What drives footwear exports of Vietnam and Cambodia

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This article is a follow up to the one by Saeba Ruslana of Policy Research Institute (PRI) entitled 'Why Footwear could be the next RMG' that was published in the Financial Express, in its issue on March 2017.

Footwear is a leading export item of Bangladesh at $714 million in fiscal year (FY) 2016. In Bangladesh the per capita usage of footwear is rising and the per capita consumption of footwear, including leather, is three-pairs, which was 1.7-pairs five years back. The local footwear market that was worth Tk 160 billion (16,000 crore) in 2016 is growing at an annual rate between 10 and 15 percent.

The sector has a high potential for capturing a larger share of the global market, which is about $240 billion annually for all types of footwear like leather, manmade leather and denim or others fabrics. But in recent years Vietnam and Cambodia have been forging ahead in seizing big chunks of the European Union (EU) and North American markets with strategies that are worth noting and emulating. Bangladesh, though far behind, has all the potential to catch up fast.

Footwear exports from Bangladesh rose by 22.96% from FY 14 to FY16 as shown in Figure 1. However, it faces tough competition from China, the world's leading footwear exporter at 40.3% share, followed by Vietnam and Cambodia which are the two other thriving exporters. Bangladesh barely holds only one per cent of this market as shown in Fig.2.

Recently, China has been withdrawing from the global leather goods market and Bangladesh should be ready with huge potential to attract foreign investment in the sector. China's annual leather footwear production had dropped by 5.29 per cent in 2013 and 7.45 per cent in 2014. The main reasons for China's focus shift, is the rising labour cost. In consequence, Bangladeshi manufacturers are now planning to fill the vacuum in the international footwear market being left by China but Vietnam and Cambodia are ahead in this game as we will find out.

In 2016, footwear sector in Vietnam recorded a strong performance with current value growth of 14%, which was mainly to gradual economic improvement and higher awareness among the Vietnamese consumers of branded products .

What drives the Vietnam Footwear industry? Firstly, Vietnam's leather and footwear industry is fairly competitive mainly due to the country's economic, political and social stability in addition to its abundant supply of cheap and highly-skilled labour. Vietnam has become the second largest footwear exporter in the world, after China ($53 billion), accounting for about 11% of the global market. In 2016 Vietnam's revenues of footwear exports reached US$16.2 billion, up 8.8% from 2015 and the figure is expected to hit close to US$18 billion in 2017 and US$54 billion by 2030. The structure of footwear exports has also seen improvement as high-value products are currently making up 10%, up from the previous 5%.

Secondly, Vietnam has established a firm position among exporters to the US. Despite an imposed average tariff of 14.3% since 2011, Vietnam's footwear exports to the US have increased by 20-21% a year and captures 10% of the US market footwear.

Free trade agreements with the Republic of Korea, Russia, Kazakhstan and Belarus in addition to an agreement with the EU to take effect in the future, are opening new windows for Vietnam's leather and footwear industry thanks to large tariff cuts, easier access to technology and lower input costs. In addition, Vietnam's leather and footwear sector remains the beneficiary of support projects from the EU, United Nations Industrial Development Organisation (UNIDO), SWITCH Asia and Confederation of British Industries (CBI).

Fourthly, the formation of the Association of South East Asian Nations or ASEAN Economic Community (AEC) has created new conditions to stimulate Vietnam's leather and footwear industry.

In addition, the community affords Vietnam an opportunity to cooperate with other countries in the region to develop materials and form new supply chains, thereby helping to reduce investment costs, increase productivity, reduce the ratio of imported materials, raise added values and contribute to maintaining market shares in the US, EU and Japan.

Fifthly, Vietnam is negotiating the Regional Comprehensive Economic Partnership (RCEP), a trade agreement which includes ten ASEAN countries, China, India, Japan, the Republic of Korea (ROK), and New Zealand, and is expected to be finalised in 2017. Although the agreement’s contents and scope are smaller than those of the Trans Pacific Partnership (TPP), it is also expected to stimulate trade across Asia and encourage investment in new supply chains and increase the region’s appeal as a common production base.

Vietnam signed the (now nearly defunct) TPP deal and other free trade agreements (FTAs) expecting they would present more opportunities in production and business for Viet Nam’s enterprises, including firms from the textile, garment, leather and footwear industries. Outlook for Vietnamese footwear is positive, especially when export tariffs to the EU and other TPP countries (probably in a truncated TPP) will be reduced to 0% and Vietnam abides by the geographic origin regulation for its products.

A number of companies have also actively increased investment, reformed corporate governance and restructured them selves. Moreover, Vietnam’s leather and footwear sector is working to raise the domestic content to 60% to meet the strict rules of origin in the trade agreements that it has signed.

