experiencing a trade deficit with the United States in excess of $8 million, largely attributable to a substantial increase in imported athletic footwear from the United States. Canadian manufacturers do not produce significant quantities of athletic footwear.

2. Strengths and Weaknesses

Structural Factors

The Canadian footwear industry is made up mainly of a number of small firms, most of which are located in two provinces, serving a large, geographically dispersed domestic market. By catering to small niches and relying on low overheads, quick response times and domestic marketing expertise, they have managed to retain a segment of the Canadian market. However, their small size, lack of financial and management resources, limited design capability and export marketing expertise all inhibit the growth required to achieve the necessary economies of scale to compete more effectively against low-cost countries.

Canadian footwear manufacturing is, however, generally competitive with developed countries with similar wage structures. Unit labour and material costs, from 1978 to 1984, were slightly higher in Canada than in the United States. In 1985 and 1986, however, Canadian costs were somewhat lower. If this cost advantage can be maintained, Canadian exports to the United States are expected to improve as U.S. industries do not have any special advantages of scale or technology. However, both countries are under import pressures from low-cost countries.

In recent years, the newly industrialized countries (NICs) have begun to produce leather footwear which competes more directly with the bulk of Canadian production. This development is mainly due to escalating wage rates in the NICs which make non-leather footwear less profitable to export than leather footwear.

In 1986, Taiwan increased its leather footwear exports to Canada by more than one million pairs, or 118 percent, and an additional 1.2 million, or 61 percent, in 1987. Hong Kong also increased its leather exports substantially during this period. These increased exports competed directly with Canadian production.

With restructuring and specialization, assisted in many cases by government productivity programs, the domestic industry has improved its competitive position. In general, it is now competitive with imports from the United States and Europe at the high-priced end of the market. It has all but abandoned the largely non-leather, athletic-leisure market to imports from the Far East. In 1987, low-cost sources supplied 81 percent of all footwear imports into Canada, measured in pairs, the bulk of which was non-leather. Taiwan and the Republic of Korea together accounted for more than 53 percent.

In its 1985 comprehensive report on the situation in the domestic footwear industry, the Canadian Import Tribunal concluded that the process of adjustment in the early 1980s had strengthened the industry and enabled it to compete successfully against imports in the coming years. In November 1985, therefore, all quotas on footwear imports were removed, except for those on women's and girls' shoes, the production of which the tribunal found remained vulnerable to injury from imports. Women's and girls' footwear account for 36 percent of the Canadian footwear market and 43 percent of Canadian production, measured in pairs. The remaining quotas expired in November 1988. Removal of quotas from 1985 to 1987 resulted in a 48-percent increase in imports, mainly from Taiwan, the Republic of Korea and the People's Republic of China, accompanied by a 13-percent decrease in Canadian production, measured in pairs. Under this new trading environment, the industry has been involved in mergers and buy-outs designed to strengthen its competitive position.

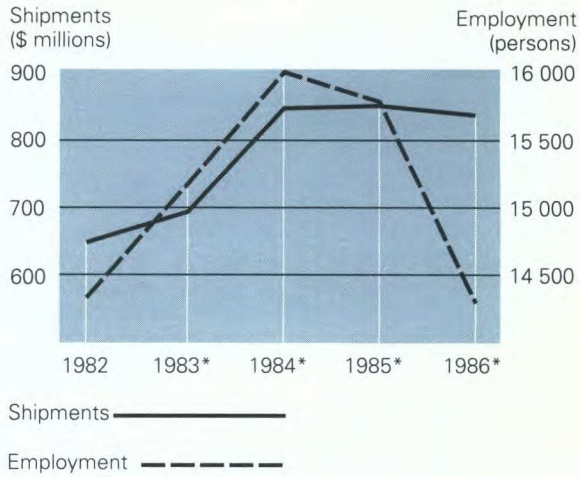
Management expertise in the footwear industry has improved in all areas since 1974, particularly in production and financial control. Although many firms have made major improvements in marketing, it remains a capability (along with faster introduction of high technology) on which the industry as a whole needs to focus in order to take advantage of domestic and international opportunities.

