

THE EVOLUTION OF THE TEXTILE AND CLOTHING INDUSTRY – ROMANIA: FROM LOHN TO LOSS

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Abstract

Textile industry and clothing represent an important source of income and employment opportunities for many developing countries. Recent global economic events determined rapid changes which led to restructuring and reorganization of the industry. In recent years, in Europe and implicitly in Romania has increased the competition from a number of third countries, particularly in Asia, which benefit from low labour costs. An important feature of European textile and clothing industry is the widespread use of lohn production, which means that labour-intensive operations with lower added value are transferred in countries where labour cost is much lower. This article aims to analyze the evolution of textile and garments sector in Romania, which ranked among the top three manufacturers in the field at European level, highlighting the political and economic changes that have occurred and influenced the economic indicators of the industry. The analysis carried out is based on data collected from Romanian statistical yearbooks and the findings suggest that lohn production is not a long-term advantage for subcontracting companies.

Keywords: *textile and garment industry, lohn production, subcontracting activities, outsourcing*

JEL classification: *L67, M21, P42*

1. General Aspects Regarding the Textile and Garment Industry

Textile and clothing industry is one of the oldest and largest export industries and each year it generates sales of billions of dollars globally. It is a diverse and heterogeneous industry characterized by a large number of

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activities, including processing fiber yarns and fabrics, synthetic yarn production, wool, home textiles, textile, clothing, clothing with embedded technology etc. The light industry is divided into textile and garment production, having as main features: development of fashion trends, brands, distribution network development through shops and optimizing logistics from production to stores. Due to technical and technological developments of the last decades, the clothing and textile industry have implemented new methods and procedures leading to increased productivity and the emergence of new textiles on the market. The trend in terms of growth rate, design, fashion, and the use of a specific size range is determined by large centres of consumption, respectively the most developed countries from economic point of view.

2. Characteristics of the Textile and Clothing Industry

In the apparel sector, the production can be dispersed in multiple locations inside or outside the country. In developed countries, this is associated with outsourcing production to developing countries, and in the case of the latter, the production moves to other places and between countries in search of cheaper or faster labour force. Transnational corporations can move their capital across borders in order to reduce production costs, but small businesses and individual workers do not have this mobility, being forced to work in a market with increasing uncertainty, characterized by exacerbated competition (Gîrneală, Mascu, 2014).

The major retailers have a strong impact on value chains because these companies retain control of all strategic functions, while subcontracting production. It is well known that luxury brands are produced in low-wage countries under the strict control of companies that subcontract. Production in subcontracting firms is controlled by engineers and production specialists to ensure quality standards. In the headquarters marketing strategies are designed and the products are sold through the company's sales chains. A number of textile and clothing manufacturers that have developed their own brand, conduct trading activities rather than production.

Depending on the activities, degree of outsourcing of production or the attention given to research and development processes, companies in the textile and clothing can be of several types. The main ones are:

- **Subcontractors for production processes (CTM - Cut trim make)** - It includes mainly micro or small enterprises working in the lohn system

for large companies. The latter provide the raw material required to manufacture the orders requested, establish the quantities to be delivered and impose prices. The subcontractor's managers have limited decision-making power, making it difficult for companies to raise capital due to the low profit margins obtained. The price is determined by labour costs and productivity. Strong competition between subcontractors from the same regions, as well as from those from abroad, has exerted strong pressure on prices, which are often close to marginal costs.

- **Evolved subcontractors (co-contractors)** - These subcontractors, although limited to the manufacturing process, provide high quality services and the products offered involve complex processes. Besides labour force, these co-contractors provide their customers personalized service, having the capability to become industrial partners. They have competences in different activities assimilated to production processes, such as production scheduling, quality control, employee motivation, technical innovation, cost control and efficiency practices. The competitive advantage of these companies is proactive cooperation with customers and the geographic proximity in relation to those to the detriment of companies from China or Asia that work in lohn system.

- **Hybrid enterprises that includes both subcontracting activities and own production** - These are usually evolved subcontractors that execute in parallel their own production for the domestic market as well as for a retailer that subcontracts. The two parallel businesses are not comparable in terms of management and entrepreneurial skills since the successful management of their production requires certain competences and additional skills. This type of enterprise includes, in addition to efficiency, labour management and cost control also the success factors of their own production respectively product design, product portfolio management, marketing or commercial activities. The support of a foreign partner is important for this type of companies, and creating networks locally and internationally is a key success factor.

