

**An Examination of the Sources of Competitive Advantage in the
Wenzhou (China) Footwear Industry**

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ABSTRACT

The purpose of this thesis is to explore the sources of competitive advantage in the Wenzhou, China footwear industry. China produces 52% of the world's footwear and Wenzhou is its most important production region accounting for 25% of the country's output. In addition Wenzhou's enthusiastic transition to a free market economy is well known in China as the Wenzhou Economic Model. These two facts, the industry's importance and the region's transition toward capitalism, make it an interesting subject for research on competitive advantage.

The research begins by applying Michael Porter's framework on the competitive advantage of nations to the case of the Wenzhou footwear industry. In addition to assessing the industry on each of the four factors comprising Porter's model: (1) factor endowments, (2) related and supporting industries, (3) the nature of demand conditions and (4) firm strategy, structure and rivalry, the research also discovered other factors only loosely considered by Porter. These included the role played by the local government and community leaders in such initiatives as the creation of a "Wenzhou" brand and the establishment of the annual Wenzhou Footwear Fair which helps to showcase the city as a world centre for the footwear industry..

The impact of China's recent entry into the World Trade Organization on both the footwear and supporting industries was also analyzed. The research concludes that elements of Porter's framework play an essential role in the region's competitive advantage. However it also concludes that role of the government in supporting the industry and creating initiatives such as the Trade Fair, industrial parks and the promotion of the Wenzhou brand is also critical.

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CHAPTER 1

INTRODUCTION

1.1 Competitive Advantage in the Wenzhou Footwear industry

The research question contained in my thesis pertains to the origin of competitive advantage. It will try to explain how geographic regions create and sustain competitive advantage for specific industries so that this knowledge can serve as a model for other firms and regions. Wenzhou, is one of three leading centres of the footwear and leather industries in China. The others are Dongguan with 1,200 shoe factories which concentrates on ladies shoes, sports footwear and casual shoes; Jinjiang, with 1,000 factories concentrating on sports footwear; and Chengdu, with 3,000 small and medium sized shoe factory enterprises producing low grade women's shoes and children's shoes. In addition there are lesser centers that have significant shoe manufacturing such as Shandong.

Table 1 shows that at present, there are 6,300 shoes & leather enterprises in Wenzhou, having 18.5 billion RMB output values and 4 billion RMB export value which represents 12.74% and 12.6% of the Chinese total respectively.

Table 1 Value of Wenzhou Footwear Industry

Wenzhou Shoe and Leather Enterprises	Value in Billion RMB Canadian Dollars	Percentage of all Chinese regions
Output Value	18.5 C\$3.5	12.74%
Export Value	4 C\$0.73	12.6%

Three enterprises have won the title of "Chinese Ten Shoes Kings", and 34 enterprises have gained the "Genuine Leather Mark" (Equivalent to 38% of all China companies). Moreover, the greatest shoe material markets, cowhide markets, pigskin markets, and footwear machinery markets, all are in Wenzhou. Specialists have predicted that the focus of China footwear, shoes & leather industries will be in Wenzhou, which has established a substantial foundation for stepping into the international market.

The Wenzhou footwear and leather industry has a long and well-known history. Early in the Chenghua epoch of Ming Dynasty, Wenzhou shoes were listed as tributes. In the 1920's a leather-making district, a leather shoe district and leather appliances district had been established in Wenzhou. By the early 1930's, Wenzhou shoe products had spread throughout half of China and trading relations in shoe leather had been established with some southeastern Asian countries such as Singapore, The Philippines, and Indonesia. After the establishment of the

Peoples Republic of China, the Wenzhou shoe and leather industry developed rapidly. Many national firsts, such as the first pair of pigskin shoes, the first batch of vulcanized leather shoes, and the first pair of adhesive rubber/leather shoes industry, were developed in Wenzhou. In 1978, at the beginning of China's economic reform and openness policy, the output of leather shoes had reached 3,500,000 pairs. Wenzhou, as one of the sources of China's footwear industry, is representative of the industry's history in China. In the 1990's, the Wenzhou City government developed and began to implement its "famous brands" strategic policy, the purpose of which was "to establish the city (as a footwear center) relying on quality, and the business development of famous brands". Over the past ten years the Wenzhou footwear industry has achieved (1) a fairly large size, (2) a coherent industry development, (3) an effective method of industry coordination and (4) an advanced market network and (5) a unique area economic culture.

Among the ten so called "China Genuine Leather Shoe Kings" authorized by the Light Industry Department and the China Leather Industry Association, three firms are in Wenzhou. They are Kangnai, Aokang, and Jierda. Now a substantial amount of industrial activity in the city has formed around an industry system consisting of the three supporting and related industries of leather processing chemicals, leather machinery, and leather hardware and shoe materials in addition to shoe manufacturing. Wenzhou houses some 1000 advanced shoes leather production assembly lines operated by over 20 shoe leather manufacturers, and employs over 400,000 persons in these related industries thus standing as one of the important bases of leather products manufacturing in China. Naibao, Dongyi, Zheda, Rongguang, Duoerkang, Huite, Red Dragon Fly, Qiaonai, Fushida, Sainasi

brands are also well known brands throughout China. Wenzhou shoes are gaining in the foreign market segment of Chinese footwear manufacturers. Various brands of Wenzhou shoes have spread beyond the domestic Chinese markets and have entered into the competitive international market. All these advances indicate that the quality, quantity and grade of Wenzhou shoes are well advanced in China, and that the Wenzhou shoe industry is living up to its reputation. With the further confirmation of Wenzhou as “China’s Shoe Capital”, Wenzhou will reinforce its leading role even more. The Wenzhou industry leaders are determined that its shoes brands will become established in the international footwear market in the first quarter of this century.

1.2 Michael Porter’s Competitive Advantage of Nations

According to Michael Porter’s Competitive Advantage of Nations (Porter, 1990) the basic unit of analysis for understanding competition is the industry. The industry is a group of competitors producing products or services that compete directly with each other. A strategically distinct industry encompasses products where the sources of competitive advantage are similar. The industry is the arena in which competitive advantage is won or lost. Firms, through competitive strategy, seek to define and establish an approach to competing in their industry that is both profitable and sustainable.

My thesis uses the competitive advantage theory to explore the reasons why the footwear industry emerged, developed and expanded in Wenzhou, China. It explores how the area advantage contributed somewhat and then seeks to explain the related elements that constitute the area such as geographic location, culture, government influence, policy and economic philosophy.

Michael Porter's contribution (Porter, 1990) focuses more on the perspective of international business. Porter endeavors to give persons interested in opening or operating a business in an international environment a more realistic approach to doing business abroad by helping them to select an industry that will be internationally competitive. Porter's paradigm, which is partly based on his work on competitive strategy and industry analysis in domestic industries (Porter, 1980), challenges the 200-year-old concept of "comparative advantage" in economic analysis of international competitiveness. Porter and his associates conducted in-country research in ten leading nations closely studying the patterns of industry success and the company strategies and national policies that achieved it.

Porter's research identifies the fundamental determinants of national competitive advantage in an industry, and how they work together as a system. He explains the important phenomenon of "clustering," which is the key concept in his system. By clustering, related groups of successful firms and industries emerge in one nation to gain leading positions in the world market.

Among the over 100 industries examined are the German chemical and printing industries, Swiss textile equipment and pharmaceuticals, Swedish mining equipment and truck manufacturing, Italian shoes, fabric and home appliances, and American computer software and movies. Building on his theory of national advantage in industries and cluster, Porter identifies the stages of competitive development through which entire national economies advance and decline.

Porter's findings are important for both firms and government policy. He describes how a company can tap and extend its nation's advantages in

international competition. Porter provides a plan for government policy to enhance national competitive advantage. (Monitor Group, 2002). Although some scholars note that Porter's model has not yet been subjected to critical empirical testing (Hill, 2003) they acknowledge that it has already made an important contribution to thinking about trade.

According to Porter, four broad characteristics of a nation determine the environment in which local firms compete and these characteristics either hinder or support the creation of international competitive advantage. These characteristics are:

1. **Factor conditions** The nation's position in factors of production, such as skilled labor or infrastructure, necessary to compete in a given industry.
2. **Demand conditions.** The nature of home demand for the industry's product or service.
3. **Related and supporting industries.** The presence or absence in the nation of supplier industries and related industries that are internationally competitive.
4. **Firm strategy, structure, and rivalry.** The conditions in the nation governing how companies are created, organized, and managed, and the nature of domestic rivalry.

In addition to these four economic variables, Porter also acknowledges the important roles that governments play in supporting competitive advantage. A Key element of Porter's model is the relationships among these characteristics, expressed in a diamond shape. The diamond represents a mutually reinforcing system where the influence of one attribute depends on the others. Sophisticated

domestic demand conditions, for example, not only influence strategic responses but also encourage the development of related and supporting industries such as research institutes. A second key element of Porter's diamond model is the importance placed on clustering whereby successful industries in a country are grouped into clusters of related and supporting industries. These national characteristics will be examined more fully in chapter 4 where they form the central focus of the analysis of the Wenzhou footwear industry.

