



# If the Shoe Fits: Wenzhou Aike Shoes Company, Ltd.

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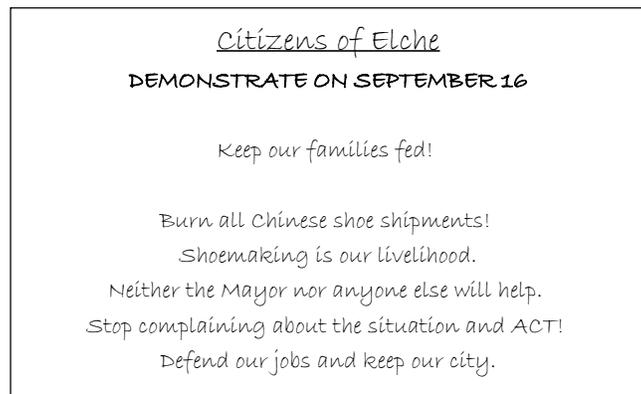
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**Abstract.** This case study addresses critical aspects of the strategic management decision to be made by Wenzhou Aike Shoes Company, Ltd., a Chinese multinational shoe manufacturer. The specific focus is on Aike's operations in Elche, Spain. Over a period of several years, upheaval stemming from a multitude of Chinese new entrants to Elche's revered shoemaking industry reached a flashpoint. The Chinese new entrants run operations significantly differently than the local Elche businesses in terms of daily practices, production, imitation, price competition, and supply chain management. All of these aspects derive from deep cultural differences and are highlighted in the case. Several strategic options, such as foreign partnership, brand acquisition, and exiting Elche are presented for discussion.

**Keywords:** China, dumping, international.

## 1. Introduction

Ma Juncheng was President of Wenzhou Aike Footwear Company. On September 16, 2004 he was anxiously waiting to hear from his Regional Manager in Elche, Spain. Ma was going to have to make big decisions fast about how to handle rising hostility toward his Elche operations. A large and growing number of people in Elche were beginning to despise Chinese shoes. The animosity and tension seemed about to explode: last month a sign appeared on the wall of one of the company's manufacturing plants.



As Ma waited nervously to hear from his Regional Manager, he thought about the situation in Elche. The city is located 420 kilometers Southeast of Madrid. It is the capital of Spain's footwear industry. Elche is historically renowned in European and international shoe markets for the high quality and fine styles of the footwear produced by its artisans and sold in its shops. Because of this fame, growing numbers of shoemakers from China had moved to Elche and the surrounding areas during the past several years to run shoe businesses. Most of these immigrants came from Wenzhou, China's largest shoe manufacturing center. Wenzhou has at least 4,000 factories that produce massive quantities of low-priced shoes using cheap labor amidst poor working conditions. After a tidal wave of Chinese shoes from Wenzhou, Elche's shoe stores and factories had incurred a sharp recession. In fact, 60% of those stores and factories had already gone out of business by 2002.

One response to these trends was a growing insurgency among Elche's citizens. Ma had long feared it would reach a flash point. The reaction of the citizens was premised on a perception that competition with the Chinese was not just about low-priced products. Rather, most of the Chinese shoe inventory in Spain was untaxed or sold on illegal markets, which made it all but impossible for law abiding businesses to compete. Local entrepreneurs blamed the Chinese for not respecting Spanish business customs. The Chinese shoe stores in Elche were open for at least three hours longer than the locally-owned ones. As well, Chinese businesses received shipments on Sundays while local ones were closed.

## **2. Fire!**

Ma's Regional Manager finally came through on the telephone with a frantic update. As the posted sign had threatened, the tension in Elche had indeed boiled over on September 16. Over 7,000 citizens marched through the streets protesting the demise of the shoe industry. Angered by the loss of local jobs and businesses since the influx of shoes from China, infuriated protesters shouted loudly and carried large billboards, declaring "Chinese out!" Several hundred protesters entered Elche's Karus industrial area aggressively and hurled stones at Chinese wholesalers and footwear stores. Once they reached Aike's location, it was not long before a warehouse and large trailer were ablaze in flames. More than €1.2 million worth of Aike's shoe inventory – all manufactured in China and transported to Spain – was up in smoke. The Chinese government asked Spanish authorities to protect the Chinese and their property and compensate the businesses. Several arrests were made.

Ma was relieved nobody was hurt but very distressed about the predicament. He saw the destruction of his inventory as symptomatic of a longstanding deeper problem. Now the complexities of that problem were compounded, intensified, and more apparent than ever before. It was almost as though the fire that had just

destroyed so much of his inventory was a metaphor for the “fire” of dangerous external forces spreading around his business. He needed to make some hard strategic decisions fast about how to stop the flames, but it was unclear to him how he could do so while keeping his business intact.