- **Producing companies (own brands)** - Small and medium producing enterprises which are specialized in a specific segment that have continuity and achieve high economic performance can be considered top-sellers on their market. This type of enterprises focus on creativity and innovation in order to improve product design and technical performance.

The latest economic crisis has caused a steady decline in production, loss of markets which triggered the dismissal of a large number of employees, closing underperforming enterprises or moving production to countries with cheap labour force (Iamandi, Munteanu, 2014). To cope with increased competition and the changes in the market, developed countries have adapted and intensified research of automated technological processes, leading to progress in the field of automation and robotics. (Colovic, 2012)

Entrepreneurship is highly important for sustaining growth and development worldwide (Munteanu, Iamandi, Tudor, 2015). Due to the increasing competition on the global market, large retailers have resorted to relocation of production to developing countries, whose principal advantage is the low cost of labour. This type of international contract where a subcontractor executes the manual labour of a product at the request of the beneficiary, on the basis of technical documents and materials necessary, for fixed remuneration is called outsourcing or Lohn production.

The contractors have chosen to outsource their production to Romania due to lower labour costs. Also, its geographical position in Europe has facilitated the orders to be transported at lower expenses compared to cases in which it would be imported from Asian countries, but also it reduces the response time to any requirements from external partners. They provide the transfer of know-how in the country and the implementation of modern production technologies.

3. Analysis of the Textile and Clothing Industry in Romania

In the national economy of Romania, textile and clothing industry is an important segment due to considerable weight in GDP, exports figures and the large number of employees in these companies (Girneata, Potcovaru, 2015). However, the socio-economic and political changes that have occurred in Romania in the past two decades, have affected the sector, which was forced to constantly adapt to the changes taking place and the permanently changing market (Girneata et al, 2015).

This sector of light industry has a long tradition in Romania. There are companies with over 100 years of existence such as: Carpatex SA; Fabrics SA; Textile Olt SA, Ciserom SA. It can be said that the textile and clothing industry has contributed to regional development having a significant share in

the economy of Timis, Sibiu, Iasi, Mures counties and Bucharest. The most active textile and clothing producing area in the country is located between Iasi and Bacau, which produces natural and synthetic fibers and the employee salary remains at a low level. Next is the area of Banat, Timisoara and Arad, dominated by companies with foreign capital, especially Italian. The third area, the surroundings of the Sibiu city, is characterized by companies with investors or German clients due to cultural affinities, and the fourth area is Bucharest, which has as main advantage the infrastructure, available workforce and the opening to a large market.

During communism, there was great concern for the country's industrialization, therefore high capacity factories were built in textiles and clothing. The period 1965-1980 was a peak of progress on production in the area. The factories were provided with machinery, equipment and technologies in much of the country. However, putting production in the forefront through considerable financial and human effort was not carried out in parallel with increased interest in marketing, so that a gap developed between the production of textiles and clothing and foreign trade. Before 1989, textiles and garments were exported mainly to socialist countries.

Following the revolution and communist political regime change in 1989, Romanian products had strong competition from Asian countries, at a much lower price (Botescu, Nicodemus, 2008). Also, during communism, most textile and clothing factories were owned by the state and after the socio-economic changes in 1989 they were gradually privatized, much of which were closed, but in the same time numerous export and brokerage companies with foreign capital appeared. In this way, the communication with foreign markets was facilitated, diversifying the commercial relationships and applying marketing strategies especially for apparel products. Since 1990, Romanian firms have entered into competition with the global manufacturers, some of them with unfair practices and benefiting from the vast resources of raw materials for the textile industry and whose development was supported by state policies, such as Turkey, China, India, Mexico, etc.

Between 1990 and 2000 there were an increasing number of private companies and their main advantage was that they could adapt to market and consumer requirements easier. In this period of transition to a market economy, there is an upward dynamic in the apparel industry, particularly after 1995 (Popescu, 2005). In the same period, the textile sector has experienced a sharp decline and could not provide the resources needed to

produce items of clothing. Thus, one way to ensure a competitive apparel industry was to outsource the production for export. The share of clothing in the total group increased from 28% in December 1989 to 62.5% in January 2008, while the share of textiles has decreased considerably, from 52% in December 1989 to 15.2% in January 2008 (Textile Industry, 2008). The main lohn contractors were in the first phase German, Belgian, French companies, and then the Italian, English and Greek ones.