Besides trying to apply Porter's diamond to the Wenzhou shoe industry, my thesis must also take into account the existing phenomenon that Wenzhou is a small area with a unique policy and culture. One historical explanation for the emergence, development and continued success of the Wenzhou footwear industry has been simply its low labor cost. This thesis concludes, however, that all of Porter's diamond is important, moreover that government policy, a free market approach, a high capital reinvestment rate and the development of highly skilled workers all contribute importantly to Wenzhou's competitive advantage.

In Chapter 3 I will give some examples of the existing successful footwear industry in Wenzhou, China. At the same time I will summarize the most important advantages that the existing Wenzhou footwear industry have gained and will continue to develop in the future. Chapter 4 relates the facts to Porter's model and demonstrates the linkages among the elements of the model as well as the linkages between the model and other factors such as the local culture, policies and other useful resource favourable to footwear production. In particular, the entry of China into WTO gives more confidence to the leadership of the footwear

industry in Wenzhou to use the trade liberalization to benefit the trading here.

1.3 The Entry of China into the WTO and its Effect on the Footwear Industry

China's entry into WTO meant more gains than losses to its leather industry as a whole, with different sectors subject to different impact. The entry is favorable to tanning, shoes making, leather clothing sectors, but for leather, chemicals and machinery the impact is more negative than positive.

The leather refining is an industry that earns foreign exchange through export. Its export value account for over 50 per cent of its total production value. Thus the leather industry relies heavily on its export. After China became a members of the WTO, the leather industry began to share the benefits brought by the integration of economy. One of the most direct benefits is to increase export. With the cancellation of unilateral quotas on China's exports, the leather industry will expand its export program in an all-round way. On the negative side, following China's entry into WTO; the government will greatly give up its protection on its domestic industries, thus undergoing to a certain extent negative influences on leather making, leather chemicals and machinery.

1.3.1 China's WTO Entry Benefits the Footwear and Leather Sectors Most.

Some of the positive and negative results of the entry of China into WTO are:

- (1) As the import tariff declines, local enterprises can equally procure the raw and auxiliary materials, chemicals, and machinery it needs. It will help to lower cost and improve product quality, so as to sharpen their competitiveness to meet the challenge.
- (2) Local enterprises may expand their exports dramatically, because they will

have the same rights as those enjoyed by the other WTO members This will be conducive to tapping new world market in a concerted way.

- (3) With more and more foreign companies and products entering China's market, local enterprises are sure to lose some market share and be confronted with more competitive pressure.

China's WTO entry also brings new impetus to the local markets. The advanced technology, management know-how and concepts introduced from abroad will help local enterprises to improve its operational mechanisms.

For the footwear industry per se (as opposed to the supplier and supporting industries already mentioned) the unfavorable aspect of W.T.O entry will be the increasing imports of high-end leather shoes and products which will have a negative impact on those local enterprises engaged in such kinds of production. Fortunately the most imported leather products are the most expensive grade, which does not really put great pressure on local enterprises, who produce medium and utility grade leathers and shoes.

1.3.2 Benefits to Wenzhou from the Entry of China into the WTO

China is stepping into WTO, which shows a bright future on shoes and leather industry. Being labor-intensive, the footwear and leather industries will benefit the most from it. Economists predict that since the Wenzhou municipal government has made a policy to build a " China Shoe Metropolis", it will make their every effort to take the advantage on resource and market, and strengthen its control and power.

The Shoe Capital Industrial park, currently under construction is the future site of Wenzhou's largest and most well reputed shoe-making enterprises.

Occupying an area of 6.5 square Kilometers, scientific research, trading, information exchange and manufacturing are to be conducted at this large shoe production base. It is expected to become the world's largest shoe-making center (Liu and Li, 2003).

The initiative, to become "China's Shoes Metropolis", will push the footwear & leather industry to a new level that will be conducive to penetrating the international market.

1.3.3 China's Dominance of the Footwear and Related Industries.

China is the world's largest manufacturing base and potential market for shoes. China annually produces 6 billion pairs, 51% of the world's total volume. China's annual output of leather shoes reached 2.4 billion pairs, ranking the 1st in the world. China is the 2nd largest consumption market for shoes, its consumption of leather shoes occupies 22% of the global volume, second only to the USA. Shoe trading companies, shoe material traders and shoe machinery manufacturers from Hong Kong, Taiwan, Europe and America have set up their factories and representative offices in China. (Adsale, 2003a).

1.3.4 Trade Liberalization Effects of China's Entry into the WTO

After China entered the WTO, the tariff rate for shoes and related accessories began its step-by-step decline from 24% to 15% or lower in the ensuing five years, which will have made imported products more competitive in the Chinese market. In 2001 (Table 2) the import value of the main commodities (shoes, finished products) of China's leather industry reached USD 3.39 billion, an increase of 5.5% over that of 2000, among which, the import value of leather and raw materials reached USD 3 billion, an increase of 6.5% over that of 2000. At the same time the export value of the principal commodities of China's leather industry reached USD

2.48 billion, an increase of 6.1% over that of 2000. The export quantities of leather shoes is up to 868 million pairs, an increase of 4.7% over that of 2000; the export value of shoe accessories reached USD 419 million, an increase of 9.3% over that of 2000. (Adsale, 2003b)

Table 2. Change in Footwear Imports/Exports 2000-2001

Product	2000	2001	% change
	Millions	Millions	
Footwear Import	US \$3,228.57	US \$3,390.00	5%
Leather & Material Import	US \$2,816.90	US \$3,000.00	6%
Footwear export	US \$2,337.42	US \$2,480.00	6%
Shoes (pairs) export	829	868	5%
Shoe accessories Export	US \$383.35	US \$419.00	9%

1.3.5 Market Situation of the Local Shoe Industry

At present, there are approximately 20,000 Chinese leather enterprises and 1.6 million local employees engaging in China's shoe industry. Eighty-five percent of the domestic shoe production belongs to low to middle-grade. Most of the middle to top-grade shoes are imported from overseas although this is significantly changing. (Adsale, 2003c)

There are 4 major shoe products produced in China: leather, fabric, rubber and plastic shoes. The consumption of leather shoes has increased from 9% to 35% in recent years. Sales emphasis also has been changed from city to suburb and buying behavior has been switched from low to middle-grade products.

According to the market survey, most of the Chinese Consumers accept the price between RMB100~300 for a pair of shoes. In eastern coastal areas, some of the famous local brands with the price range of RMB 200 per pair are mostly

welcomed. People living in big cities like Beijing, Shanghai and Southeast coastal region represent the highest purchasing power for shoes. (Adsale, 2003c).

1.3.6 Fast Growing Market Demand

Among China's total population, about 100 million people have the capability of purchasing imported products. A large number of Chinese people have overseas traveling experience. They are familiar with a lot of international brands of both fashion and footwear. The retail distribution channel, which was monopolized by large department stores and state-owned enterprises is now fully open.

1.3.7 International Market for Domestic Products

The United States of America is the biggest market for China's domestic shoe products. The European Union, Japan and Hong Kong are another three major markets after USA. With China's Entry into WTO, China's export volume on shoes is expected to increase fast in these four international markets.

1.4 Research Methodology

The principle question is what are the sources of competitive advantage in the Wenzhou footwear industry. What characteristics of the Wenzhou account for the growth and success of the industry? Can it all be explained in terms of Porter's model of national competitiveness or are their unique features to the Wenzhou region that are responsible for success?

1.4.1 Justification of the Question—Value of the Study.

1. This research is intrinsically interesting because Wenzhou has enjoyed great success and is considered a model in China for the transition to private

enterprise and free market orientation. The thesis hinges on explaining its success. The timing of the study is appropriate.

2. Its success is not known well in the West. It is a good and interesting question for Westerners who have not had exposure to cases such as this. The success of Wenzhou model is well known in Chinese business and academic circles but is much less known in the West. The research contributes to knowledge because it opens up an interesting business situation for the first time through the translation of Chinese language documents and interpretation of interviews conducted in Chinese.
3. Wenzhou's success is partly related to the region's unique economic system. An important question arises as to how much of the regions competitive advantage can be attributed to the private enterprise, free market model and how much to other theoretical explanations.

1.4.2 Data Collection

The thesis relied on examination of documents and interviews with a few industry participants. The first stage of the interview process was to develop an interview protocol—a collection of general questions that should be raised during the interview. Introductions to industry participants was made through a member of a shoe importing enterprise in Los Angeles who had close industry contacts in Wenzhou. The initial interview protocol consisted of twelve questions regarding the history of the firm, its growth rate and the respondent's impressions of the reasons for success. These questions serve only as a guideline to keep the interview on

track.