Dark smoke rises from a fire at Wenzhou Aike Company, Ltd.’s warehouse in Elche, Spain (September 16, 2004). *Hu Xiao / China Daily*

### **3. Background**

#### **3.1. Chinese Shoemakers**

In China, shoemakers were widely known as “shoe locusts” because of their extraordinary reproductive capacity. As business organizations, they move fast in dynamic swarms and high-density droves. Their growth rates are very high, and they can destroy or transform any market system they enter if given free reign. Chinese shoemakers produced no less than six billion pairs of shoes in 2004. That level of production equated to at least one pair of shoes for every single person on earth.

Wenzhou is the source of this production activity. Though the shoes manufactured in Wenzhou dominate a global industry, virtually none of the millions of workers there speak Western languages. In fact, these workers tend to be so uneducated they cannot even speak standard Mandarin Chinese well. As

such, they do not share or develop specialized knowledge about product quality. Instead, they only emphasize simple information about productivity and quantity. Most of them have only a primary school education that is supplemented by years of experience emphasizing volume and conducting fast business in flea markets. Thus, the only real business principle they understand is that lower prices mean higher sales. With this rudimentary orientation, they will dare entry into any new market. If there is an opportunity for profit, they rush in; if there is no opportunity, they hurry away. If a first mover generates profit, then a large swarm will follow quickly. Sometimes the hoarding activity of Chinese shoemaking companies damages the natural environment. The intense production emphasis also tends to exploit physical labor in China. Organizational characteristics and norms deriving from these practices sometimes cause foreign markets to be unreceptive to Chinese shoemakers.

### 3.2. Wenzhou Aike Footwear Company

China suffered from many shortages of manufactured goods in the 1980s. Shoes, for example, were difficult to buy in the centralized economic system. Ma founded his company based on an opportunity he discovered to respond to this inefficiency. In 1992, with the help of a successful Hong Kong businessman, Ma began to produce leather for a Belgian company. He invested his entire family fortune (about \$100,000) in the operation and named the business “Aike” because of its phonetic similarity with the famous “Nike” brand. The Belgian company exported shoes made with Ma’s leather to Russia, which was another centralized economy struggling with similar shortages. Aike’s total sales in 1993 were about \$1.3 million.

True to form, it was not long before many imitators cropped up in Wenzhou to chase the same kind of success. The hotness of the competition made Ma uncomfortable, and middle men such as the Belgian company had begun to capitalize on Chinese competition. This process drove Aike’s prices down. As a result, Aike separated from its distributors in 1997 and opted to conduct its international business independently.

The first country Aike entered was Russia. The original installation was a large booth in a Moscow bargain market. When Aike arrived there were already two other Wenzhou shoe makers in the market. Soon there were more. Aike occupied the booth in 1999 at a rental rate of €10,000 per year. By 2000, there were more than 100 Wenzhou shoemakers in the market, which drove rent up to €25,000 per year. By 2002 there were more than 300 Wenzhou shoemakers in the market. Rising rent and a fierce price war with other Chinese shoemakers narrowed Aike’s profit margins considerably and Ma decided to leave Russia.

Aike next moved into Hungary, Poland, and the Czech Republic. Ma decided on these locations for a couple reasons. First, not many Chinese competitors had

reached these markets yet. Second, Ma had acquired some business skills and cultural understanding during his Russian experience that enabled him to do business in these formerly centralized economies. Third, as most Eastern European countries had recently become members of the European Union (EU), Aike could eventually use them as pivot points to enter larger markets in Western European countries.

### 3.3. Entering Elche

Aike finally entered the Western European market in 2000 with the purchase of a small shoe manufacturing workshop in Elche. When Aike first began conducting business, the main shopping street in Elche was packed full of local shoe stores. Each one had a retail area near the front and a manufacturing facility in back. There were only two Chinese manufacturers in the entire city. Elche originally welcomed the Chinese, and local business people had very positive relations with them. At that point there were no economic or political issues related to Chinese trade or immigration. For example, though there was a limiting quota on imports, some local shops even agreed to help absorb excesses by storing inventory for the Chinese stores. Ma visited several of the local stores and noticed their operations were very small. There were many such stores, but most had very few employees. Ma recognized that competition with these stores based on economies of scale would be easy. The strategic approach allowed Aike to thrive in Elche manufacturing shoes for the next several years.

By 2004, Elche's main shopping street had changed dramatically. Most of the shoe stores were now run by Chinese shoemakers who manufactured and sold inexpensive shoes. The average price for a pair of Chinese shoes was €9.00. The Spanish stores, by contrast, were selling shoes for €15.00-20.00. The strategy of the Chinese was to compete on price. Later, as Chinese shoemakers began to compete intensely with each other, the prices for shoes were driven very low. Before long, shoes in Elche could be bought from Chinese stores for €2.00-3.00. In the meantime, many Spanish shoe stores closed.