Trade-related Factors

Canadian tariffs on imports of non-rubber footwear qualifying for Most Favoured Nation (MFN) status vary between 20 and 23 percent, while tariffs on imports of comparable non-rubber footwear qualifying for General Preferential Tariff (GPT) status are currently in the 13 to 14 percent range. The latter accounts for approximately 25 percent of all imports, by value, entering Canada.

The European Community (E.C.) rates are from seven to eight percent, while U.S. rates vary between eight and 10 percent.

Almost 48 percent of the industry's input costs are leather, about one-quarter of which is imported. The United States accounts for about one-fifth of these imports, which are dutiable at rates of 12.5 percent. Plastic-coated fabrics account for another seven percent of input costs and are subject to duty rates of some 25 percent for vinyl or 7.5 percent for polyurethane. Most other input materials, on which tariff rates range from 10 to 15 percent, are obtained domestically. Canada has no non-tariff barriers (NTBs) on imports of material inputs. Unlike apparel and textiles, footwear is subject to the normal rules of GATT, which require that any quota be applied to imports from all sources and not just to those from low-cost countries.



Total Shipments and Employment

** Estimate*

Australia, New Zealand and Japan maintain footwear import restrictions in one form or another. In the case of the E.C., formal quantitative restrictions have been limited to imports from eastern European countries and the People's Republic of China, while industry-to-industry arrangements are in place between the United Kingdom, the Republic of Korea and Taiwan, as well as between France and Taiwan. Many E.C. countries also effectively restrict imports of safety footwear by enforcing rigid safety standards. The U.S. footwear industry is currently afforded no special border protection measures other than a "Buy America" advertising campaign, despite an import market share which has reached more than 80 percent.

Under the Canada-U.S. Free Trade Agreement (FTA), footwear tariffs will be phased out over 10 years, while those on all leathers used in the footwear industry will be phased out over five years.

Technological Factors

Technology in the traditional footwear industry has remained essentially unchanged for a number of years, except for ongoing improvements in machinery to reduce labour and overhead costs. However, the industry is moving ahead in the introduction of computerized management information and control systems, which are having a positive effect on deliveries and quality. The main technological breakthroughs over the past few decades have been injection moulding of the soles to the uppers (used mainly in sports footwear, which is not produced in Canada to any great extent, and in work boots), and the slush-moulding process to produce cheaper winter footwear and rainboots. Canada has kept up-to-date with these developments, as have most other international footwear companies, since footwear equipment is sold by specialized machinery manufacturers on the world market.

As can be seen by the fact that production of footwear continues to be highly labour intensive, the evolution of technology has been slow. Unlike primary textiles, there have been no technological breakthroughs which could offset the labour cost advantage of third-world suppliers to any great extent. The production process, involving numerous, relatively complex operations, and the nature of the raw material, which is less uniform and more difficult to work with than textile material, are the major factors impeding the progress of automation in this industry. However, over the next decade, the application of computers and computerized machinery (including the latest computer-aided design/computer-aided manufacturing (CAD/CAM) systems) is expected to reduce the total costs substantially, not only in Canada, but around the world.

The effect of these new technologies will be to reduce the competitive advantage of low-cost countries as compared with developed countries such as Canada. However, the cost of introducing the new technologies is prohibitive for small firms in a fragmented Canadian industry operating in a relatively small market. As a consequence, the Footwear and Leather Institute of Canada (FLICCC), assisted by government, has established two technology centres — one in Quebec and one in Ontario — to provide common services, particularly computer-aided design (CAD), and training of product design personnel, so that smaller companies can benefit from these new technologies.

3. Evolving Environment

The Canadian footwear industry has restructured its operations over the past decade, taking advantage of import restrictions, in place since 1977, to modernize and rationalize its operations and improve its management skills. With the complete removal of footwear quotas in November 1988, the strengthened industry will be facing stronger competition from low-cost imports, including leather footwear in which it is strongest.