The main immediate advantages of Romanian companies regarding production in the lohn system were those that it decreased their supply costs and potential risks: the materials were delivered to them directly by contractors; orders were exported to foreign markets without having to prospect markets; they benefited from know-how transfer from foreign partners; they could use the knowledge acquired in increasing labour productivity or the quality of workforce or they upgraded their machinery, thus improving the technological processes. In the early 2000s, there was a significant increase in the number of companies producing in lohn system, from 789 in 1993 to 8,600 in 2008 (Capital, 2008).

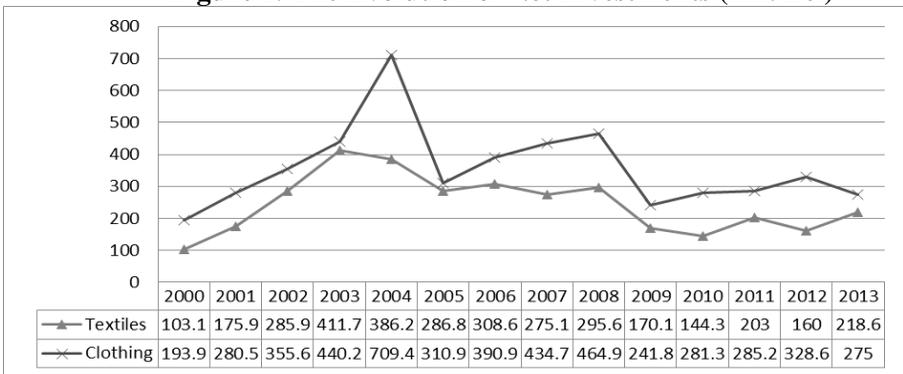
However, production in the lohn system does not allow subcontractors to have their own identity and their main criterion for selection is represented by low labour cost, an unsustainable long-term advantage. The income obtained only from processing are much lower than that generated by selling the product under their brand. Companies lost their identity, because their names are not visible on product labels.

The years 2003 and 2004 were the peak period in terms of exports of clothing: Romania was the leading garment exporter from the European Union, accounting for almost half the country's foreign trade (Nita, 2008). The following period, that of accession to the European Union constituted the decline of the clothing and textile industry, determined by liberalization of European market to Asian exports and the depreciation of the euro against the national currency. Lohn production was transferred to other countries that offered cheaper labour force. This has resulted in loss of many jobs and reduction of the economic performance of this industry. However, exports of textiles and clothing had a significant share in export of national economy, even in years of economic crisis and clothing sector has the largest number of employees in the manufacturing industry. Currently, the main importers of Romanian apparel are Italy, Germany and France.

Based on data collected from statistical yearbooks of Romania the competitiveness of the textile and clothing was analyzed for a vast period of time. For some of the indicators, data were available between 1990 - 2013, for example, the number of employees, and other indicators were analyzed in the period 2000 - 2013, as is the case for net investments, annual production etc.

According to **Figure 1** that highlights the textiles and clothing attractiveness among investors, there is a clear difference of the investment evolution between the two sectors. Thus, if the start of the period, i.e. 2000, in the apparel industry there were investments of about 90 million lei higher than those in textiles, in 2003 the amounts invested for the two sectors were approximately the same. Amid the sharp rise of production in the lohn system, in 2004 over 709 million lei were invested in the garment firms, while the funds allocated to textile firms were lower by approximately 25 million than in 2003. Investments were made mainly in machinery and production equipment so that firms can accept external controls. This explains the decrease to less than half of this indicator in the next year as firms have already been retechnologized. Continuous fluctuations followed, without a predetermined pattern that can reveal a dependency or similarity between the two sectors. In 2013, it can be noted an improvement of this indicator compared to data from 2000. Investments in textiles doubled, reaching 218.6 million lei in 2013, while in the garments industry investments were only of 275 million lei.

