Week 4: Week 4--July 29 - Team Case Analyses

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Read Case 4- 2 ECCO A/S -- Global Value Chain Management
The purpose of this case is to challenge you to sort through a relatively large amount of information to find solutions.

Assignment:
Read Chapter 4
Review Chapter 4 PowerPoint Presentation in Doc Sharing

Use information in the chapter and standard analytical techniques and models from strategy (Porter's Value Chain, 5 Forces, SWOT, and VRIO) and other relevant resources to answer the following questions.

1. Describe the competitive environment of ECCO and determine how well ECCO is positioned (vis-a-vis the competitors) to take advantage of changes in the industry.
2. Analyze ECCO's global value chain. How well does this configuration match the drivers in the industry?
3. ECCO has a fully integrated vertical value chain. What are the pros and cons of this strategy? What economic and strategic factors should be analyzed to answer this question? (insert a document)
4. Is ECCO following the inside-out or outside-in strategic perspective? What are the implications of this choice and how can ECCO increase their sales/marketing efforts?
5. How is family ownership affecting ECCO? Comment on the corporate ownership structure and its implications for strategy-making and implementation. What alternatives exist?

Case 4-2 ECCO A/S—Global Value Chain Management

Bo Bernhard Nielsen, Torben Pedersen, and Jacob Pyndt

Despite the summer, the weather was hazy on that day in May 2004 as the airplane took off from Hongqiao International Airport, Shanghai. The plane was likely to encounter some turbulence on its way to Copenhagen Airport in Denmark. The chief operations officer (COO) of the Danish shoe manufacturer ECCO A/S (ECCO), Mikael Thinghuus, did not particularly enjoy bumpy flights, but the rough flight could not overshadow the confidence and optimism he felt after his visit to Xiamen in southeast China. This was his third visit in three months.

During 2003/2004, ECCO spent substantial resources on analyzing where to establish production facilities in China. On this trip, together with Flemming Brønd, the production director in China, Thinghuus had finalized negotiations with Novo Nordisk Engineering (NNE). NNE possessed valuable experience in building factories in China, experience gained through their work for Novozymes and Novo Nordisk. Now everything seemed to be in place. Construction was to begin in August, machines would be installed in January 2005, and the first pair of shoes would be leaving the factory by the end of March 2005 if all went well. The plan was to build five closely connected factories over the next four years with a total capacity of five million pairs of shoes per year, serving both export needs and the Chinese market, which was expected to grow in the future.

Thinghuus felt relieved. He was confident that the massive investments in China would serve as a solid footstep on a fast growing market and provide a unique export platform to the global shoe market. However, he could not rest on his laurels. The massive investment in China was an integrated part of ECCO's continuous attempt to optimize various activities in the value chain. Operating five distinct factories in Portugal, Slovakia, Indonesia, Thailand and shortly in China combined with a declared vision of integrating the global value chain, the task at hand was certainly complicated. Moreover, ECCO had one tannery located in the Netherlands and two located adjacent to shoe production facilities in Indonesia and Thailand. These tanneries enabled ECCO to maintain control of leather processing and ensure the quality of the leather utilized in ECCO's shoe manufacturing.

IVEY

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Professor Bo Bernhard Nielsen, Professor Torben Pedersen and Management Consultant Jacob Pyndt wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

Introducing ECCO

> It has always been our philosophy that quality is the only thing that endures. That is why we constantly work to create the perfect shoe—so good that you forget you are wearing it. It has to be light and solid, designed on the basis of the newest technology and knowledge about comfort and materials. ECCO have to be the world's best shoes—shoes with internal values.
>
> Karl Toosbuy, founder

With the simple slogan "A perfect fit—a simple idea," Karl Toosbuy founded ECCO in Bredebro, Denmark in 1963. Inspired by the open and harsh

landscape of southern Jutland, Toosbuy presented ECCO as a company with a passion for pleasant walking. Today, after more than 40 years of craftsmanship and dedication to uncompromised quality, ECCO remains extremely committed to comfort, design and a perfectly fitting shoe with the goal of constantly developing shoes that are pleasant to walk in regardless of the weather conditions. The company's vision is to be the "most wanted brand within innovation and comfort footwear—a position that only can be attained by constantly and courageously researching new paths, investing in employees, in our core competencies of product development and production technology."[1]

ECCO aimed at producing the world's most comfortable and modern footwear for work and leisure. Footwear for work, leisure and festive occasions had to be designed and constructed with uncompromising attention to customer comfort. Evidently, trends in the market in terms of fashion and elegance were important, but usability was ECCO's highest design priority. As Søren Steffensen, executive vice-president, stated: "ECCO is not a fashion brand and it never will be. We do not sell shoes where the brand name is the most important and quality is a secondary consideration. Primarily, we sell high-quality shoes and that is where we seek recognition."[2]

Products and Markets The ECCO group produces various types of shoes including casual and outdoor shoes for men, ladies, and children, as well as semi-sport shoes, for two different seasons—spring/summer and autumn/winter. In 2004, the sales split between the different categories was children 11 per cent, ladies 47 per cent, men 30 per cent, and sport 12 per cent. The sport division produced outdoor, walking, running and golf shoes. ECCO's golf shoes category had experienced particularly significant growth. ECCO's development of golf shoes had started as a joke between Toosbuy and Dieter Kasprzak, chief executive officer (CEO), on the golf course 10 years ago. In 2004, the joke turned into 300,000 pairs sold, sponsorships of international golfers like Thomas Bjørn and Colin Montgomerie, and numerous endorsements in independent tests of golf equipment in the United States. Having tested ECCO's golf shoes, Rankmark, an American company conducting objective tests and analyzes of golf products, stated that "ECCO Golf Footwear was preferred by more than 90 per cent of golfers over their current brands."

In 2004, ECCO exported more than 90 per cent of its production, with the United States, Germany and Japan being the main markets. ECCO's international profile was reflected in the workforce composition. In the same year, ECCO employed 9,657 employees of which 553 were located in Denmark. The company worked constantly on creating new markets, particularly in Asia and Central and Eastern Europe. The North American market—the United States and Canada—was of great importance to ECCO. In 2004, the company's American operations attained 17 per cent growth in sales when compared to 2003. That year, the American operations accounted for DKK 875 million in revenue, roughly 26 per cent of ECCO's total sales.[3] The American subsidiary had streamlined its vendorship, cutting the number from 1,200 in 2002 to 1,000 in 2004, yet the remaining dealers had purchased a higher volume. In addition, ECCO increased its number of partnerships by 18 to 34 in 2004. The American market was lucrative as shoes were selling at high prices. Men's shoes typically cost between US$150 and US$450 and the highly successful golf shoes were sold for between US$200 and US$400. The majority of ECCO's sales in North America went through exclusive department stores, such as Nordstrom's and Dillard's.