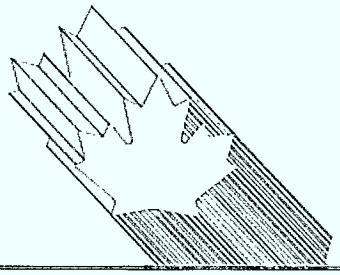
Import levels are expected to stabilize by 1990. Ongoing consultations with low-cost countries, high tariffs and continued government support for projects such as the footwear technology centres now being introduced, should contribute to a more orderly market in the future.

Over the next five to 10 years, the following factors are expected to affect the industry if exchange rates remain relatively stable:

- The FTA will bring the Canadian industry face to face with stronger U.S. competition in a domestic market already dominated by imports. Imports from the United States should increase in dress and casual footwear, one of the Canadian industry's strengths, in part because of the increased variety of styles that will be offered. To offset this increase, the industry will expand exports to the United States to provide greater variety and quality to U.S. consumers.
- The FTA will provide the opportunity for Canadian footwear manufacturers to reduce some input costs immediately (e.g., fine leathers). In addition, it will accelerate the specialization of their production, with the opportunity to achieve economies of scale in a much larger market, and allow them to increase exports of recognized Canadian quality footwear such as fashionable shoes, winter boots and work footwear. The overall effect of the FTA should be the continuation and possibly acceleration of the rationalization already occurring in the industry.
- The current round of Multilateral Trade Negotiations (MTNs) will also affect the performance and structure of the industry. In particular, the outcome of those negotiations on tariffs, safeguard measures and rules of origin will have a direct bearing on the industry's future.

4. Competitiveness Assessment

The Canadian footwear industry is generally considered to have up-to-date production facilities equal to those of its U.S. counterpart. It has undergone major changes in the past 10 years, specializing its product lines, raising the level of expertise of its management, and improving its production, performance, financial control and domestic marketing. While it is only a residual supplier in many product areas, notably the low-end part of the market, the industry is generally competitive in relation to the developed countries. It exports successfully to the United States in certain quality niches.



The net impact of the FTA is expected to be moderately positive for the Canadian industry.

Except for certain products, such as injection-moulded plastic footwear, which requires relatively little labour input, existing tariff levels cannot, by themselves, fully offset the wage advantage of low-cost countries. Non-leather imports from low-cost countries and imports of leather dress and casual footwear from Brazil, East European countries, and now from newly industrialized countries will continue to exert pressure on domestic manufacturers to continue to specialize, upgrade product lines and expand their market in narrower niches.

For further information concerning the subject matter contained in this profile, contact:

Service Industries and Consumer
Goods Branch
Industry, Science and Technology Canada
Attention: Footwear
235 Queen Street
Ottawa, Ontario
K1A 0H5

(613) 954-2921

PRINCIPAL STATISTICS

SIC(s) COVERED: 1712 (1980)*

	1973	1982	1983	1984	1985	1986
Establishments	164	162	172	172	166[e]	165[e]
Employment	16 826	14 355	15 200[e]	16 000[e]	15 800[e]	14 300[e]
Shipments:						
Value ($ millions)	286.3	651	698.3	843	850.4	830[e]
Volume (million pairs)	46.1	34.1	36.2	41.9	41.2	40.0
Gross domestic product (constant 1981 $ millions)	275.9	313.4	335.4	374.6	366.7	373.1
Investment ($ millions)	N/A	7.1	21.2	18.6	18.9	17.9
Profits after tax:						
($ millions)	N/A	26.7	20.3	16.3	20.6	N/A
(% of income)	N/A	3.7	3.1	1.9	2.3	N/A

TRADE STATISTICS

	1973	1982	1983	1984	1985	1986
Exports ($ millions)	18.4	49.3	46.8	52.1	56.1	53.2
Domestic shipments ($ millions)	267.9	601.7	651.5	790.9	794.3	776.8
Imports ($ millions)	94.5	373.0	403.5	460.2	483.3	652.6
Canadian market ($ millions)	362.4	974.7	1 055.0	1 251.1	1 277.6	1 429.4
Exports as % of shipments (by value)	6.4	7.6	6.7	6.2	6.6	6.4
Imports as % of domestic market (by value)	26.1	38.3	38.2	36.8	37.8	45.7
Canadian share of international market — %	N/A	1.2	N/A	N/A	N/A	N/A