1. What is the name of your company? When was it founded?
2. What footwear related product does it manufacture—or what function does it perform (for non-shoe manufacturers such as machinery vendors)?
3. What form is it—Joint Venture, Privately owned, Foreign subsidiary, other?
4. Who founded your company? Where did the investment come from?
5. Please compare your initial and current sales volume.
6. How many factories do you operate? Where are they? How many production lines? How large is your labour force?
Compare founding to present
7. What milestones in company history?
8. Explain company's value chain—who performs various functions from procurement to shipping?
9. How demanding are your domestic customers? Your international customers? How has the quality of the product evolved over time.
What quality level do you target?
10. What other companies in your industry are important to you? Which suppliers? How helpful are the local government and trade associations?
11. Who are your Chinese competitors? Please describe a few of them in terms of size, products etc.

12. In your opinion what accounts for your success? Competitive advantage?

Often, some of this information was also available through company documents and web sites. A thorough investigation of these questions would require a comprehensive, multi-method, multi study research agenda. The present thesis can be considered a pilot study—an initial explanation. The interview protocol served as a reminder to keep the interview on track.

I made in-depth interviews with participants whom I already had established a relationship or who were related to my family. I was able to spend time in the shoe importer's premises in Los Angeles, observing operations and interviewing employees about all phases of the shoe importing business and the reasons for Wenzhou firms' success as an exporter.

1.4.3 Secondary Sources of information

I collected publicly available information and data from industry directories, Wenzhou company internet sites and government sources in China. Much of this information was in Chinese which I translated into English.

Summary

The Wenzhou footwear and leather industries have had a long and well-known history. With the entry of China into WTO, the competitive advantage of Wenzhou in the footwear industry has expanded even more. The most important basis of Wenzhou's early successes in entering the domestic and then the international footwear markets has been its exploitation of already existing area advantages such as low labor costs rather than more advanced factors such as the development of highly skilled worker or the availability of significant pools of

reinvestment capital, The latter two gain significance during the later stage of development. With the trade liberalization effect from the entry of China into WTO, Wenzhou footwear is gaining a larger portion of both the Chinese domestic and overseas markets.

CHAPTER 2

SOURCES OF WENZHOU'S COMPETITIVE ADVANTAGE

We begin by examining the role of the home area in creating and sustaining competitive advantage. Yet this role is far from a simple one. My research for a new way of understanding area advantage must begin from a number of premises. The competitive advantage of Wenzhou, China in the footwear industry is difficult to describe definitely following Michael Porter's theories (Porter, 1990) without first examining the local factors that are related to the emergence, development and expansion of the industry over the past twenty years. I will begin by describing the region of Wenzhou.

2.1 General Character Description of Wenzhou

Wenzhou lies in the middle section of China's golden coastline. Bordering on the East China Sea and standing by the Oujiang River, it is the economic, political and cultural as well as communication center of the southern part of Zhejiang Province. Under its jurisdiction are 3 districts, 2 cities and 6 counties with a total population of 7.04 million. Wenzhou covers a total land area of 11,784 square kilometers.. The East China Sea continental shelf of the estuary of the Oujiang River is rich in deposits of natural gas and oil, which are in exploitation. The acreage devoted to parkland and scenic spots accounts for 22.2% of the total territory of the city. With a coastline 355 kilometers long, Wenzhou Harbor has been listed as one of 20 main hub ports in China. Wenzhou Airport has opened 45 domestic air routes and 2 regional air routes linking to Hong Kong and Macao. Wenzhou has become one of the 45 key highway hub cities in the terms of land

transportation. The Jin-wen Railway opened to traffic in June 98. Program controlled exchanges with 1.06 million channels have been put into operation. In the aspect of power industry, the transmission lines construction has been connected with and incorporated into the East China Power Grid. Wenzhou is the second largest commercial port in Zhejiang Province, and is a sea-river shipping juncture for the southern part of Zhejuang and the northern part of Fujian. It is also an important foreign trading port in China's southeast coastal area, serving as an outlet for passenger and cargo traffic in areas along the Oujiang River. (Wenzhou Bureau of Foreign Trade and Economic Cooperation, 2003)

Through a dozen years of reform, Wenzhou has formed an economic structure with diversified economic sectors coexisting and multiple industries developing simultaneously and secured a “one step ahead” advantage in the development of market economy. The people of Wenzhou are energetically carrying out “ the Second Pioneering Campaign” in the economic and social development. When completed, it cannot be denied that Wenzhou, with the new look of a great modernized and brand-new metropolis, stands towering at the southeastern coast of China.

2.2 The Premises Assumed in the Approach to the Analysis

First, the nature of competition and the sources of competitive advantage differ widely among provinces and even specific districts. I should isolate the influence of the area’s ability to compete in specific industries and industry segments, and with particular strategies, rather than in broad sectors. Then I allow for different sources of competitive advantage in different industries rather than rely

on any single, overarching one such as labor costs or economies of scale. Since products are differentiated in many industries, I will explain why Wenzhou is better able to differentiate itself than other areas in China and how she will expand more during the specific time period.

Second, national competitors often perform some activities in the value chain outside their home district. The regional expansion of competition does not negate the role of the home district in competitive advantage but does change its character. It means that the task is not only to explain why Wenzhou's success in operating internationally is unique, but why the nation of China is a more or less desirable home base for competing in an industry. In other words, Wenzhou competitive advantage is embedded in China's competitive advantage. The home base is where strategy is set, core product and process development takes place, and the essential and proprietary skills reside. The home base is the platform for a global strategy that supplements advantages drawn from the home nation.

Third, a region gains and sustains competitive advantage in international competition through improvement, innovation, and upgrading. Innovation, according to Porter (1990), includes both technology and methods, encompassing new products, new production methods, new ways of marketing, identification of new customer groups, and the like. Innovations that lead to competitive advantage involve an accumulation of small steps and protracted effort as much as dramatic breakthroughs.

2.3 Effects Resulting from Wenzhou's Private Economy

During the twenty years of China's economic reform, meeting the changes

and performing practically, Wenzhou has made a rapid progress and resulted in establishing the “Wenzhou Economic Pattern” which is characterized as private economy and based on market. Thus the specific area economy flourished. The total annual income of the district grew from 130 billion RMB in 1978 to 7332 billion RMB in 1999, an almost five fold increase. The total industry annual income grew almost seven folds from 222 billion RMB to 15550 billion RMB at the same time. We can assume that the speedy economic development in Wenzhou is largely depended on the emergence and expansion of the private economy.

2.4 The History and Development of Wenzhou’s Private Economy

The Wenzhou private economy consists of different types and models. The footwear, cigarette lighter, and low-voltage electric equipment occupy the higher portion of the Chinese market. The broad coverage of the Wenzhou private economy allows itself pursue business opportunities that other state controlled economic sectors are not willing to touch. In addition, some infrastructure projects and government projects were dominated by Wenzhou Companies, which have played a leading role in that work.

The success of the region has its origins in both the past and the present. Before the economic reform in China (1979), the economic development of Wenzhou was slow and often delayed due to insufficient cultivated lands for most rural area people, insufficient investment from the central government and poor traffic conditions. From the establishment of People Republic of China in 1949 until to 1981, the central government invested only RMB\$ 65.5 billion. It is impossible to develop the region based on that low level of government investment. So the

development of private economy in Wenzhou since 1981 has functioned as a master model. There are three stages in the development of Wenzhou private economy.

- The initial stage of economic reform occurred when a large portion of rural labor sought opportunity in Wenzhou's factories.
- The second period was characterized by family-based economy model. Between 1980 to 1990, as the family-based economy model developed, the boundary between different areas, lines of profession and ownership became blurred. Eventually the Wenzhou economic model became more capitalized and a shareholder style economy started to develop.
- The last stage began after 1993 when the Wenzhou private economy became more modernized and well organized. (Qian Xing Zhong, Wenzhou Coordinator, CCP Central Party School Press, 2002)

Wenzhou private enterprises do have strong advantages compared to other enterprises in different provinces in China, They are more profit oriented and focussed thus assuring that those who contribute more gain more. Decision-making, investment center, operation center, responsibility center and profit center are controlled by different individuals. This kind of private enterprise gained a large market share in China at that time period when other areas were still functioning in the old State Operation model.

The shift change idea of how to make a enterprise more successful and profitable gave Wenzhou enterprises some advantages over their peers from other

parts of China. In the entire Chinese market, the Wenzhou private sector played a leading role. First of all, it created a large portion of employment opportunity for this area. Lacking basic investment and developed land, Wenzhou was considered a non-development area in the early period of economic reform. The development of the private sector contributed a great number of employment opportunities for migrants from rural and hinterland areas. Second, a greater portion of the Wenzhou economy is reliant on the private sector, which has made this area more stable and cosmopolitan. Third, the greater effort and commitment since economic reform in China has led to the conclusion that Wenzhou private sector is the main reason and origin for the regions remarkable economic development. In recent years Wenzhou private enterprises also made more effort in the area of research, marketing, and brand establishment. The following five explanations (2.4.2 to 2.4.6) are offered to clearly summarize the reasons for Wenzhou's development

2.4.1 Development of Wenzhou's Private Sector and Market Economy

The first explanation of Wenzhou's development is that the wealth of the Wenzhou people forms the bases for the Wenzhou private sector and thus provides the foundation for the market economy. . The key success factors for button market, badge market, low-voltage electric market and plastic material market were well established and defined during family-style stage. After twenty years cultivation, Wenzhou has developed a well-organized market system that includes information, funding, technology, skilled labor and an educated workforce. Those give a good foundation for further enhancement of regional economy. Furthermore a lot of Wenzhou people travel beyond this particular area to open regional and even overseas markets. In Tianjin, Xian, Taiyuan, Kunming,

Zhengzhou and Tibet you will find the traces of Wenzhou.