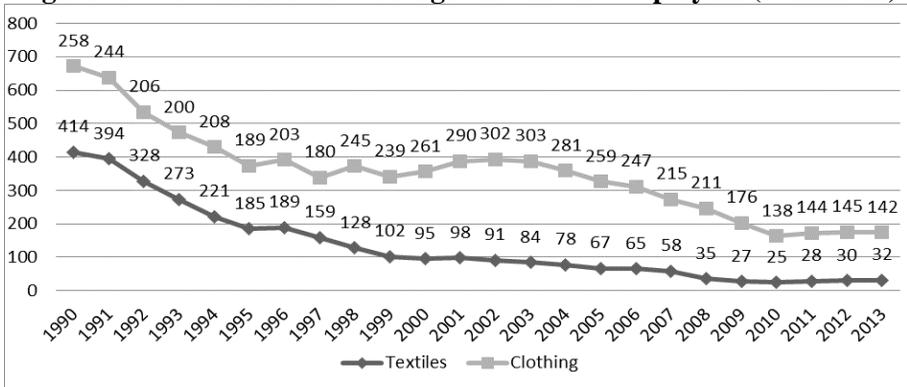
Figure 1. The Evolution of Net Investments (mil. Lei)



Source: Developed by the author on the basis of Romanian Statistical Yearbooks, www.insse.ro

The number of employees had a spectacular development during 1990 - 2013. As it can be seen in **Figure 2**, the textile industry has been in a continuous decline until 2011, when it started a slight revival of the indicator. Instead, the clothing industry has recorded sustained growth in the period 1999-2003 and a sharp decline in 2011. The biggest drop is in the textile sector, where in 1990 there were 414,000 employees and in 2013 were registered only 32,000 workers. The clothing industry counts 142,000 employees, 161,000 fewer compared to 2003, the year the industry had the largest number of employees.

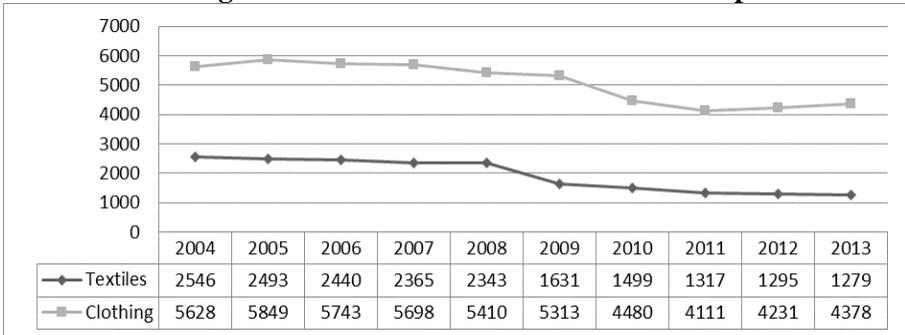
Figure 2. The Evolution of Average Number of Employees (thousands)



Source: Developed by the author on the basis of Romanian Statistical Yearbooks, www.insse.ro

Due to the decline of this sector’s competitiveness and attractiveness to investors, the number of enterprises in the area fluctuated during 2004 - 2013. As shown in the chart in **Figure 3**, the highest decrease was registered in the textiles sector, where in 2004 there were 2546 companies registered, while in 2013 their number has been halved, reaching 1279. It can be also stated the situation in the garment industry was more fluctuating. 2005 was the year when most companies activated in this sector, namely 5849. In the following years their number has decreased gradually until 2010, when the sector has felt the economic crisis and over 800 companies were closed. In 2013, there were 4878 companies registered in the garment sector.

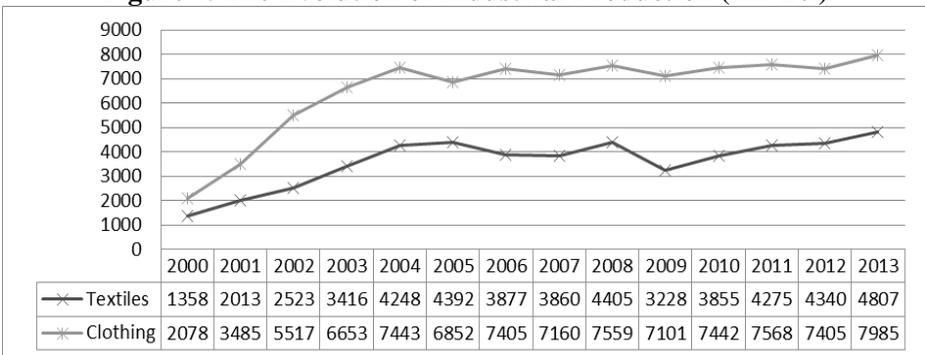
Figure 3. The Evolution of Number of Companies