Source of imports (% of total value)		U.S.	E.C.	Asia**	Others
	1982	7	31	36	26
	1983	6	30	42	22
	1984	6	37	42	15
	1985	7	41	39	13
	1986	7	39	42	12

Destination of exports (% of total value)		U.S.	E.C.	Asia	Others
	1982	83	11	—	6
	1983	86	10	—	4
	1984	92	5	—	3
	1985	94	3	—	3
	1986	94	3	—	3

(continued)

REGIONAL DISTRIBUTION — Average over the last 3 years

	Atlantic	Quebec	Ontario	Prairies	B.C.
Establishments – % of total	2	43	48	6	1
Employment – % of total	2	39	58	1	—
Shipments – % of total	2	36	61	1	—

MAJOR FIRMS

Name	Ownership	Location of Major Plants
Taurus Footwear Inc.	Canadian	Various locations, Ontario and Quebec
Bata Industries Limited	Canadian	Batawa, Ontario
Susan Shoe Industries Limited	Canadian	Hamilton, Ontario
H.H. Brown Shoe Co. (Canada) Ltd.	American	Richmond, Quebec
Bastien Inc.	Canadian	St-Émile, Quebec

e Estimate
* Excluding rubber footwear
** Taiwan, the Republic of Korea, Hong Kong, the People's Republic of China, India
N/A Not available

Note: Statistics Canada data have been used in preparing this profile.

Regional Offices

Newfoundland

Parsons Building
90 O'Leary Avenue
P.O. Box 8950
ST. JOHN'S, Newfoundland
A1B 3R9
Tel: (709) 772-4053

Prince Edward Island

Confederation Court Mall
Suite 400
134 Kent Street
P.O. Box 1115
CHARLOTTETOWN
Prince Edward Island
C1A 7M8
Tel: (902) 566-7400

Nova Scotia

1496 Lower Water Street
P.O. Box 940, Station M
HALIFAX, Nova Scotia
B3J 2V9
Tel: (902) 426-2018

New Brunswick

770 Main Street
P.O. Box 1210
MONCTON
New Brunswick
E1C 8P9
Tel: (506) 857-6400

Quebec

Tour de la Bourse
P.O. Box 247
800, place Victoria
Suite 3800
MONTRÉAL, Quebec
H4Z 1E8
Tel: (514) 283-8185

Ontario

Dominion Public Building
4th Floor
1 Front Street West
TORONTO, Ontario
M5J 1A4
Tel: (416) 973-5000

Manitoba

330 Portage Avenue
Room 608
P.O. Box 981
WINNIPEG, Manitoba
R3C 2V2
Tel: (204) 983-4090

Saskatchewan

105 - 21st Street East
6th Floor
SASKATOON, Saskatchewan
S7K 0B3
Tel: (306) 975-4400

Alberta

Cornerpoint Building
Suite 505
10179 - 105th Street
EDMONTON, Alberta
T5J 3S3
Tel: (403) 495-4782

British Columbia

Scotia Tower
9th Floor, Suite 900
P.O. Box 11610
650 West Georgia St.
VANCOUVER, British Columbia
V6B 5H8
Tel: (604) 666-0434

Yukon

108 Lambert Street
Suite 301
WHITEHORSE, Yukon
Y1A 1Z2
Tel: (403) 668-4655

Northwest Territories

Precambrian Building
P.O. Bag 6100
YELLOWKNIFE
Northwest Territories
X1A 1C0
Tel: (403) 920-8568

For additional copies of this profile contact:

Business Centre
Communications Branch
Industry, Science and Technology Canada
235 Queen Street
Ottawa, Ontario
K1A 0H5

Tel: (613) 995-5771

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