Finance and Ownership Structure

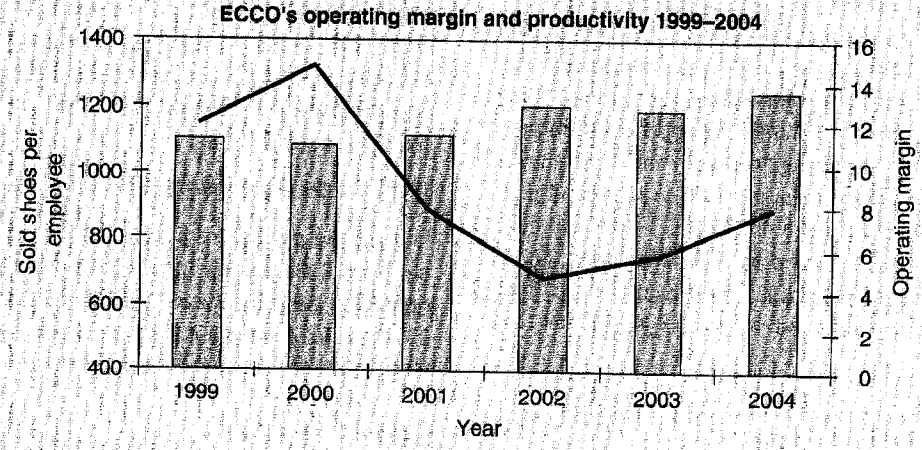
During the period from 1999 to 2003, ECCO experienced stagnating productivity and declining operating margins (see **Exhibit 1**). For instance, the operating margin fell from 15 per cent in 2000 to five per cent in 2002. Moreover, company debts

[1] http://www.ecco.com/int/en/aboutus/index.jsp, accessed April 2005.
[2] *Berlingske News Magazine*, March 7, 2004.
[3] *Børsen*, December 22, 2004.

Exhibit 1 ECCO's Financial Highlights 1999 to 2004

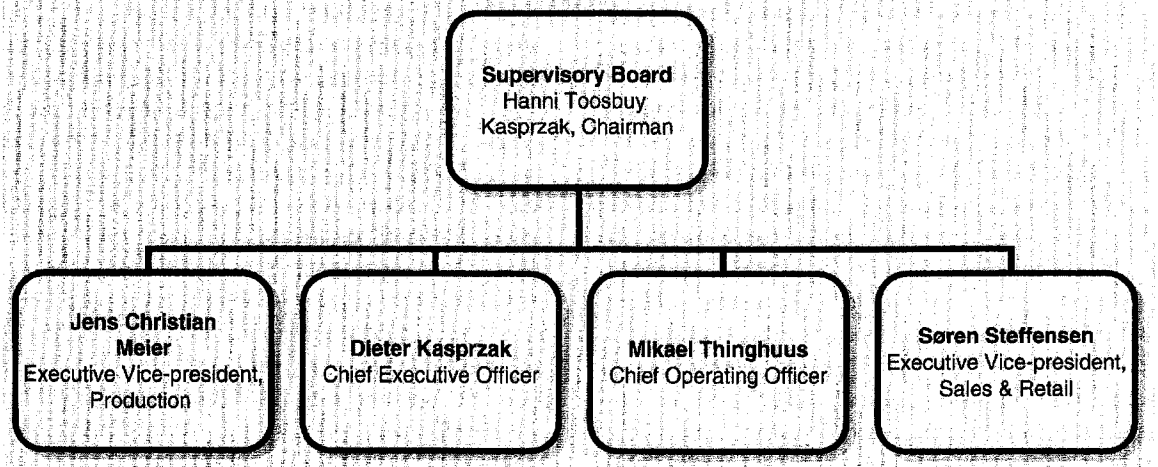
ECCO's consolidated financial highlights and key ratios 1999–2004

(DKK million)	1999	2000	2001	2002	2003	2004
Net revenue	2,552	2,836	3,216	3,360	3,169	3,394
Profit before amortization and depreciation	409	560	416	343	370	448
Amortization and depreciation	−106	−143	−167	−187	−189	−181
Profit before financials	302	416	249	156	182	267
Net financials	−25	−112	−93	−73	−61	−61
Profit before tax	277	305	156	82	120	206
Group profit	195	216	123	60	71	164
Profit for the year	185	208	115	51	62	151
Key ratios (%)						
Operating margin	11.9	14.7	7.8	4.6	5.7	7.9
Return on assets	11.7	10.6	5	2.8	4.3	7
ROIC	12.7	14.5	8.1	5.3	6.5	9.1
Investment ratio	3.3	2.2	1.5	1.2	1.2	1.2
Return on equity	28.9	25.7	12.4	5.3	6.5	15.2
Solvency ratio	30.9	31.1	31.4	33	34.1	35.1
Liquidity ratio	1.8	1.9	2.1	2	1.9	2
Pairs of shoes sold (millions)	9.160	9.603	10.14	10.65	11.22	12.04
Number of employees (2004)	8,290	8,853	9,087	8,839	9,388	9,657
Sold shoes per employee	**1,104**	**1,084**	**1,116**	**1,205**	**1,195**	**1,247**



Source: ECCO annual reports 1999–2004.

Exhibit 2 Composition of Management Board as of 2004



Source: ECCO's annual report 2004.

increased from DKK 1 billion to DKK 2 billion following investments in expansion and inventories. In response to these negative trends, ECCO launched strategic initiatives to streamline logistics, focus on more modern shoes and facilitate monitoring of the market. 2004 brought signs of improvement as the company achieved earnings of DKK 150 million and lifted its operating margin to eight per cent. The reduction of stock had a particularly notable effect on the 2004 result, further freeing up capital to finance ECCO's ambitious growth plan. The company's goal was to increase revenue to approximately DKK 8 billion to DKK 9 billion by 2013, selling 24 million pairs of shoes per year.

Despite financial constraints in the beginning of the 21st century which could have triggered an Initial public offering (IPO) to raise capital, ownership of the company was kept within the family. Prior to his death, Toosbuy passed on his shares to his daughter Hanni Toosbuy, who was chairman of the supervisory board (see **Exhibit 2**). Commenting on the ownership structure of ECCO, Karl Toosbuy stated:

> I do not believe that an IPO is in the best interest of the company. ECCO is stronger given the family ownership. The family can take higher risks. We are able to allocate. In many cases, we do not have the time to investigate things as profoundly as a listed company ought to do. Yet, we are sure that what we want is the right thing. Then we act instead of waiting.[4]

Organizational Developments Operating on a global scale required employees with international mindsets and good adaptability skills. Since its inception ECCO had given high priority to the continuous education and training of its employees. The company invested aggressively in vocational training, career development, developmental conversations and expatriation. ECCO's establishment of the Education and Conference Centre in 1994, the research centre Futura in 1996, and the ECCO Business Academy in 2001 served as signs of commitment to these issues. According to Karl Toosbuy, these investments were vital to allowing ECCO to recruit internally for management positions and, thereby, accomplish his strategy announced in 1991. This strategy stated that 80 per cent of the company's leaders should come from inside ECCO. Twice during the 1990s, Toosbuy had stepped down as CEO only to reinstall himself some years later,

[4] *Børsen*, February 20, 1998.

underpinning the importance of knowing the company inside-out and adapting to ECCO's culture.