### 3.4. Chinese Operations and Competition in Elche

Chinese shoe businesses had distinct operational characteristics in Elche. Whereas the local stores were closed for a respite every afternoon from 2:00pm-4:00pm, the Chinese ones were always open during this time. Spanish stores were also closed every Saturday and Sunday, but the Chinese ones were still open. The Chinese stores almost never had local citizens working in them. Rather, they hired Chinese employees. The stores were linked with a supply chain that stretched from manufacturing to retail and populated only by Chinese people.

The dynamics of Chinese competition were intense. Unlike the Spanish shoemakers, Chinese manufacturers copied each other based on material, style, production technique, and any other notable practice. Once a popular style was identified, it was certain that exact imitations of it down to the last detail would be for sale on the main street in a couple of days. Soon enough, imitation amongst players in the shoe market and its effect on prices became a strategic enabler. For example, in 2000 a pair of popular shoes would be available for sale at 1-2 locations and generate €3 in profit. In 2004, a pair of popular shoes, or exact imitations, would be available at 20 locations and the same margin was down to €0.20. The dynamics of competition began to hinge on price and efficiency, at the expense of brand and quality.

### **3.5. Environmental Forces**

The practices of Chinese shoemakers in Europe eventually met with objections from not only local but international authorities. In 2003, Chinese shoes totaling €2 million were destroyed in Rome because of counterfeiting and smuggling. In June 2005 the EU began to investigate the Chinese shoe industry for dumping practices in Europe and began to inaugurate anti-dumping tariffs for all shoes made in China. A gradually increase in those taxes from 4% to 19% over a five-year period was planned by the EU.

In 2006, in the context of this environment, Aike faced two forces from a strategic management perspective. The first one, which was immediate, derived from Chinese competition in fierce price wars. The second one was more daunting and related to the general political and legal environment. It derived ultimately from the EU, which had already threatened tariffs and anti-dumping legislation. It was also germane to local towns and municipalities that did not appreciate so many Chinese shoemakers entering their markets. How could Aike deal with both challenges at once?

## **4. Next Steps for Aike**

For Ma, how to engage the first challenge was fairly straightforward but would be difficult. He knew that over the long run, the cost advantage of Aike and the other Chinese shoemakers was not sustainable. In Malaysia and Vietnam, for example, shoes could now be made even cheaper than in China. Noting as many of the parameters as he could identify, Ma pondered several potential strategic approaches for Aike as next steps.

First, he considered manufacturing in Africa, where labor was very cheap. It was true that Nigeria's government saw Chinese imports as destroying local industries and had just forced Chinese retailers out in 2004. Nigeria also

announced that they would stop importing 31 different products from China, including shoes. One Chinese shoemaker saw an opportunity, however, and sought to invest in Nigeria by establishing a shoe factory that hired many local employees (over 2,000), trained local sellers, and shared technology. The shoemaker eventually gained access and also paid taxes to local governments, helped solve unemployment problems, and became the largest shoemaker in West Africa. By 2005, that shoemaker's production capacity exceeded one million pairs and sold for an average of €10. The highest quality shoes made in Africa could even be exported to the USA and Europe; because they were made in Africa, there were no anti-dumping regulations and they were not overtaxed. Could Aike move operations to Africa?

The second option involved establishing a brand. In the Chinese market, luxury shoes cost more than €120 and were only made by foreign brands outside China. Ma knew the reason was not only based on quality, but also because Chinese shoemakers did not understand how to establish brand recognition and loyalty. Foreign shoemakers used a brand advantage to attract Chinese customers. Therefore, some Chinese shoemakers had purchased foreign companies just for their brands. In 2002, for example, a Wenzhou shoemaker met the founder of Wilson, an Italian company with a revered 50-year history. Wilson was an original equipment manufacturer for Polo and Armani. The daughter of the founder had no interest in running the family business. Therefore, the Wenzhou company was able to buy Wilson's operations for €1.5 million. The acquisition afforded many strategic enablers. For one, imitation was not an issue because original designers were utilized to make the product. As well, Chinese competitors were not supposed to copy the design due to strict Italian intellectual property guidelines. In addition, there were no anti-dumping regulations because it was an Italian company. Aike had just enough resources to make such an acquisition, but it would be a massive change for the company. Was buying a foreign company an option?

The last option was to just cooperate with foreign companies. Ma knew of a few examples of such cooperation. In 2004, a Wenzhou company allied with Geox, the largest shoemaker in Italy. The CEO of Geox, Diego Bolzonello, granted the Chinese company sole status as its Asian manufacturing base. The alliance involved completely sharing Geox's distribution network for products. Geox provided technology and international channels to market for the Wenzhou company. The cooperation helped the Wenzhou company establish an image. It was then able to produce highly desirable products and keep pace with the European market. If this option was viable, how could it be done?