Source: Developed by the author on the basis of Romanian Statistical Yearbooks, www.insse.ro

As presented in Figure 4, there is a discontinuous trend of national production of textiles and clothing over the 14 years examined. This uneven evolution of the indicator that notifies growth in a year and then decrease it in the next year can be explained by the fact that companies in the garment still prioritize cheap labour. They may get contracts on short periods of time, when the production grows, but the collaborations end the following year and revenues from production decrease significantly. Garment production registered 7985.16 million lei in 2013, while the textile industry registered 4806.56 million, very high figures than those in 2000.

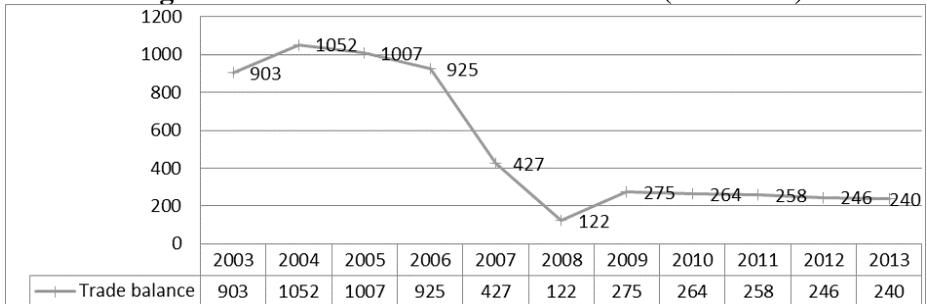
Figure 4. The Evolution of Industrial Production (mil Lei)



Source: Developed by the author on the basis of Romanian Statistical Yearbooks, www.insse.ro

A significant part of the clothing production went to export, which has maintained a positive trade balance throughout the period. It can be noted that trade balance represents the difference between exports and imports and positive figures are an indication of a sustainable industry. As can be seen from the graph shown in **Figure 5**, although imports of clothing increased after 2008, they remain at about a third of the export value of the sector. At the height of the garment industry, namely 2003 and 2004, exports of these products had values above 3.200 million, and the balance of trade has exceeded one billion Euros. Compared to 2003, in 2013 the trade balance fell by over 75%. Moreover, it can be seen that after consecutive declines in 2007 and 2008, this indicator failed to regain even half of the figures in 2003.

Figure 5. The Evolution of Trade Balance (mil Euros)



Source: Developed by the author on the basis of Romanian Statistical Yearbooks, www.insse.ro

Companies must realize that in this sector the competitive advantage consists in innovation, not low cost of labour. Also, the ability to supply products on a variety of markets facilitates attracting a greater number of consumers and thus eliminates dependence on a limited number of contractors.

4. Conclusion

Romanian textile and clothing industry has a long tradition of production and supply to foreign markets, due to its proximity major Western importers. An advantage for potential investors is that there are prerequisites for genuine competition for companies in the market. In the recent years, the declining of Romanian consumers' purchasing power determined a lower domestic demand for the clothing and textile. The decline in the supplying raw materials sectors has led to a reduction in the production of garments.

After the 90s an extensive process of privatization of state companies occurred, most of which were reorganized or closed. Economic phenomena such as the liberalization of imports, reduced markets for the domestic products, the rising cost of raw materials or energy resources in production determined the adaptation to the new demands of this trade oriented sector. In the years following the collapse of the communist regime the manufacturing industry was dependent on the lohn production system and the effects were visible afterwards. The production capabilities were modernized through minimal or relatively affordable investments in the case of clothing and knitwear, where the demand exceeded the supply. It followed the trend of increasing the number of small and medium enterprises with a flexible and easily adaptable to market changes but unable to achieve a high investment effort required for research and development processes. In time, Romanian textile and clothing industry has lost its attractiveness in terms of lohn production. Retailers have directed orders to other countries that offered lower labour and this transfer of production decreased the indicators that characterize the industry, such as investments, number of employees, number of companies and trade balance. The sole indicator which recorded increases in 2013 compared to 2000 was production of textiles and garments.

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