Despite the founder's intention of internal recruitment for management positions, on two recent occasions this ambition could not be met. In 2001, ECCO hired Søren Steffensen in the position as sales and marketing director. Coming from a position as retail director in the Danish fashion clothing company, Carli Gry, he had a reputation of knowing every shopping corner in Europe and was an efficient negotiator. In addition, Mikael Thinghuus took over the position of chief operating officer (COO) in 2003, having held positions at IBM and the East Asiatic Company. The third member of the executive committee was Jens Christian Meier, executive vice-president, who had spent most of his career within shoe manufacturing. He actually initiated his career at ECCO, continued at Clarks, and then moved on to Elefanten Shoes as managing director before returning to ECCO. His main responsibilities lay within the fields of logistics, sourcing and handling ECCO's production facilities. When Karl Toosbuy died in June 2004, his son-in-law, Dieter Kasprzak, became CEO. Kasprzak had spent 23 years with ECCO, primarily as the director of design and product development. Whereas Toosbuy was known for his abilities to develop unique production techniques, Kasprzak was a designer by trade and was much more involved in product development and branding. The death of Toosbuy triggered considerations about future development becoming more market oriented. Thinghuus commented: "Evidently, we may learn something from the marketing oriented firms [Nike, Reebok and Adidas]. We should aim at becoming better at telling what we stand for. We cannot expect that our unique production technology will last an eternity."[5]

ECCO's Global Value Chain

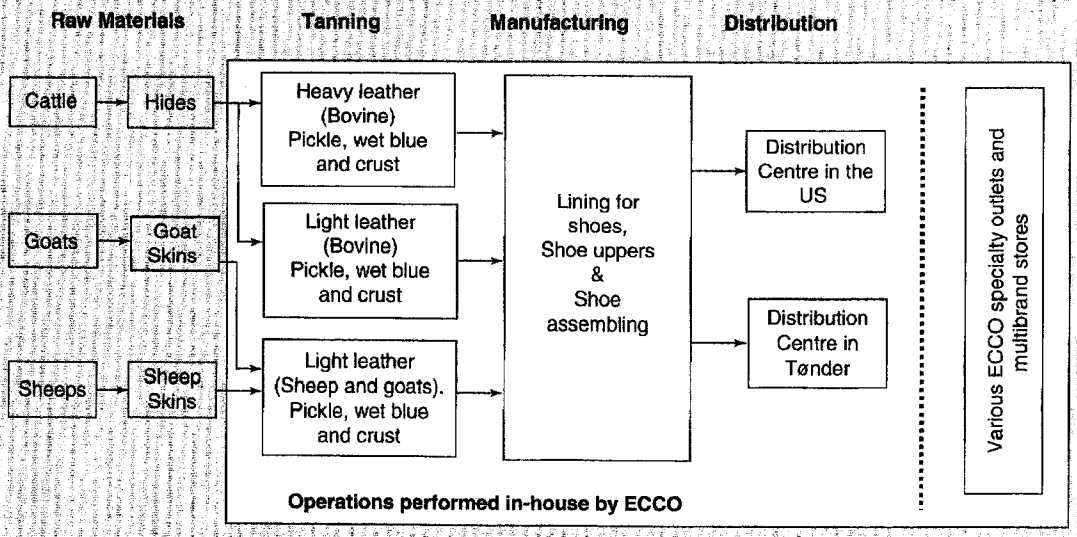
ECCO maintained focus on the entire value chain or from "cow to shoe" as the company liked to put it. ECCO bought raw hides and transformed these into various kinds of leather usable in shoe manufacturing. Leather constituted the main material in shoe uppers which were produced at ECCO's production sites (see **Exhibits 3** and **4**). The company owned several tanneries in the Netherlands, Thailand (opened in 1999) and Indonesia, which supplied leather to ECCO's factories all over the world. ECCO's 2001 acquisition of the largest tannery in the Netherlands, followed by a tannery and leather research centre in 2002, made it possible to access leading expert knowledge about tanning. ECCO's Dutch tannery manufactured around 3,500 rawhides a day, corresponding to approximately one million cows per year. Apart from providing ECCO's factories with "wetblue" (see **Exhibit 3**), the development and research centre's main task was to explore less polluting tanning methods and experiment with various kinds of leather for the coming generation of ECCO shoes. The centre employed 15 specialists who were also responsible for training employees from Thailand and Indonesia, allowing new technology and improved tannery methods to be disseminated. ECCO was among the five largest producers of leather worldwide. The majority of the rawhides originated from Germany, France, Denmark and Finland. Apart from supplying leather to its shoe factories around the world, it also sold leather to the auto and furniture industries. Explaining ECCO's tanning activities, Toosbuy commented: "To us, it is a matter of the level of ambition. We make high demands on quality and lead times—higher than any of our suppliers have been able to accommodate. In essence, we really do not have an alternative to being self-sufficient."[6]

In addition, the plan was to set up a tannery in conjunction with the factories in China. ECCO's strategy was quite unique, as most of its competitors had phased out in-house production. Companies like Clarks and Timberland had followed Nike's marketing oriented business model by outsourcing the production to a large extent. These companies were described as branded marketers,

[5] *Berlingske News Magazine*, March 7, 2004.

[6] *Jyllands-Posten*, May 22, 2002.

Exhibit 3 ECCO's Value Chain and Explanation of Tannery Operation



Explanations:
***Pickled**: the stage of tanning where the hair is removed usually for sheepskins*
***Wetblue**: the next stage when lime is added to preserve skin*
***Crust**: the third stage when the remaining flesh and fat proteins are removed*
***Finished**: the final stage when the skin is dyed and finished using chrome sulphate and is converted to processed leather.*

i.e., manufacturers without factories, who only design and market their goods. While Timberland produced approximately 10 per cent of its shoes in-house, Clarks had completely outsourced its production. ECCO, by contrast, produced 80 per cent of its shoes in-house. The remaining 20 per cent were outsourced as these shoes (for instance, ladies' shoes with thin soles and certain types of sport shoes) contained specific features that would not benefit from ECCO's "direct injected" technology.

ECCO's production process could be divided into five strategic roles or phases: full-scale, benchmarking, ramp-up, prototype and laboratory production. The objectives of full-scale production were to uphold demand, quality and operational reliability, and still produce high volumes. Benchmarking production, on the other hand, strove to retain knowledge and competencies in terms of opportunities for improvements and production cost structure. ECCO had full-scale production units in Portugal, Indonesia, Thailand, Slovakia and China (in operation from March 2005). A logical consequence of ECCO's control of their value chain was that benchmarking served more to evaluate such aspects as the production unit in Portugal, *vis-à-vis* the plant in Slovakia, than to establish parameters upon which to evaluate external partners. The ramp-up process encompassed the set-up for the production system at large, such as running an assembly system based on new technology. While the newest technology came from Bredebro, Denmark, the actual establishment of the production system, including the streamlining of processes and the specific volumes of various kinds of materials, took place in ECCO's foreign production units. The development of new products, prototypes and laboratory production technologies, was carried out at ECCO's production site in Denmark. In particular,

Exhibit 4 Converting Skin and Hides into Leather

Steps in leather production

The production of leather from hides and skins involves the treatment of raw materials, i.e., the conversion of the raw hide or skin, a putrecible material, into leather, a stable material. This material is obtained after passing through the different treatment and processing steps described in points 1 to 4. The production processes in a tannery can be divided into four main categories, though the processes employed in each of these categories may change, depending on the raw material used and the final goods that are to be produced.