2.4.2 Labour Mobility and the Development of Wenzhou's Private Sector

The second explanation for Wenzhou's development is that the economic reforms since 1978 and the central government policy changes have made it possible for Wenzhou residents to go further to other province and make a living. After twenty years commitment, there are a large number of persons from Wenzhou who have made successful careers elsewhere in China and who now form a network outside Wenzhou. Here are some statistics: almost 1,200,000 Wenzhou people have moved elsewhere in China and most of them engage in the lines of business as footwear, clothes, textile, low-voltage electronic machinery, glass and lamps. Among them around 40 thousand are in each of the following cities Beijing, Shanghai, Tianjin, Hangzhou, Wuhan, Qunming, Chengdu Shengyan and Xian. This kind of movement has helped areas both inside and outside Wenzhou to modernize become more rich. Among the entire sale amount of the aforementioned products, around 60% are made in Wenzhou. These linkages form a good base for a marketing network. Fund-raising experience is tremendous and personal mobility has increased management experience and the pooling of talented workers who are amenable to a market system. The marketing network has made Wenzhou's product famous and well known. Overall Wenzhou's accumulated experience and transition to a market economy are responsible for the rapid industrialization and prosperity of the region.

2.4.3 The Private Sector of Wenzhou is Linked to Economic Clusters

The third explanation for Wenzhou's development is its development as a

centre for footwear and related industries. Regional economic clusters are not new. Agricultural villages, shipping centers or manufacturing towns, for example, are some of the early economic clusters. Today's clusters, however, have evolved out of the new, global economy, which dictates that capital, goods, technology and information can be sourced from anywhere in the world. As technology speeds up and competition comes from unexpected places, the keys to staying alive for many industries are the ability to innovate, be creative, and continuously learn (Porter, 1990). Michael Porter explains that today's economic map of the world is dominated by clusters, which he defines as "critical masses in one place of unusual competitive success in particular fields." Regional economic clusters are somewhat of a paradox, Porter explains, because "the enduring competitive advantages in a global economy lie increasingly in local things: knowledge, relationships, motivation that distant rivals cannot match." Porter also explains that even though old reasons for clustering have diminished in importance with globalization, new roles of clusters in competition have taken on growing importance in the increasingly complex, knowledge-based and dynamic economy of the 21st century.

The Wenzhou model is kind of typical: The first stage originates with the transition of state run factories to a market economy; the second stage marks the specialization of factories that formerly produced a variety of products to a narrower range of products based on market needs and profitability. The third stage is the clustering of similar producers and related and supplying industries nearby. We can understand the way as focused on several specific lines of business in a certain area and developing a regional advantage within the country.

In the Wenzhou footwear case, most of the companies were founded between the late 1980's and the middle 1990's. A healthy cluster does not develop overnight. According to numerous cluster case studies, a developing cluster requires a decade or more to develop depth and to gain real competitive advantage. This is one reason why government attempts to create clusters from the ground-up normally fail. Michael Porter asserts that clusters affect competition in three ways: by increasing the productivity of companies in the region; by driving the pace and direction of innovation (which is the foundation for future productivity and growth); by stimulating the formation of new businesses, which expands and strengthens the cluster itself. The Wenzhou model is totally market driven and not government organized.

2.4.4 The Development of Wenzhou is Linked to the Development of its Small Cities

The fourth explanation for Wenzhou's development is the growth of small cities in the region. The private economy and professionalization of segments of the labor market came together in Wenzhou and furthered the city's development. In 1978, there were only 18 sub-urban district (pockets of semi-urban development surrounding the central city) around Wenzhou and now there are around 146. Having passed its transformation from handicraft industry to the current modernized industry, Wenzhou has now established a complete industrial structure in machinery, chemicals, light textiles, medicine, food, paper-making, leather-making, plastics, arts and crafts, ceramics, building materials, household electrical appliances, low-voltage electrical machinery, metallurgy, ship-building and electric power. It has opened several markets in the city specialized in selling low-voltage

mechanisms.

Many enterprise groups dealing with more than 1000 industrial products have been formed in Wenzhou. Most of these products are labeled as *famous, good, special or brand new*. And 62 of them have won honors at city level such as electrical appliances, fashion clothing and shoes. People in Wenzhou have shown themselves as ready to take challenges and blaze new trails in pursuing enterprise expansion. They are insightful enough to cultivate relevant market systems appropriate to these commodities. Their sense of efficiency, risk and competitiveness has won them acclamation. At present, Wenzhou is taking further steps to improving the functioning of its government and the operating mechanisms of its enterprises. As a result, the mechanism of self-governance and shouldering profits and losses on their own has been accepted in most of the enterprises. A multi-form, multi-channel, open, orderly, and competitive market under the macro control of government follows. To standardize a share-holding system, to form a sound financial system, and to perfect the laws of land use are all on the agenda of Wenzhou government. (The office of Wenzhou, the Municipal Government, 2002)

2.4.5 The Development of Wenzhou Depends on its Unique Culture

The fifth explanation for Wenzhou's development lies in its unique culture and history. Wenzhou, also known as Yongjia (or Yung-chia) has a history, which goes back to about 2000 BC, when it became known for its pottery production. In the 2nd century BC it was called the Kingdom of Dong'ou. Under the Tang Dynasty, it was promoted to prefecture status and given its current name in 675 AD. Throughout its history, Wenzhou's traditional economic role has been as a port

giving access to the mountainous interior of southern Zhejiang Province. In 1876 Wenzhou was opened to the foreign tea trade, but no foreign settlement was ever made there. In 1937-1942 during the war with Japan, Wenzhou became an important port due to its being one of the few Chinese ports still under Chinese control. It declined in the later years of the war but began to recover after coastal trade along the Zhejiang coast was re-established in 1955.

Today Wenzhou remains the chief economic, political and cultural center of southeastern Zhejiang Province. While ignoring the political trends of China through the years, it has embraced the recent economic changes to the point that it is in the midst of a frenzied development boom. It exports foodstuffs, tea, jute, timber, and paper. Besides footwear and the other modern industries already mentioned, Wenzhou's traditional main industries are food processing, papermaking, building materials, and farm machinery. Food products produced in Wenzhou include medicinal tea and wine. Alunite (a non-metallic mineral used to make alum and fertilizer) is so abundant here that Wenzhou claims to be the "Alunite Capital of the World". Exploration for oil and natural gas has commenced in the East China Sea 100 km off the coast at Wenzhou.

The culture of Wenzhou has been shaped by its isolation from the rest of China and its exposure to foreign influences through centuries of sea trading. The people of Wenzhou are said to be strong and self reliant, yet have maintained feelings of solidarity and community spirit.. Ou Models are a famous handicraft produced in Wenzhou, combining the stereoscopic effect of a sculpture with the vivid colours of a painting. Another handicraft is Ou Embroidery, which combines

embroidery and painting. The Nanxijing Scenic Area just to the west of Wenzhou is described as a place of beautiful forests, waterfalls and ancient villages. A famous poem written about this area by Xie Lingyun is called "Clouds Linger over Misty Forest, Meandering River Running into the Sunset".

Summary

Wenzhou is the economic, political and cultural as well as communication center of the southern part of Zhejiang Province. Through twenty years of reform, Wenzhou has formed an economic structure with diversified economic sectors coexisting and multiple industries developing simultaneously. It has secured a "one step ahead" advantage in the development of market economy. Areas gain and sustain competitive advantage in national competition through improvement, innovation, and upgrading. Wenzhou's private enterprises have strong advantages compared to other enterprises in different province in China; they are more profit oriented and focus more on the principle that those who contributes more should gain more.

CHAPTER 3

THE DEVELOPMENT OF WENZHOU'S FOOTWEAR INDUSTRY

Wenzhou, situated in east China, bordering the East China Sea and Pacific Ocean, is the most important shoe-making city in China. Today, there are more than 4000 shoemaking enterprises, and more than 1000 leather tanning enterprises there. Wenzhou not only has many manufacturers, which are centralized, but also has large surrounding market potential. Many wholesale agents, domestic and foreign, select Wenzhou as their purchasing base, which also serves to enhance the reputation of Wenzhou's manufacturing firms. With about 20 years' development, from pure hand production in 80's to massively introducing production lines in 90's, many enterprises survived the intense rivalry and continuously grow in strength. Therefore the competition between enterprises is not purely the competition in producing capacity and scale, but also the competition in brand, image and actual strength.
(<http://www.cnshoes.com/enshoes/zxjdwz.htm>)

Recently, Qian Xingzhong, mayor of Wenzhou city, declared that this city is planning to apply for the title of "China Shoe Capital" from the state, and will further establish a large-size shoe market which merges scientific research, trade and manufacture into an organic whole by utilizing Wenzhou's current shoemaking advantages.