In the global supply chains of giant manufacturers such as Nike and Adidas, Vietnamese companies are at a passive position as they are only outsourced companies and their production heavily relies on the outsourcers’ orders. Currently there are about 800 enterprises with more than 624,000 employees (75% of whom are female); 70% of big exporting enterprises are joint ventures or 100% foreign capital. 90% of Vietnam’s footwear are processed products that are dependent on technical devices, technology, design, and sources for imported supplies of raw materials, accessories in this sector in Vietnam, of which the foreign-invested enterprises account for only 23% but contribute 65% of export revenues.

Vietnam is independent of its materials for canvas shoes (100%), however more than 70% of enterprises completely depend on imported materials. Every year, Vietnam spends approximately US$ 300 million on importing leatherette and leather. Leather factories are incapable of supplying 10% of their demand and are now working with only 25% of their capacity due to lack of materials. Raw materials account for a large proportion (68-75%) of price structure of footwear.

What drives the Cambodian industry? As for the Cambodia footwear sector it continued to record strong growth in 2015, with exports increasing by 21.8% to a total of US $ 538 million largely destined for the EU market followed by the US, which represent a 18% share. One unique aspect of the footwear industry's growth is that the value of each unit of output has been growing at the same time as the volume of the exports has increased. This growth in unit value implies that the footwear industry is climbing the value chain in sophistication and quality faster than other export sectors.

Cambodia's duty-free access to the EU has also attracted foreign investors from South Korea, Vietnam and other countries that do not enjoy preferential treatment. Most of the leather and other raw materials used to produce footwear are sourced from within the ASEAN region. Unlike garments, competition is less affected by order cycle. At the same time, there are greater opportunities for local design and procurement since there is less diversity in fashion and in materials. . In 2015, combined garment and footwear exports accounted for 78% of the country's total merchandise exports as shown in Fig 3.

There are few restrictions on foreign investment in Cambodia. Foreign investors may own 100 per cent of their investment projects except in some sectors. There is little or no discrimination against foreign investors either at the time of initial investment or after investment. Qualified Investment Projects are entitled to receive different incentives such as profit tax exemptions, special depreciation, and duty-free import of production equipment and construction materials. Investment projects located in designated special promotion zones or export processing zones are also entitled to the same incentives.

According to the Cambodian Investment Board (CIB), 78 new garment and footwear investment projects were approved in 2014. These projects were largely funded by investors from mainland China and Hong Kong (China), with a small proportion from Taiwan and other economies. The new garment and footwear projects approved in 2014 accounted for US $452 million of fixed assets (a slight decline compared to 2013). Investments in the garment and footwear sector represented 28% of the total newly approved investment in fixed asset value in 2014.

In conclusion, leather and footwear sector of Vietnam and Cambodia will continue to reform and integrate further into the global economy thanks to institutional reforms, restructuring efforts and internal potentials of enterprises, whether the TPP is present or not.

Production outsourcing has driven export growth in Vietnam, and Cambodia which is the main driver for foreign direct investment (FDI) and the development of a well-integrated supply chain. Global footwear markets are dominated by leading retail companies through outsourcing much of their production to developing countries which requires a complex and sophisticated supply chain .In this kind of production structure, efficient cross-border supply chain management becomes critical for success and that has been made possible by FDI inflows into countries like China, Vietnam, Indonesia, and Cambodia as shown in Fig4.

Without courting FDI in the sector (domestic and Export processing Zone or EPZ), it is fair to say that Bangladesh's footwear exports can still expand but is unlikely to become a $ 5.0 billion export industry by 2021. The importance of inbound FDI goes well beyond mere financial capital. Multinational enterprises bring valuable know how as well as links to global supply chains and markets. Longer-term, the economic impact of these "non-financial resources" can be much larger than that of financial capital.

By now Bangladesh economy has made commendable progress by mobilizing domestic sources of finance rather than relying on other foreign sources of finance that may delay the process. First, as a least developed country (LDC), Bangladesh has been given duty-free quota-free (DFQF) access for its exports by many developed and developing countries (e.g. Japan, , India, China, EU) under the WTO regime of GSP in its various forms (like EBA in EU) and subject to various degrees of rules of origin (ROO) restrictions. This gives Bangladesh exports price advantage over competitors whose exports to these markets are subject to duties.

Bangladesh is also emerging as a leading supplier of non-leather footwear — the most dynamic component of footwear market — at low prices and good quality. The country is now supplying sports shoes, flip-flops and boots to a number of leading global retailers including H&M,, Skechers, Fila and Puma. Non-leather footwear exports stood at $171.57 million in FY14. Presently there are 110 export-oriented factories manufacturing footwear in Bangladesh. Enhancing its global reputation in footwear (as it did in RMG) and capturing more of the future market will be the clear strategies going forward. There is much to learn from the success of Vietnam and Cambodia, not far from our neighbourhood.