1. **Hides and Skins Storage and Beam-house Operations**
   Upon delivery, hides and skins can be sorted, trimmed, cured (when the raw material cannot be processed immediately) and stored pending operations in the beam house. The following processes are typically carried out in the beam house of a tannery: soaking, de-haring, liming, fleshing (mechanical scraping off of the excessive organic material) and splitting (mechanically splitting regulates the thickness of hides and skins, splitting them horizontally into a grain layer, and, if the hide is thick enough, a flesh layer).
2. **Tannery Operations**
   Typically the following processes are carried out in the tannery: de-liming, bating, pickling and tanning. Once pickling has been carried out to reduce the pH of the pelt prior to tanning, pickled pelts, i.e., sheepskins can be traded. In the tanning process the collagen fibre is stabilized by the tanning agents so that the hide (the raw material) is no longer susceptible to putrefaction. The two main categories of tanning agents are minerals (trivalent chromium salts) and vegetable (quebracho and mimosa). The tanned hides and skins, once they have been converted to a non-putrescible material called leather, are tradable as intermediate products (wetblue). However, if leather is to be used to manufacture consumer products, it needs further processing and finishing.
3. **Post-Tanning Operations**
   Post-tanning operations generally involve washing out the acids that are still present in the leather following the tanning process. According to the desired leather type to be produced the leather is retanned (to improve the feel and handle of leathers), dyed with water-soluble dyestuffs (to produce even colours over the whole surface of each hide and skin), fat liquored (leathers must be lubricated to achieve product-specific characteristics and to re-establish the fat content lost in the previous procedures) and finally dried. After drying, the leather may be referred to as crust, which is a tradable intermediate product. Operations carried out in the beam house, the tannery, and the post-tanning areas are often referred to as wet processing, as they are performed in processing vessels filled with water to which the necessary chemicals are added to produce the desired reaction. After post-tanning the leather is dried and subsequent operations are referred to as dry processing. Typically, hides and skins are traded in the salted state, or, increasingly, as intermediate products, particularly in the wetblue condition for bovine hides and the pickled condition for ovine skins.
4. **Finishing Operations**
   The art of finishing is to give the leather as thin a finish as possible without harming the known characteristics of leather, such as its look and its ability to breathe. The aim of this process is to treat the upper (grain) surface to give it the desired final look. By grounding (applying a base coat to leather to block pores before applying the true finish coats), coating, seasoning, embossing (to create a raised design upon a leather surface by pressure from a heated engraved plate or roller) and ironing (to pass a heated iron over the grain surface of the leather to smooth it and/or to give it a glossy appearance) the leather will have, as desired by fashion, a shiny or matt, single or multi-coloured, smooth or clearly grained surface. The overall objective of finishing is to enhance the appearance of the leather and to provide the appropriate performance characteristics in terms of colour, gloss, and handling, among others.

Source: A Blueprint for the African Leather Industry—a development, investment and trade guide for the leather industry in Africa, UNIDO 2004, p. 17.

ECCO's research centre, Futura in Tønder, Denmark, experimented with new materials, processes and technologies. Over the years ECCO had seen a sharp division of tasks between Denmark and various foreign production sites. Earlier operations in Denmark had encompassed all design, prototype, ramp-up, quality control, branding, marketing and most research and development (R&D) aspects, while ECCO foreign plants performed volume production. For instance, ECCO had split up R&D activities relocating many activities to the production sites, which evidently were more in touch with ECCO's R&D efforts from a practical perspective. The R&D activities conducted at the production sites revolved around support for the production process and optimization of materials.

ECCO's full-scale production process involved both manual labor and capital-intensive machinery. Normally, the uppers were cut by hydraulic presses called clicking machines, although at times hand cutting was used in the manufacture of shoes made of fine leather (see **Exhibit 5**). The upper was then attached to the insole with adhesives, tacks, and staples. Applying advanced machinery, the uppers were then placed in an injection-molding machine where the shoe bottom, including the outsole and heel, was attached to the uppers under very high pressure. Lastly, each pair of shoes went through the finishing process using various operations such as bottom securing and edge trimming which improved the durability and appearance of the shoe. According to ECCO's estimates, each pair of shoes comprised approximately 30 minutes of manual labor.

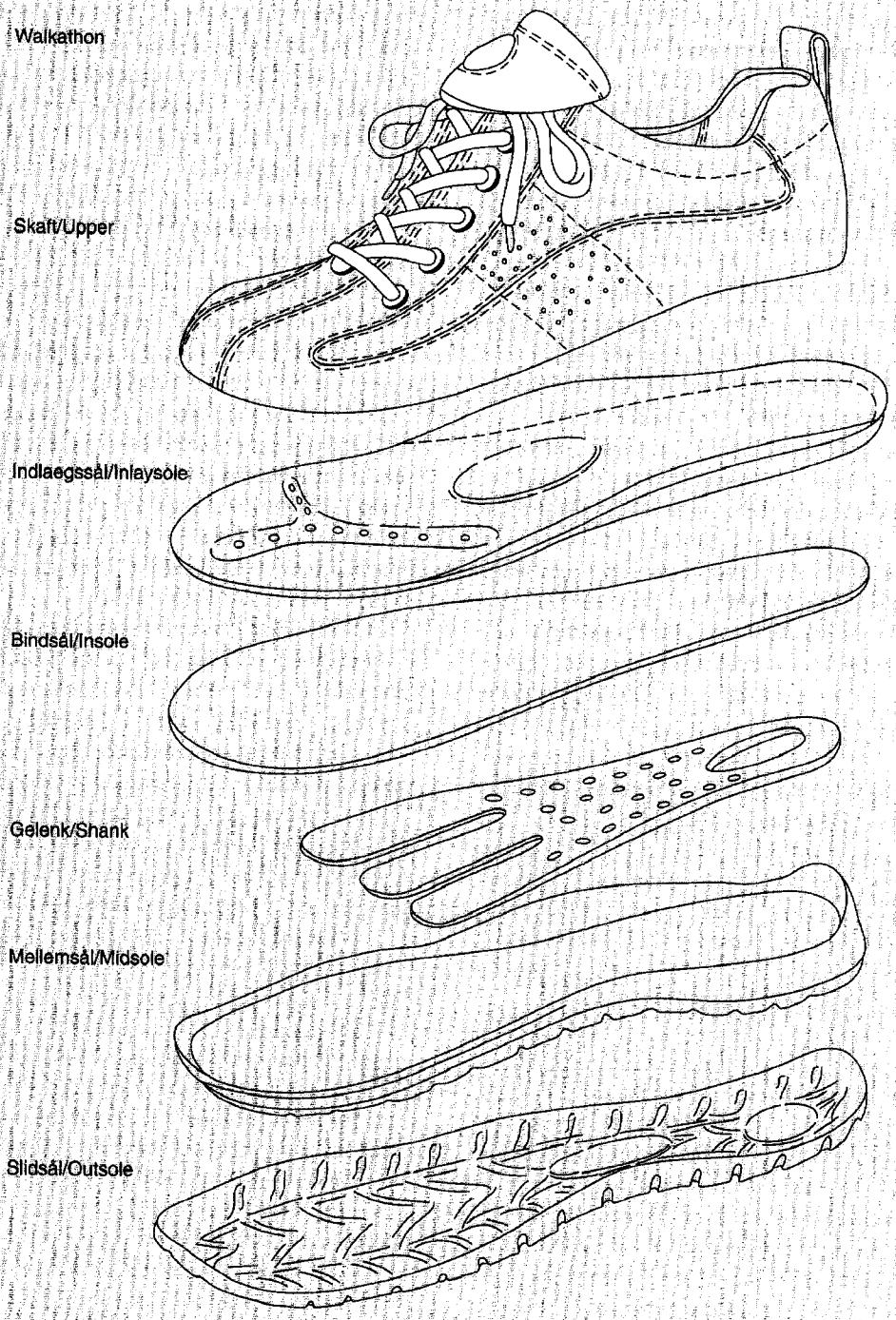
ECCO's tannery operations revolved around similar phases including prototype, laboratory and ramp-up production of leather, which took place in the Netherlands. The full-scale processing of leather took place in tanneries in Indonesia and Thailand. ECCO's maintaining ownership of the tannery operations not only reflected the company's commitment to quality but also illustrated a high level of ambition and confidence. ECCO's profound belief that "we cannot get the best quality if we do not do it ourselves," as often stated by Toosbuy, still permeated the company's business philosophy in 2005.