3.1 Brand Advantage

Because rivalry in current shoe markets clearly hinges on brand recognition, Wenzhou management focused all their efforts to make their footwear industry

prosperous by publicizing the Wenzhou brand and even encouraging citizens to wear Wenzhou shoes in order to build up the Wenzhou brand. After more than 10 year' of efforts, more than 20 leather shoe enterprises in Wenzhou have currently hung the trade mark of "real leather symbol," which is displayed by more than 30 percent of national leather shoe enterprises. Wenzhou Kangnai, Aokang, Ji'erda are on the list of the "Ten Real Leather Shoe Kings of China" awarded by the State Light Industrial Bureau and China Society of Leather Industry. Monopoly shops (company owned or franchised retail outlets) of Wenzhou shoes have spread all over China's larger cities. For example, Aokang Group has established more than 200 monopoly shops and "shops in shops" in more than ten provinces and cities, such as Anhui, Hunan, Henan, Shandong, Shanxi, Chongqing, Sichuan and Xingjiang. Many famous merchants welcome Wenzhou shoe enterprises to sell their products in the shops with the most favorable terms. A Street of Wenzhou Shoes is built up in Shenyang "China Shoe City". In addition, Wenzhou Leather Shoes are entering Into International Market, According to the customs statistics, during the period from January to August in 1998, the export of leather shoes reached up to 85 million dollars, an increase of 22% over the previous year. Although recently the Chinese market has been depressed, the business of most leather shoe enterprises in Wenzhou having a certain momentum and their own certain international reputation is brisk and their production and marketing are thriving. Wenzhou shoes are benefitting from its "famous brand" strategy.

3.2 Accessory Advantage

One reason for the rapid development in Wenzhou's shoe industry is its cooperation and division of labour and synchronization of its processes with the

following supporting industries: (1) Baishi Sole Production Base, (2) Yongjia Huangtian Shoe Decoration Production Base, (3) Hetongqiao Shoe Material Market with 3 billion RMB of annual sales volume,(4) Rawhide Market, (5)Leather Machine Market and (6) Leather Chemical Market with 2 billion RMB of annual sales volume. In addition, professional design institutes, information institutes and exhibition institutes have been set up in Wenzhou. After investigation, the specialists of the Chinese Leather Industry Society, the China National Information Center for the Shoemaking Industry and the leather associations in other countries such as Italy, have all taken Wenzhou as one of the highest potential cities in the Chinese Footwear industry.

3.3 Personnel Advantage

In Wenzhou shoe and leather industries, there is a group of entrepreneurs and marketing personnel who have experienced the severe test of market economy, for example Wang Zhentao in Aokang Group, Zhen Xiukang in Great Wall (Kangnai) Shoe Industry Corporation, Yu Ji'erda's Shoe Industry Co. Ltd. Qian Jinhbo in Hongqingting Group and Wang Yuejin in Bali Group and so on. They dare to throw themselves into work, to go all out in work and to be the first, and have the spirit of doing pioneering work. From 1994 to 1998, these entrepreneurs had introduced more than 1000 sets of advanced equipment, both domestic and from overseas, and had newly established millions of square meters of factory building. Annually invested average capital used for technological innovation is up to 0.5 billion RMB which has established a strong foundation for Wenzhou shoes to create a famous brand. At the same time, Wenzhou enterprises have also devoted their large amount of financial capacity, manpower and material

resources to participate in various kinds of shoe and leather exhibitions at home and abroad. More than one hundred thousand footwear and leather products' marketing personnel are spread all over the world. They build up monopoly shops and chain stores, contract to lease the market and have made their contributions to take and exploit the market for Wenzhou footwear and leather products.

3.4 System Advantage

The shoemaking industry is a trade with a concentration of manpower and significant hand-made component as its main features. For shoe manufacturers, human resources are the dominant factor and fully arousing people's initiative and originality are the roots achieve market position and dominance.. At the beginning of 1990's, with individual enterprises and stock companies as its main body, Wenzhou Shoe manufactures emerged suddenly like a dark horse and have become the new force of the entire trade. The internal management systems of these enterprises are very flexible and can adapt to the market very well; the productivity of labor of these enterprises is very high; and their development and innovation speeds are very quick. All of these enable the Wenzhou Shoemaking industry to be full of vitality and activity. They are also the keys to establish the Wenzhou Shoemaking Industry's rank among China's most advanced brands, marketing measures and product classes.

According to the incomplete statistics by a concerned government department, now there are more than 6000 shoe manufacturers in Wenzhou with 350 thousand employees. The gross industrial output value in the whole trade is 18.5 billion RMB, with 0.8 billion RMB of profit tax and 4 billion RMB of export.

Currently, the Wenzhou Shoemaking industry possesses the fundamental conditions for its rapid development. Each enterprise works out good strategies to catch hold of current opportunity, and continuously enhances its products' entire quality level to create highly desirable products. The accomplishment of the Wenzhou Shoemaking industry depends on combining technical progress, as a precondition, with relentless marketing measures.

3.5 Some Successful Examples of Wenzhou Footwear Companies

3.5.1 Wenzhou Great Wall Shoes Corporation is a key member enterprise of the China Leather Industry Association and China Shoes Manufacturing Commission, as well as Zhejiang Province's key industrial enterprise. Founded in 1980, the company has 3,800 staff members and 35,000 square meters of factory buildings. High-grade Kangnai brand shoes are the company's major products. The company is one of Wenzhou City's top shoes producer and has won the title of "model enterprise" for three successive years. It's Kangnai brand shoes are one of China's top 10 branded leather shoes. Registered by the international quality system certificate ISO9002; the company attaches great importance to the quality of Kangnai shoes. So far, the company has also attracted a large amount of talents and specialists. And with the construction of Kangnai Industrial Zone and the establishment of the Great Wall Group Co., Ltd., Wenzhou Great Wall Corporation and Kangnai Shoes will face a brighter future.

3.5.2 China Aokang Group Co. LTD, located in Wenzhou, is a leading manufacturer of leather shoes. Established in 1988, Aokang specializes in top quality leather goods, including men's and women's shoes, handbags, belts and wallets. Aokang own 15 international first-class assemble lines imported from Italy

and more than 3800 skilled workers who produce six million pairs of shoes annually. Aokang follows ISO9002 and CIS standards in both its production and management procedures.

Aokang has been named in the Top Ten Genuine Leather Shoe companies of China for three years consecutively. Aokang Group has 2000 chain stores Mainland China. Aokang brand shoe has been one of the best sellers for many years in China. Aokang has fashion design offices in Guangzhou, China and Italy to ensure its styles are on the cutting edge of world fashion. Its overseas distribution offices in Italy and the Netherlands guarantee efficient export business with Europe, the United States, Japan and other countries. Because it values co-operation for mutual benefit, Aokang has succeeded as an overseas business partner. (<http://www.aokang.com>)

3.5.3 Wenzhou Jielida Shoes Ind. Co., Ltd. is a foreign Joint Venture, which produces fine men's and womens leather dress shoes for exports and the domestic market. It is a genuine-mark enterprise of China Leather Industry Committee; it's registered trademarks are "Jielida" and "Uniaosi".

3.5.4 Wenzhou Dongyi Shoes Co.,Ltd was set up in 1991 and now has become the magnet enterprise that attracts other small enterprises. Its slogan is "Unity, Opening-up, Fighting, Advancing bravely". The company covers a ground area of 15,000 square meters, the building area of which is 20000 square meters. The company has become a important base specializing in producing medium and premium grade shoes for men and women. The output exported is the largest among shoes trade in china. With a powerful technical force, the eight lines of modern production lines and also equipped with the advanced equipment imported

from Italy, the company can produce 15,000 pairs a day. Adopting the ISO9001 Quality Management System, the company has formed five systems including Production, Marketing, R&D, Inspection and Management. It gains more and more markets with good image, superior quality and famous brand .The products are sold to the USA, Russia, Mid-East, Japan and Korea. The People's Government of Zhejiang grants the trademark "DONGYI" to the company the well-known trademark for having achieved many times the first-grade prize in "China Genuine Leather Design Reward Match for Leather Shoes and Travel Shoes". This company produces a line of products with the well-known "DONGYI" trademark and strives to achieve "the marking a giant of the shoes trade and founding a famous brand for the world".