Although design and product development processes were generally conducted by the head office in Bredebro, Denmark, at times the division between the different phases was not clear-cut. For instance, the design and development of shoe uppers happened with the strong involvement of the subsidiary in Indonesia in order to transform the design into high-quality, comfortable shoe uppers. Prior to beginning actual production for the next season, the subsidiary in Indonesia was required to make production samples. ECCO's marketing team would screen the samples to forecast volumes and style of production. Based on the sales forecast headquarters would allocate production orders among its network of subsidiaries and licensees. The production of shoe uppers itself generally involved significant manual work. When the shoe uppers were completed they were shipped by sea to another group's facilities for subsequent processing according to the allocation set by headquarters. Finished shoes were distributed via the group's distribution centre and sales agents.

ECCO's distribution system was also vital to its business. ECCO had two main distribution centres; one in the United States and one in Tønder, Denmark. The latter was expanded in 2001 with four additional warehouses totaling 9,000 square meters, doubling the capacity from one million to two million pairs of shoes. The majority of ECCO's shoe production went through Tønder, however, over the last years only between six and nine per cent of total production was actually sold on the Danish market. The consolidation of distribution in Tønder also involved the closure of ECCO's distribution centre in Brøndby, Denmark and the warehouse in Bredebro, Denmark. The majority of shoe shipments arrived through the harbor of Aarhus, Denmark but ECCO also utilized vans for transportation and freight planes in urgent cases. Through the use of a bar code system the distribution centre was able to ship 60,000 pairs of shoes per day by lorry to 25 countries. Shoes for markets outside Europe were shipped by sea.

Recent developments within the shoe business had resulted in retailers ordering a larger proportion

Exhibit 5 Illustration of Different Components in the Construction of ECCO's Walkathon Shoe



Source: ECCO internal illustration

of shoes in advance. Retailers typically ordered 75 to 80 per cent of ECCO's production in advance of the season, while 20 to 25 per cent of orders aimed to fill up a retailer's stock. These replenishment orders had to be delivered with only a few days' notice.

Production Technology

Since its foundation, ECCO emphasized production technology as a key asset to the company. The founder was, above all, known and recognized for his profound knowledge of inventing and fine-tuning cutting edge production techniques. The core of ECCO's product strategy was shoes based on "direct injection" technology. In simple terms, the shoe uppers were attached to the sole under very high pressure utilizing very capital-intensive machinery. In contrast, both the sewing of uppers and the final finish before shoes left the factory were performed manually. Competitors had tried for a long time to apply the same techniques or to license ECCO's production techniques, however, ECCO performed many small tasks differently throughout the process which improved quality and made it hard to imitate. Of a total production of 12 million pairs of shoes in 2004, 80 per cent were based on the direct injection technology. The remaining pairs, mostly shoes with very thin soles, were outsourced as they would not benefit from ECCO's core technology. Kasprzak's vision was to make individually based shoes fine-tuned to each customer. As he stated: "Our strength is our technology and our ability to produce high-tech products. I believe that we can be the first in the world to produce individual shoes in terms of design and instant fit by applying the newest technology."[7]

As a result of the importance of ECCO's production methods and the fact that production was kept in-house, in 1980 ECCO began cooperating closely with Main Group, an Italian company specialized in injection machine molds and services for footwear. In 2002, Main Group started operations in China and ECCO expected to benefit from cheaper Main Group machines when initiating its production in China in spring 2005.

[7] *Berlingske Tidende*, September 5, 2004.

Internationalization of Production

Following a decade of tremendous growth ECCO's first steps towards globalization occurred through exports and the establishment of upper production in Brazil in 1974. Since then, the main forces driving ECCO's internationalization have been i) establishment of a market presence, and ii) reduction of labor costs and increasing flexibility. ECCO was one of the offshoring pioneers in Danish manufacturing. Over a period of 25 years, ECCO established 26 sales subsidiaries covering the entire world and four international production units. The objective of these establishments, apart from achieving labor cost savings, was to spread risk. Initially, the various production sites were capable of producing the same types of shoes, indicating an insignificant degree of specialization in the production units. However, in recent years ECCO had strived to narrow each unit and capitalize on its core competencies (see **Exhibits 6** and **7**). The early internationalization process affected the composition of employees—by 2004 only 553 worked in Denmark while 9,104 worked outside of Denmark (see **Exhibit 8**). Of these, 8,094 worked in production, while 1,010 worked in sales.

Portugal ECCO's first relocation of production occurred in 1984 with part of production being moved to Portugal. Although Portugal traditionally held a leading position in both the production of uppers and shoe assembly, ECCO then relocated some of these processes to production sites in Thailand and Indonesia in 1993 and 1991, respectively. Few uppers were produced in Portugal and the number of shoes leaving the factory decreased substantially from 2000 to 2004 (see **Exhibit 7**). In addition, in response to increasing labor costs, ECCO strove to make the Portuguese unit more high-tech, thereby decreasing the number of employees. While the Portuguese unit was more capital intensive, the focus on technology had transformed the plant into ECCO's leading developer within laser-technology.

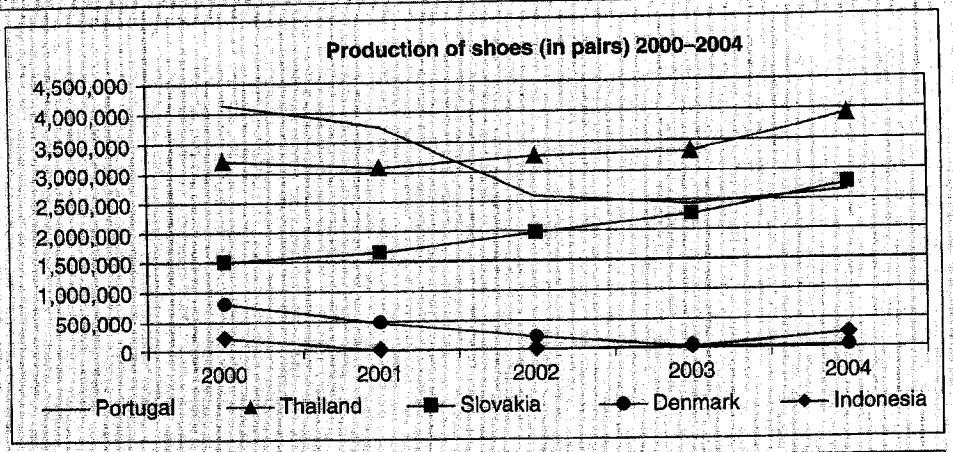
Exhibit 6 ECCO's Production Output Worldwide 2000–2004