3.5.5 Wenzhou Sanying Shoes Industry Co., Ltd. was founded in 1982 and specializes in manufacturing men's and women's leather shoes and casual shoes. Covering an area of more than 5,300 square meters, and in the Lucheng industrial zone in Wenzhou it uses several advanced production line machines imported from Italy, the Czech Republic and Taiwan. The company has a staff of about 700 and the annual outputs reach 2,000,000 pairs of leather shoes, which are of high quality and exquisite workmanship. It has built the shoe model design center and collect the best special design experts from regions throughout the country. The advanced computer design capability leads the product's types, styles and craft level to high levels. The company has successfully exported to east Europe, South America, the Middle East and Asia. ([http://www. Wenzhoushoecom/companyasp](http://www.Wenzhoushoecom/companyasp))

3.5.6 Wenzhou Saida Shoes Co., Ltd is a joint-stock enterprise which tries to maintain model management principles. It specialized in producing "Saida",

“Olderman”, and “Liderong” brands. Its shoes achieved a customer following and are sold to all kinds of cities throughout the nation because of their choice of material, perfect craftwork, new fashion and good quality. The company is located in Jinshui industry zone of Ouhai district. The first project has 2,000 square meter and 3,000 square meter built-up facilities. The department contains marketing, design, quality control, and product planning and maintains a staff of 400 highly-educated staff. It has imported two advanced production lines from Taiwan including 80 other shoe-making sets. The second project is located in “China Shoes capital”. It occupies 1,000 square meters, a staff of 800 and 4 advanced shoes-making production lines. It plans to establish a permanent mutual benefit business relationship between domestic and foreign customers.

3.5.7 Wenzhou City Ouhai Wanxin Shoes Industry Co., Ltd is located in Loudong Industrial District where the shoes manufacturing industry of Wenzhou , originated. The company produces lines of rubber, injection and leather shoes, using materials of cotton cloth, plastic leather and genuine leather, and their semi-finished products (upper vamp). It has a highly competent staff of 300 working with advanced equipment including modern production lines. Its annual output reaches 8 million .A whole range of products have been exported to over 30 countries and areas such as the U.S.A, Germany, Canada, Southeast Asia and Africa and enjoy high reputation among the customers at home and abroad.

The company sticks to the principle of "Winning for its new style", it is well-known for its fine quality "making the most freshest and best quality shoes to your heart's content". Its management saying was: "Quality First, Service First, Credit

First".

3.5.8 Wenzhou Wanjinge Shoes Company., Ltd is a Sino-foreign Joint-venture corporation. The corporation is located in the Lucheng, Wenzhou economic development zone. The plant covers an area of 15, 000 square meters and the floor space is more than 5, 000 square meters. It has several process lines and utilizes shoe-making equipment imported from Italy, Czech Republic and Taiwan.

3.5.9 Wenzhou Niusanjiao Shoes Industry Company is located in Deer City Industrial Zone of Wenzhou, which has the reputation of "China Shoes Capital", and is convenient for transportation due to its proximity to Shanghai and Ningbo.

The company is a professional manufacturer of leather shoes, which integrates development, design, production and marketing as a whole. Occupying 24,000 cubic meters, it employs over 1000 employees and is a pillar enterprise of Zhejiang province social Welfare Industry. It owns advanced production equipment including some imported from the Italian firms, Molina, Bianchi and Mastic.

The brand "Bin Du" leads the fashion lines with high and medium grade men's and ladies 'leather shoes, leisure shoes and injection shoes which have been well received by customers from all over the world due to their novel designs, high quality material, precise processing and comfort. "Bindu" shoes have sold in China as well as in Russia, America, Japan, South Korea, East and West Europe etc." Bin Du" leather shoes have been granted awards such as the "China Genuine Leather Marked Product", "China 10,000-Mile Quality Tracking Products", "Free of Quality Defects Shoes", and the "Gold Medal in Footwear Products Competition of Shoes Capital Cup"

The company has achieved ISO9001 Certification, "Trustful Shoes Enterprise", "Star Enterprise "and Technology Improvement Enterprise" .

The firm endeavors to hope set up long-term cooperation relationships with domestic and overseas customers for mutual benefits and greater development and it sticks to the belief that "your satisfaction is our greatest wish,"

3.5.10 Wenzhou Huite Shoes Co., Ltd. Since its establishment, the company has been continuously expanding its scale, improving its product development, equipment and management level as well as increasing its sales volume. Presently the company. has a staff over 1,900, among which 50 are technical professionals. Technical and quality indexes of Huite branded shoes have reached or exceeded the advance level in China. The Company uses shoe-manufacturing equipment imported from Germany, Italy and Taiwan and has several advanced production lines complete with internationally advanced quality control systems. The enterprise strategic principles of uniqueness and substantiality has been penetrated through design, production, sales and service and carried out by every person in Huite. Through decades of hardwork the company has been appraised as AAA Grade Credit Enterprise for years. The company has been authorized to label its shoes as Genuine Leather Shoes -- the highest reputation in the Chinese leather shoe industry, and Huite brand was appraised as a Famous Brand in Zhejiang Province. In 2,000, the Co. passed ISO9001 attestation. The company is also a nationally registered enterprise, a designated manufacturer of shoes for police use by the Ministry of Public Security, and a Meritorious Enterprise in China Shoe Capital as appraised by Wenzhou Municipal Government. In 2002, Huite made still further progress: Huite shoes were granted the designation "Famous

Chinese Genuine Leather Shoes” in February.

Summary

The mayor of Wenzhou city, declared that Wenzhou is planning to apply for the title of “China Shoe Capital” from the state, and will further establish large-size shoe market which merges scientific research, trade and manufacture into an organic whole by utilizing Wenzhou’s current shoemaking advantages. Brand advantage, accessory advantage, advantages in qualified personnel and advantages in system.

These advantages are what Wenzhou has gained and what will benefit Wenzhou in the developing market economy. With the more and more well organized and controlled market, Wenzhou footwear will maintain its position in the footwear market as well as expand it more in the new century.

CHAPTER 4

FINDINGS AND CONCLUSIONS ABOUT THE COMPETITIVE ADVANTAGE OF THE WENZHOU FOOTWEAR INDUSTRY

This chapter draws conclusions of the study. It is divided into two parts. Part I evaluates the extent to which Porter's theory provides a good explanation for the competitive advantages of Wenzhou's footwear industry. It does this by taking each element of the diamond and scrutinizing how direct is its relationship to the Wenzhou case. It also examines the linkages of the four diamond elements to other factors outside the diamond such as entry into WTO, actions of the Wenzhou government,

This analysis then culminates in a four element model of competitive advantage specific to the Wenzhou footwear industry. The four advantages are: Brand Advantage; Manufacturing Advantage; System Advantage and Personnel Advantage. The second half of the chapter discusses the success of the industry to date, the scope and scale of its export efforts and the benefits of trade liberalization

4.1 Porter's Diamond of Competitive Advantage

4.1.1 Factor Endowments

Factor conditions include 1. low overall labor cost, 2. availability of factories and workforce, 3. capital from savings and foreign private sources including joint ventures and FDI. 4, Development of skilled workers and management skills. Experience curve effects are defined as the systematic reduction of production costs related to the volume of activity due to learning and scale economies. For

firms, experience accumulates across different plant locations—in rough terms, a company that operates four geographically separated factories each having two production lines will gain the same experience curve benefits as a firm with one large factory with having eight lines. Here the idea is extended to the region—the local industry benefits from the accumulated experience of many factories. Granted that the learning benefit may not be as perfect as it would be in a single firm, nevertheless, it is proposed that learning has taken place in the region proportional to the amount of activity there. This is closely related to Porter's benefits of clustering to be discussed later

The emergence of footwear industry development in Wenzhou, China in some senses originated from the Factor Condition: low labor cost. The development of the private sector in Wenzhou is associated with significant movement of labor from other regions in China, mostly because of the availability of work and the associated increase in wage rates in Wenzhou. Porter distinguishes between basic and advanced factors. In Porter's terms availability of low cost labour is a basic factor, whereas availability of highly skilled labour and managers is considered an advanced factor because it requires either investment in training and development or a long period of activity to build up experience.

Availability of low cost labour is clearly a very basic factor. Although it is a key element in understanding Wenzhou's competitive advantage, it is neither unique in China nor to the footwear industry. On the one hand, its current importance cannot be overstated, but on the other hand, the cost advantage will eventually be eroded as factory workers' wages rise with demand. This phenomenon has been clearly

demonstrated in South Korea during the 1970's and 1980's, when footwear workers' wages increased tenfold and provoked the of many pioneering MNC footwear companies to move out of Korea to other lower cost locations in East Asia and Central America.

According to Porter (1990) typical advanced factors are communications infrastructure, availability of sophisticated and skilled labour, and existence of research facilities. Over time, the labour force has become more skilled and management skills have been enhanced, especially with regard to flexibility and adaptability. The resulting productivity of labor of these enterprises is very high and their development and innovation speeds are very quick. This positive linkage between personnel and technical systems is termed *System Advantage*.

In addition to to the aforementioned reasons, another factor is the existence of the Wenzhou Shoe Fair, which, by bringing footwear industry participants such as buyers, designers and machinery suppliers together in Wenzhou, serves not only to promote and sell Wenzhou footwear but also elevates the profile and status of Wenzhou in the global footwear industry.