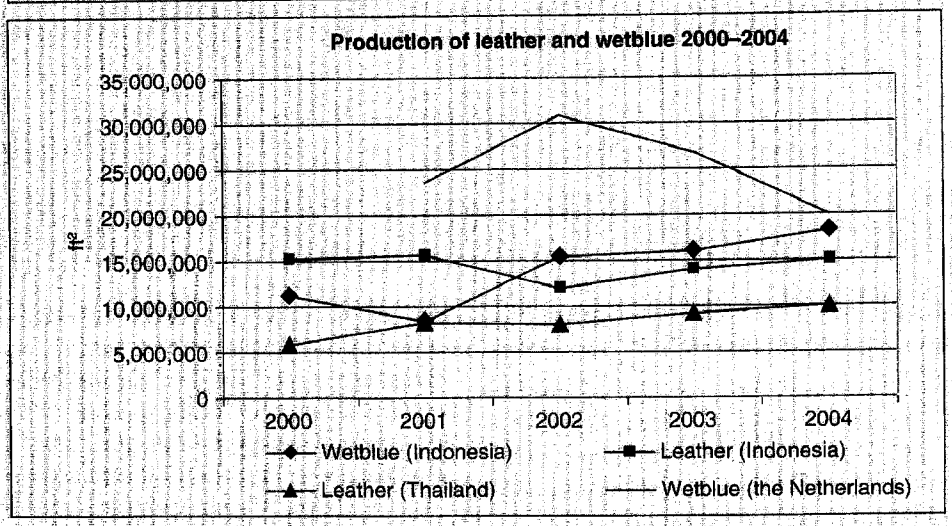
	2004	2003	2002	2001	2000
Bredebro, Denmark (1963)					
Activity: Shoe factory. Development and preparation of new articles and prototype testing.					
No. of employees: 124					
- Uppers produced (pairs)	3,805	3,720	4,482	5,281	—
- Shoes produced (pairs)	20,577	38,000	211,413	478,674	800,605
Santa Maria da Feria, Portugal (1984)					
Activity: Shoe factory. Production of uppers and shoes. No. of employees: 720					
- Uppers produced (pairs)	20,737	79,690	241,961	438,299	535,200
- Shoes produced (pairs)	2,649,178	2,442,395	2,590,327	3,769,754	4,150,000
Surabaya, Indonesia (1991)					
Activity: Tannery and shoe factory. Production of wetblue, crust, leather, uppers and shoes.					
No. of employees: 3554					
- Wetblue produced (ft^2)	18,249,560	15,970,001	15,338,582	8,432,162	11,134,743
- Leather produced (ft^2)	15,098,971	14,062,152	12,048,197	15,566,070	15,104,307
- Uppers produced (pairs)	5,326,300	4,664,023	4,063,840	3,968,559	3,750,000
- Shoes produced (pairs)	246,018	29,119	—	—	220,000
Ayudhthaya, Thailand (1993)					
Activity: Tannery and shoe factory. Production of crust, leather, uppers and shoes.					
No. of employees: 2775					
- Leather produced (ft^2)	10,095,425	9,138,590	8,046,037	8,291,589	5,800,000
- Uppers produced (pairs)	3,237,054	2,868,227	2,708,639	2,891,591	3,150,000
- Shoes produced (pairs)	3,910,382	3,319,623	3,264,747	3,102,710	3,200,000
Martin, Slovakia (1998)					
Activity: Shoe factory. Production of uppers and shoes. No. of employees: 824					
- Uppers produced (pairs)	163,297	259,136	792,473	287,694	130,000
- Shoes produced (pairs)	2,771,025	2,265,312	1,974,408	1,657,498	1,500,000
Dongen, The Netherlands (2001)					
Activity: Tannery. Production of wetblue. Leather and development centre. Acquired by ECCO in 2001.					
No. of employees: 79					
- Wetblue produced (ft^2)	19,931,818	26,704,106	30,886,062	23,686,640	

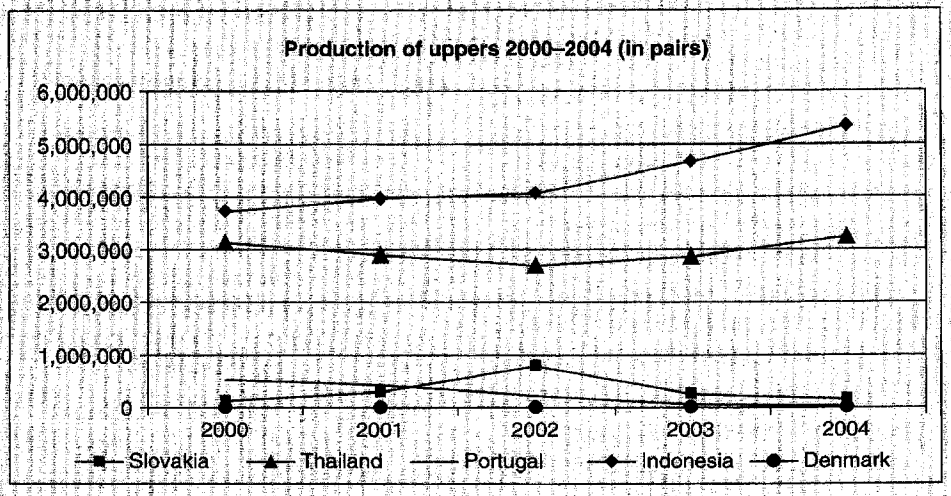
Source: ECCOs environmental report 2004

Indonesia The Indonesian production unit, opened in 1991, specialized in producing shoe uppers for the ECCO group, while the finishing processes, such as attaching shoe uppers to soles, were undertaken in other facilities of the group. The production unit in Indonesia satisfied approximately 40 to 50 per cent of the group's shoe upper demand. In shoe production, the main materials required were rawhides (procured locally as well as imported) that were processed into semi-finished and finished leather. Other materials required for production included reinforcement, yarn and accessories. Apart from the leather, the majority of the materials (70 to 80 per cent) were obtained from European suppliers, in particular granulate and Gore-Tex. Procurement of raw material took eight weeks

Exhibit 7 ECCO's Production Output Worldwide 2000–2004

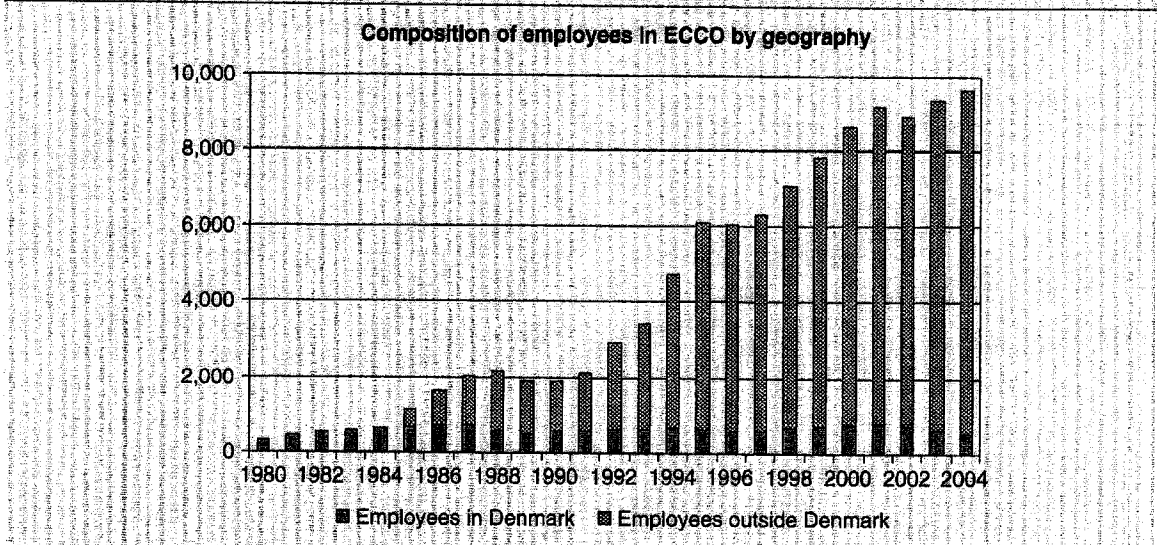






Source: ECCO annual report, various issues.

Exhibit 8 Employee Statistics–Geographical Composition 1980–2004



Source: various annual reports and internal documents

from the placement of the order until materials were ready to be shipped, and another five weeks for sea shipment.