Another advanced factory is the presence in the Wenzhou shoe and leather industries, of a group of entrepreneurs and marketing personnel who have experienced the severe test of market economy. These risk takers dare to throw themselves into work, to go all out to compete to be the first, and have the spirit of pioneering new markets and products.

4.1.2 Demand Conditions

The second element in Porter's diamond is the nature of domestic demand.

Porter argues that the sophistication of local demand, which often form the customer base of the firm, drives the firm to achieve high levels of quality and innovation. In the case of China, the demand for footwear is becoming more sophisticated. It is estimated that 100 million people in China have sufficient disposable income to purchase imported products such as shoes from Taiwan and Italy. The point here is that a sophisticated local demand is emerging and is beginning to drive the Wenzhou shoe industry. Indeed, the rapid economic expansion of major cities such as Shanghai, Guanzhou and Beijing is also associated with a rapid development of the fashion industry and fashionable lifestyles there, which in turn influence the sophistication of demand. A perusal of the catalogs of some of the Wenzhou manufacturers indicate a high fashion content in women's and women's shoes.

Another aspect of domestic demand is simply its volume, even if at a lower level of sophistication. As standards of living improve throughout China, the growing scale of production also leads to experience curve effects, mentioned earlier, in terms of unit cost reduction. Because of volume, all other things remaining equal, China's production efficiencies should continue to improve albeit at a decreasing rate

The same observations with respect to sophistication and overall volume that have been made about domestic demand can also be applied to overseas demand. Some Wenzhou footwear factories are joint foreign-Chinese joint ventures that bring a high demand for a sophisticated and quality product. For example, the Hong Kong joint venture partner that contracts to manufacture

footwear in Wenzhou is another source of customers with sophisticated demands.

The demand for high quality footwear is also reflected in the participation of many of the larger Wenzhou manufacturers in quality assurance programs such as ISO 9002. In addition, great importance is given to government designations such as “top quality” certification for enterprises or industry specific quality programs and branding such as the “Real Leather”.

4.1.3 Related and Supporting Industries

The third element in Porter’s diamond is the existence of internationally competitive suppliers and related industries. Such enterprises provide necessary technology (shoemaking supplies) quality inputs (leather, leather tanning chemicals, labour training and shoe parts such as heels, counters, and uppers, or complementary products such as shoe trees, shoe maintenance materials (polish, creams, oils, brushes, polishing machines, laces). More importantly, relationships with these related industries bolsters the firms’ knowledge flows, especially if these sister firms invest in advanced factors. These flows happen through communication between elements in the value chain as well as through the flow of labour between companies. As noted previously there are over 1000 business in the leather preparation and related industries in Wenzhou. The clusters exist in Wenzhou and have also spread to nearby outlying rural districts. The development of Wenzhou is connected with the development with small cities. In 1978, there are only 18 sub-sectors around Wenzhou and now there are around 146.

At the political level the mayor of Wenzhou city declared that Wenzhou is planning to apply for the title of “China Shoe Capital” from the

state. Wenzhou people focused all their efforts to make their shoes industry prosperous, bringing forward the watchwords of “publicizing the Wenzhou brand and wearing Wenzhou shoes to build up the Wenzhou brand.” (Qian Xing Zhong, 2002)

It will further establish large-size shoe market center which merges scientific research, trade and manufacturing into an organic whole by exploiting Wenzhou’s current shoemaking advantages. Three of these have already been described: The accessory Advantage, the personnel Advantage, and the system advantage. Brand advantage is the fourth and has two meanings: the first pertains to the strategic decision to at least partially shift from commodity footwear toward high-end branded footwear. The second is to promote the region of Wenzhou as noted in the designation, “China Shoe Capital”.

The clustering of related and accessory industries in Wenzhou further strengthened the region’s competitive advantage. Local regulations and infrastructure support are directly related to the concentration of footwear related businesses in the region. Similarly the decision of Italian shoe machinery manufacturers to locate a sales and service offices in China depends on the clustering of these business in a geographic area

The Wenzhou model is typical: it originated with market, through classifying different lines of business and eventually forming cluster. We can understand the way as focused on several specific lines of business in a certain area.

An often cited reason for Wenzhou shoes’ rapid development in the

footwear industry is that it has developed a cooperative system of dividing tasks among companies that results in a smooth integration of the processes of supporting industries. This is termed Wenzhou's accessory advantage.

4.1.4. Firm Strategy, Structure, Rivalry—fierce rivalry

The fourth element in Porter's diamond is the strategy, structure and rivalry in the industry. On the one hand, Porter here acknowledges the importance of cultural values that affect strategy and decision making. On the other hand the model also recognizes the importance of vigorous rivalry in promoting progress.

In Wenzhou there are over 4000 footwear manufacturers who must compete not only for customers, but for space, access to outlets and for the essential inputs of their processes. Many are small but because footwear manufacturing is labour intensive, twenty of them have over 3000 employees. This industry is an extreme example of fragmentation where competition is fierce not only for sales, but also for materials, design, technology and skilled personnel.

At the cultural level an "industry culture" has developed among a growing group of entrepreneurs and marketing personnel, who have experienced the severe test of market economy, who "dare to throw themselves into work, to go all out in work and to be the first, and have the spirits of doing pioneering work."

It is important to mention the role of the government in Wenzhou's development. As has been noted, the Wenzhou Economic Model reflects

private enterprise and a successful experiment in free markets. The government of Wenzhou and the Zhejiang Province has played an important supporting roles. By establishing quality standards and awards that are meaningful, such as the 3 “shoe Kings” or “China Shoe Capital, by supporting the capital market development and by establishment of professional schools directly related to the shoe industry, particularly in the areas of design and advanced manufacturing.

4.2 A Large Portion of Footwear Production Is Dominated By China

China accounts for 53% of global footwear production. It is impossible to overestimate the future expansion of the China footwear manufacturing industry. In 1999 alone, the estimated output of 5,930 million pairs of shoes made China the largest producer in the world, accounting for no less than 53% of global shoe production. By 2006, China's share in the world footwear production graph will have risen to 55%.

As well as covering its huge domestic market, China's footwear manufacturers export 3,426 million pairs of shoes annually (1999 figure), making it not only the world's largest producer but also its largest exporter of shoes. Quality of design and craftsmanship has improved over the last decade and the industry has the capacity to increase this export figure even higher. Indeed, the rate of growth over the last three years has seen exports rise by 3%, 11% and 13%. In dollar terms, from January to March this year, China's export of leather items amounted to US \$ 2.6 billion, of which the export of footwear accounted for US \$2.31 billion, up 0.3% against the same period last year.

Deutsche Bank predicts an annual growth in shoe production of 19% in the five years following accession to WTO. At present there are around 16,000 businesses and two million people involved in leather enterprises and these figures exclude operations with sales income below RMB 1 million. Of the 16,000 businesses, 7,200 are shoe manufacturers; among them producing a staggering 5 billion pairs a year. This breaks down as leather shoes: 2.3 billion pairs; cloth shoes 1.5 billion; rubber shoes 1.2 billion pairs. Most of them are produced in Guangdong, Zhejiang, Fujian, Jiangsu, Shandong, Shanghai, Liaoning, Tianjin, Henan and Hubei. It is thought that within five years the western regions of China will become the production base for low-end shoes while the eastern areas will concentrate on higher quality production.

4.3 Promotion Methods—The Importance of the International Shoe Fair to the Development of the Wenzhou Footwear Industry

This booming industry will have its own showcase as Asia Pacific Leather Fair Ltd and the China Leather Industry Association (CLIA) have joined forces to announce the launch of the China International Footwear Fair (CIFF). The first edition will take place in at the Shanghai New International Expo Centre (SNIEC), which is in the Pudong, Shanghai, China on September 3-5, 2003.

Madam Zhang Shu Hua, the Vice President of the CLIA, said "Chinese footwear production is not only the biggest in the world, but also has design capabilities which compare very favorably with much of the best production of the traditionally well-regarded footwear producing nations. Global consumers today are well aware that they can rely on Chinese manufacturers for their footwear needs and for their flexibility in presenting exciting new trends."

Michael Duck, Director of APLF said " From the launch of the All China Leather Exhibition in Beijing in 1998, it has been our intention to expand the content of ACLE as we have done successfully in Hong Kong with the Asia Pacific Leather Fair since 1994. We believe that with our partners the CLIA whose remit encompasses the whole of China's leather industry production, this launch will give a new platform for international buyers of Chinese manufactured footwear products to have a definitive place to meet and to do business. China is an enormous country and Shanghai is internationally well known as the commercial and fashion capital of China."

The China International Footwear Fair (CIFF) will run concurrently with Moda Shanghai and the All China Leather Exhibition. While the All China Leather Exhibition will continue to be the industry's best source of raw materials, the China International Footwear Fair will provide a window for the world to see China's footwear. Moda Shanghai, renowned for its display of premium collections and branded lines, will now be displaying all kinds of fashion goods including leather garments, handbags, travel ware and fashion accessories, giving buyers an overall preview of the fashion "total look".