Thailand ECCO's production facility in Thailand, opened in 1993, encompassed both tannery and assembling facilities. In 2004, the site produced roughly 37 per cent of the uppers, primarily for shoe assembly in Thailand where 40 per cent of total unit volume was produced. ECCO's production site in Thailand was rather successful in terms of output, employee satisfaction and size. Over the years, the number of employees increased substantially and annual employee turnover was less than seven per cent. Moreover, the Thais had a good eye for small details and were able to deliver first class workmanship. These characteristics led ECCO to concentrate the production of its most complicated shoes in Thailand, including golf shoes and its advanced trekking boots.

Slovakia Opened in 1998, ECCO's production unit in Slovakia primarily assembled shoes and, to a lesser extent, uppers. The plant employed 824 people in 2004 and produced shoes primarily within the men's segment. The underlying rationale for setting up production in Slovakia, apart from lower labor costs, was the country's proximity to promising markets like Russia and Poland. Prior to entering Slovakia, Toosbuy stated: "We need bigger production capacity and quicker deliveries. Our goal is to increase production capacity by 15 per cent per year. One of our challenges associated with production in Asia is the three to four week transportation time."[8] Years later, ECCO's executive production director, Flemming Brønd, added:

> Shoe manufacturing is labor intensive, thus the wage level is of paramount importance. We already had a factory in Portugal yet we were searching for an optimal location for a new plant in Europe as labor costs were raising in Portugal. We have the majority of our uppers flown in from Indonesia and India after which the shoes are assembled. Although we automated the assembly process by using robots, we still needed skilled labor to handle the machines.[9]

Having established production facilities in Slovakia, ECCO set up a production network in close proximity to the company's major markets.

[8] *Berlingske Tidende*, February 2, 1998.
[9] *Jyllands-Posten*, December 12, 2003.

This facility also provided some leeway in terms of driving up volume between plants, thereby alleviating the risks of an interruption in production due, for instance, to political unrest in Thailand. Despite ECCO's global production facilities the plant in Bredebro, Denmark still constituted ECCO's primary model in terms of the development of cutting edge production technology.

China ECCO's establishment of production facilities in China was by no means a spontaneous act. Toosbuy had, on various occasions, visited China to assess locations and the timing of entry. China's recent membership of the World Trade Organization (WTO) allowed for 100 per cent foreign ownership of production sites. This, combined with the fact that approximately 50 per cent of the world's shoe production took place in China, made the country too important to ignore. ECCO chose a site in Xiamen just north of the province of Guangdong, which Kasprzak described as "a smaller yet dynamic community where we have been very well received and provided good and competent service from the local authorities." The plan was to build five factories over the next five years, as well as a very advanced tannery including a beam house to convert rawhides. Total investment including tanneries would amount to approximately DKK 500 million. When realized, the Chinese production site would become ECCO's largest worldwide, delivering some five million pairs of shoes annually. Although mostly targeted for export, one of the factories would serve the Chinese market exclusively. ECCO expected to employ around 3,000 people in China.

Although low labor costs and taxes were considered, access to local manpower was the decisive factor when establishing operations in China. "Taxes are more or less the same in different zones so it did not influence our location decision as such. On the other hand it was important to us that Xiamen could provide local employees who we can train and keep for a longer period of time which is definitely not the case in other places in China."[10]

[10]Assistant General Manager, Morten Bay Jensen.

ECCO had high hopes for sales to the Chinese consumers as well. Over the next three years, the company hoped to double sales to 500,000 pairs. To realize this ambition, a formal sales subsidiary had been formed together with Aibu, ECCO's long-standing partner in China. Over the last eight years their partnership had evolved from one shop to selling approximately 250,000 pairs of shoes targeted at the segment for exclusive shoes. The plan was to strengthen collaborative ties even further through a combination of Aibu's unique market knowledge and position in the Chinese market together with ECCO's strong brand and accumulated experiences with positioning shoes on a global scale. In fact, the experience from other Danish design icons operating in China suggested a network approach to gain the loyalty of the Chinese consumers. However, the approach was not without risks as it involved being complaisant while at the same time keeping critical knowledge close to the chest until formal contracts had been signed. During 2003/2004, ECCO had been plagued by Chinese manufacturers copying the ECCO design. According to Søren Steffensen, executive vice-president of sales, every single case was pursued and handled by a special unit of attorneys at ECCO whose primary task was to protect the company's brand and design.

The Competitive Landscape

Generally, the market for lifestyle casual footwear was highly competitive and subject to changes in consumer preferences. Fierce competition had sparked investments in both cost optimization and new technologies. First, the quest for competitive pricing had driven the search for new ways of producing and assembling in order to lower costs and reduce time to market. Operations were streamlined and formerly manual processes were automated. Second, incumbents invested in new technology, improved customer service, and market knowledge.

Traditionally, the footwear industry had been fragmented yet in recent years the distinction between athletic and lifestyle casual footwear blurred. Financially strong athletic shoe companies, like Nike and Reebok, competed directly with some of

ECCO's products. On the other hand, ECCO's expansion into such new segments as golf shoes gave rise to new competitors. In addition, the industry felt increasing pressure from retailers that had established products under private labels. As a consequence of the fuzzy boundaries between different footwear product categories and geographical regions, pinpointing ECCO's competitors was a challenge. However, ECCO itself regarded Geox, Clarks and Timberland as its main competitive threats worldwide (see **Exhibit 9**).

Geox By all measures the Italian shoemaker Geox constituted a competitive threat to ECCO's operations in the casual lifestyle footwear segment. Founded in 1994 by the Italian entrepreneur Mario Moretti Polegato, Geox achieved impressive growth rates, increasing sales from €147.6 million in 2001 to €340.1 million in 2004, corresponding to a compound annual growth rate (CAGR) of 32 per cent. The success of Geox was based on perforated rubber soles in which a special waterproof and breathable membrane was inserted, allowing the vapor from perspiration to leave but still preventing water from entering the shoe—a technology protected by over 30 patents. Geox's headquarters and R&D facilities were located in the centre of a large shoe-making area northwest of Venice—Montebelluna. Geox had its own production facilities in Slovakia and Romania and outsourced to manufacturers in China, Vietnam and Indonesia. The entire production process and logistics were closely monitored in-house from headquarters in Italy.

In terms of distribution, Geox operated with a business model similar to ECCO's. The company's shoes were sold in more than 60 countries through a worldwide distribution network of more than 230 single-brand Geox Shop stores and about 8,000 multi-brand points of sale.

Exhibit 9 Global Sales of Lifestyle Casual Footwear Brand Sales (In US$ Million) 2002-2003

Rank	Company	2002	2003	% Change
1	Clarks	1,399	1,534	9.6%
		29.2%	29.6%	
2	ECCO	502	590	17.5%
		10.5%	11.4%	
3	Rockport	385	361	6.2%
		8.0%	7.0%	
4	Geox	208	329	58.2%
		4.3%	6.3%	
5	Birkenstock	270	300	11.1%
		5.6%	5.8%	
6	Bass	275	285	3.6%
		5.7%	5.5%	
7	Caterpillar	209	210	0.5%
		4.4%	4.0%	
8	Doc Martens	295	195	-34.0%
		6.2%	3.8%	
	Others	1,252	1,383	
		26.1%	26.7%	
	Total	**$4,795**	**$5,187**	**8.2%**

Note: Timberland is not included in the table. The company offers footwear across different categories including rugged footwear and athletic footwear as well as casual lifestyle footwear.

Geox had global ambitions. The company still had a strong penetration in the Italian market, which generated approximately 55 per cent of sales. International sales were gaining momentum, however, comprising 45 per cent in 2004, with Germany, France, Iberia (Spain and Portugal) and the United States being the largest markets. Geox increased sales by 250 per cent from 2002 (US$4 million) to 2003 (US$14 million) in the very competitive American market. As a comparison, ECCO grew only 4.5 per cent in this market with sales of US$115 million in 2003 (see **Exhibit 10**). Although extremely successful, Geox planned to enter clothing in order to circumvent sudden shifts in consumer tastes.

Clarks Clarks, the English shoemaker, was the biggest player within the casual lifestyle footwear segment achieving global sales of US$1,534 million in 2003 (see **Exhibit 9**). Since its humble beginnings in 1825, Clarks had grown into a global shoemaker producing 35 million pairs and offering

Exhibit 10 U.S. Sales of Lifestyle Casual Footwear Brand Sales (In US$ Million) 2002–2003

Rank	Company	2002	2003	% Change
1	Clarks	339	375	*10.6%*
		18.8%	*21.5%*	
2	Rockport	291	266	*–8.6%*
		16.2%	*15.2%*	
3	Bass	258	265	*2.7%*
		14.3%	*15.2%*	
4	Doc Martens	195	127	*–34.9%*
		10.8%	*7.3%*	
5	ECCO	110	115	*4.5%*
		6.1%	*6.6%*	
6	Birkenstock	110	80	*–27.3%*
		6.1%	*4.6%*	
7	Dansko	62	71	*14.5%*
		3.4%	*4.1%*	
8	Mephisto	55	55	*0.0%*
		3.1%	*3.1%*	
9	Sperry	49	53	*8.2%*
		2.7%	*3.0%*	
10	Josef Seibel	33	35	*6.1%*
		1.8%	*2.0%*	
11	Caterpillar	33	30	*–9.1%*
		1.8%	*1.7%*	
12	Sebago	20	16	*–20.0%*
		1.1%	*0.9%*	
13	Geox	4	14	*250.0%*
		0.2%	*0.8%*	
14	Stonefly	10	11	*10.0%*
		0.6%	*0.6%*	
15	FinnComfort	10	11	*10.0%*
		0.6%	*0.6%*	
	Others	220	224	
		12.2%	*12.8%*	
	Total	**$1,799**	**$1,748**	**–2.8%**

Source: JP Morgan—Apparel and Footwear Yearbook 2003

a wide product portfolio under the slogan "from career wear to weekend wear." Clark's product portfolio included casual, dress casual, boots and sandals. Central to various categories were Clark's widely used technical features like "active air" (an air-cushioning technology) and "waterproof" (impermeable membrane sewn inside the boot), which sought to improve comfort, performance and versatility.

Clarks, like other shoe manufacturers, had vigorously sought lower labor costs in response to fierce competition. The company once had 15 plants across the United Kingdom but by 2005 only one small factory with 37 employees remained in Millom, Cumbria. The most recent closure occurred in early 2005 when the company shifted production to independent factories in Vietnam, Romania and China. According to company spokesman John Keery, this move was vital to ensuring that the business remained financially viable. As he stated: "The cost of manufacturing in the UK has increased over the last 20 years and we have been able to source our shoes cheaper in the Far East."[11] Based on cost considerations, availability of materials and capacity issues within individual countries, Clarks sourced shoes from 12 different manufacturers located primarily in Asia. Clarks kept less than one per cent of its production in-house. By using many independent manufacturers, Clarks was exposed to a variety of technologies, materials and shoemaking techniques and thus could access various types of expertise. However, monitoring material standard and product quality was an enormous task.

Timberland Founded in Boston in 1918 by Nathan Swartz, Timberland designed, marketed and distributed under the Timberland® and Timberland PRO® brands. Their products included footwear and apparel and accessories products for men, women and children. Having introduced the waterproof boot based on injection-molding technology in 1973, Timberland's primary strength resided within the outdoor boot category, which competed with ECCO's outdoor and sport product categories. In 1978 and 1979, Timberland added casual and boat shoes to its line to become more than just a boot company. In the eighties, the company strived to be recognized as a lifestyle brand and entered Italy as the first international market. During the 1990s, Timberland introduced kids' footwear and launched the Timberland PRO® series designed for maximum surface contact and targeted at skilled tradesmen and working professionals.

Timberland's 2003 total revenue of US$1.328 million was comprised of footwear (76.7 per cent) and apparel and accessories (23.3 per cent), making Timberland twice the size of ECCO in terms of product sales. Despite the company's late appearance in international markets, international sales comprised 38.5 per cent of total generated revenue—up from 29.5 per cent in 2001. Timberland's products in the United States and internationally were sold through independent retailers, department stores, athletic stores, Timberland specialty stores and factory outlets dedicated exclusively to Timberland products. In Europe, products were sold mostly through franchised retail stores.

In terms of manufacturing, Timberland operated production facilities in Puerto Rico and the Dominican Republic. Contrary to ECCO, which on average produced 80 per cent of its shoes in-house, Timberland manufactured only 10 per cent of total unit volume with the remainder of the footwear production being performed by independent manufactures in China, Vietnam and Thailand. Timberland believed that attaining some internal manufacturing capabilities, such as refined production techniques, planning efficiencies and lead time reduction, might prove beneficial when collaborating with manufactures in Asia. To facilitate this collaboration, Timberland set up a quality management group to develop, review and update the company's quality and production standards in

[11] www.bbc.co.uk/somerset/content/articles/2005/01/10/clarks_feature.shtml, accessed March 2005.

Bangkok, Zhu Hai, Hong Kong and Ho Chi Minh City (Saigon).

In terms of leather supplies, Timberland purchased from an independent web of 60 suppliers who were subject to rigid quality controls. This required substantial resources in order to scrutinize and monitor the supplier network. Analysts argued that Timberland was vulnerable to price increases on raw materials. Gross margins were negatively affected by increases in the cost of leather as selling prices did not increase proportionally. Shoe manufacturers like Timberland found it difficult to pass on the extra cost to the consumer. In order to diminish the effect of increasing prices for leather and other materials, Timberland was forced to closely monitor the market prices and interact closely with suppliers to achieve maximum price stability. By 2003, 10 suppliers provided approximately 80 per cent of Timberland's leather purchases.

As the plane approached Copenhagen Airport, Mikael Thinghuus recalled a management board meeting prior to his visit to China. Several viewpoints concerning ECCO's future strategy had been presented and, while no one discredited ECCO's unique production assets, there was a sentiment that advantages accruing from world-class production technologies could not be sustained forever. "We are not going to exist in 20 years time if we cannot excite and cast a spell over our customers," one member of the committee commented. Another added: "We do not operate marketing budgets of the same magnitude as the big fashion brands. But our shoes are produced with an unconditional commitment to quality and our history is truly unique. We need to be better at telling that story." Thinghuus was pondering:

> "We need to be more concrete about the process towards market orientation. How can we relate better to our customers while at the same time being able to exploit efficiencies from a global value chain? Integrated or not. And what about entering new markets? The recent market expansion in China was just the beginning. Long term outlook seemed favorable. Yet, was it feasible to invest in new markets, increase marketing efforts, and optimize a global value chain—all at the same time?"

Irrespective of the outcome of these thoughts, it was pivotal to consider how strategic initiatives would go hand in hand with ECCO's philosophy of integrating the value chain from cow to shoe.