Genuine Leather Mark (G.L.M.) for leather products has been adopted in China leather trade since 14th October 1994, as a proven trademark. GLM has registered in many foreign developed countries by CLIA (China Leather Industry Association). As registered in the State Administration for Industry and Commerce of the People's Republic of China by CLIA, G.L.M. is a certification trademark protected by the law. It will certify the following points to the customers:(1) The

leather products are made from natural leather; (2) The leather commodities belong to excellent medium and high-quality commodities; (3) The enterprise possesses an excellent after sale service guarantee system. In general, GLM is the mark of excellent genuine leather products therefore, not all the products made of natural leathers (furs) can qualify for it. With the popularization of GLM, now the leather garments and shoes without the GLM trademark can't enter famous supermarkets in China especially in many Northern cities such as Beijing and Shanghai.

CLIA will hold a GLM seminar in Wenzhou at the end of May, to strengthen the management of GLM, popularize its influence at home and abroad and renew the way of rating enterprises and accrediting them. The core of this seminar is to confirm the future development of GLM and to make a market investigation about GLM. Though GLM is widely accepted by leather shoes and garments-manufacturing factories in North China, the influence of GLM is limited in the south and most consumers know little about it. Furthermore, more and more countries are eager to know what GLM is with the entry of WTO. At the meeting the participants may put out many questions to help CLIA know the existing problem and make out the new way of management in the new century.

4.4 Benefits from Trade Liberalization

As the global trend of shifting footwear production to China continues, the industry has expanded by leaps and bounds in the mainland in recent years. Today, five leading footwear production and distribution bases have emerged, namely Guangdong, Fujian, Wenzhou, Chengdu and Chongqing. Together these five centers house more than 20,000 shoemakers producing about 6 billion pairs a

year, accounting for 50% of the world's total. Of these, over 2 billion pairs are exported annually, carving a 20% share of the global footwear market.

China is not only the world's largest footwear producer and exporter, but also a major market in its own right. As economic reforms continue and people's living standards improve, great changes have taken place in the mainland footwear market in terms of design, materials, production techniques and consumer profile. Among the four major categories -- leather shoes, cloth shoes, plastic shoes and PVC shoes -- consumer preference has shifted towards leather shoes, whose share in the four categories has increased from 9% to 35%.

Supported by a number of large-scale manufacturing bases in the coastal cities, China produces about 2 billion pairs of leather shoes each year. As for plastic shoes, China is currently the world's leading producer and exporter, with an annual output of 910-930 million pairs. China's consumption of plastic shoes accounts for two-thirds of the world total, with consumption in its rural areas accounting for two-thirds of the national total. Consumption of plastic shoes in China is estimated at 910-970 million pairs in 2000, while exports are estimated at 600-700 million pairs. The pursuit of a leisurely lifestyle over the past years has made cloth shoes increasingly popular. Buyers of these comfortable and inexpensive shoes are also moving from old people to middle-aged and young people.

Medium-to-low range items account for the majority of mainland footwear manufacturers' output, especially leather and plastic shoes. For example, locally produced medium-to-low range products take up more than 85% of the leather

shoe market. In pricing, shoes within the Rmb100-300 price range are the most popular while those exceeding Rmb300 can hardly sell. In coastal cities, leather shoes of famous domestic brands that sell for just over Rmb200 are hot items. Imported shoes, despite their superior materials and better workmanship, have a small share of the market due to their high prices.

WTO entry will have significant impacts on China's footwear exports and domestic market. First, its footwear exports will benefit. After joining the WTO, China will have access to a fair mechanism for trade dispute settlement, thereby safeguarding the rights of Chinese footwear exporters in international trade. On the other hand, elimination of quotas will help Chinese exporters with foreign trade rights reduce operating costs, which will in turn boost their competitiveness. Furthermore, the lifting of quotas will also make it easier for companies whose major export markets are experiencing downturns (such as Japan and Southeast Asia) to shift to the European market.

Upon WTO accession, lower tariffs in fellow member countries will help Chinese exports reduce costs and enhance their competitiveness in the international marketplace. It is understood that the tariff rate of developed countries on all kinds of footwear will be about 40% lower while that of developing countries is slightly smaller. Also, since China is joining the WTO as a developing country, it will enjoy GSP treatment in developed countries. As the world's largest footwear exporter, China stands to benefit most from liberalization of the footwear trade.

Second, foreign companies will have easier access to the China market. As market liberalization and import tariff reduction are fundamental obligations of all

WTO members, China has made commitments to further open its market and slash average tariff rate from the present level of 17% to 10% by 2005. In the wake of tariff cuts, imported footwear, especially medium-range products from Spain and Italy, are set to make a foray into the China market. This will pose a serious threat to the high-end shoes produced by domestic enterprises. At present, footwear factories in the mainland are already struggling to survive amid fierce competition. After WTO accession, competition is bound to intensify with the entry of international rivals.

WTO entry is set to expedite the pace of state-owned enterprise reform and industry restructuring. In the footwear industry, it can be expected that consolidation will be a common phenomenon with the smaller workshops being merged by large factories (including foreign-invested operations).

At present, Hong Kong footwear manufacturers have successfully captured a share of the mainland market thanks to their trendy designs and unique business strategies. As competition intensifies after China's WTO accession, Hong Kong companies must further upgrade their product range. In expanding the domestic market, they may acquire Chinese footwear factories or commission mainland enterprises to produce shoes of their own designs and market the products locally. This strategy is especially suitable for breaking into China's inland market. Acting as agents for foreign brands in the mainland market is another option for Hong Kong companies.

4.5 Summary

The emergence of footwear industry development in Wenzhou, China in

some senses originated from the Factor Condition: low labor cost. The competitive advantage here makes the development realistic. In addition the decade's accumulation of capital from retained earnings enables the footwear companies to make technological innovations in related and supporting industries as well as design creation. Domestic market demand for footwear is growing as well as international market opportunities.

Due to the entry of China into WTO, the advantages which Wenzhou, China footwear industry has gained in the past decades should be maintained and be even more expanded. Marketing tools such as internet promotion are growing fast which will help the Wenzhou footwear industry to increase its competitiveness.

In summary, the competitive advantage of the Wenzhou footwear industry can be understood in terms of four advantages: Brand, Personnel, Accessory and System. Each of these relate to elements of Porter's diamond. A final question is "what is behind the Wenzhou's diamond? Why is the diamond turn out this way?"

The success of the region has its origins in both the past and present. Before the economic reform in China (1979), the economic development of Wenzhou was slow and often delayed. The total annual income of the district enhanced from RMB 1300 billion in 1978 to RMB 7332 billion in 1999, almost five folded. The most basic explanation is the outgrowth of the unique free-market development know as the Wenzhou Economic Model which is manifest in private development of the industry from capital sources both inside China, and from neighbouring Asian regions such as Taiwan and Hong Kong

A second, and somewhat related explanation has to do with the human factor.

The development of Wenzhou is well combined with the unique culture here. The culture of Wenzhou has been shaped by its isolation from the rest of China and its exposure to foreign influences through centuries of sea trading. The people of Wenzhou are said to be strong and self reliant, yet have maintained feelings of solidarity and community spirit.

These advantages are what Wenzhou has gained and what will benefit Wenzhou in the developing market economy. With a more better organized and controlled market, Wenzhou footwear will maintain its position in the footwear market as well as expand it more in the new century. Wenzhou has made a rapid progress and resulted in establishing the "Wenzhou Economic Pattern" which is characterized by private enterprise and a market economy.

4.6 Limitations of the Study

1. There was not enough data—need more statistics on company transactions and mix of international and domestic activity.
2. Need more interviews to interpret the data.
3. Relied too much of information from second hand sources.
4. Not all companies are prosperous—findings are biased toward largest, most successful companies Even data collection is limited—for example small firms may not even have publicly available websites.
5. The interviews were most valuable part of the study but relied on the judgment and opinions of the respondent. Interview data has gained more acceptance in research as Blalock (1974, p138-139) has pointed out: "The

advantage of using human judgment as a means of measurement are generally thought to outweigh the disadvantages”.

4.6 Recommendation for Future Study

The following recommendations are suggested for continuance of this line of research:

1. Larger scale statistical research is now required. The present interview study has created some preliminary expectations which can now be elaborated by a wider scale interview study leading to a survey study .Both of these should be supplemented by the collection of more yearly government and industry statistics.
2. A larger sample of firms should be researched to understand the diversity of strategies pursued within the Wenzhou industry. A perusal of the catalogs of some of the major manufacturers indicates that despite the similarities across companies of a certain size, they pursue different markets with different product market strategies.
3. No attempt was made to extend the study to other regions of China. Although Wenzhou is the acknowledged “shoe capital” there are other important centers which comparison may yield insight into the unique nature of the Wenzhou competitive advantage.

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