

Ewa Grandys

Technical University of Lodz  
Institute of World Economy and Textile Marketing  
ul. Żeromskiego 116, Lodz, Poland  
e-mail: ewa.grandys@poczta.onet.pl

# Impact of External Determinants on the Functioning of Polish Clothing Manufacturers

## Abstract

*The period of recession that troubled the Polish clothing industry for many years was followed by economic transformation that slowed down the decline in production. This article analyses the amounts of production sold and labour productivity per worker between 1995 and 2005, as well as the role that the export of clothing plays in the current business environment in Poland.*

**Key words:** Polish clothing market, production sold of clothing industry, export of clothing.

The pressures of the competitive market oblige clothing enterprises to monitor their micro- and macro-environment on a continual basis. In an earlier publication [1], the author presented the process of making strategic decisions which are used to analyse the market. The internal and external factors identified in the course of the analysis should form the basis for initiating strategic and organisational actions. The effectiveness of these actions depends on the organisation's ability to respond fast to changes taking place in the environment, but also on its skill in creating a unique configuration of solutions concerning the corporate culture, procedures, and structure of production. The author's research has been focused on the external determinants that significantly affect the functioning of enterprises.

## The liberalisation of the domestic market for textiles & clothing products, and its effects

In January 1990, the Polish Parliament enacted a package of laws that triggered transition processes in the entire economy. The processes stirred up a crisis that also hit the textile and clothing industry. For the first time in Poland's post-war history, firms suffered from insufficient demand for their products, which brought about a deep recession and reduced the the clothing industry's sales to 74.3% (in the period 1991-1989 [8]). The main causes for this were:

- the impoverishment of households caused by high inflation (with consequent lower demand), and
- the disintegration of economic ties linking the countries comprising the Council for Mutual Economic Assistance (smaller export of textiles and clothing).

In this situation, the Polish government followed the World Bank's recommendation and requested the Boston Consulting Group to prepare a sectoral study exploring the textile and clothing industry in Poland. The BCG's opinion was ready at the beginning of 1991, and gave a favourable evaluation of the clothing industry's growth opportunities after its profound restructuring.

In the years 1992-1997, clothing production increased in Poland. The improvement stemmed from the generally better situation of the domestic economy as whole. The factors that helped overcome the recession included the following [5]:

- good business conditions in the EU member states (translating into greater exports of Polish clothing onto the EU market),
- customs-free access to the EU market for providers of outside processing services for the clothing industry,
- growth in demand on the domestic market (higher incomes of households and the deferred purchase effect),
- reduced inflows of illicit import of clothing, owing to the sealing of national borders,
- the dynamic development of the border trade,
- restructuring processes in Polish clothing enterprises, with measures such as debt reduction and turnaround solutions,
- clothing industry's low demand for capital, enabling the mushrooming of new firms.

However, these growth factors did not form an enduring trend. In 1998, another economic crisis reduced production for the following reasons:

- the restrictions that the Polish government imposed on residents from the CIS (Commonwealth of Independent States) in January 1998, and the crisis

that struck the Russian economy in August of the same year. Both events reduced the export of clothing to the markets. In 1997, the export to Eastern European and CIS countries was valued at US\$114.6m, but in 1999 it dropped to US\$97m [7].

- the crisis in Asia that devalued Far East currencies. The lower prices of clothing manufactured in this part of the world triggered an inflow of cheap articles onto the EU markets, which reduced imports of Polish clothing.
- the growing imports of under-priced clothing to Poland, breaching the rules of fair competition.
- the large-scale import of second-hand clothing; in the period 1997-1998 these imports accounted for 90% of the production capacity of the Polish clothing industry by product type [4].
- the gradually fading comparative advantage of Polish manufacturers in the export of clothing, starting from 1998, due to the heavy burden of non-wage costs levied on the payroll [6].

## Integration with the EU market – key external determinants of the Polish clothing industry

Poland joined the European Union on 1 May 2004. This act contributed to the further liberalisation of trade and international cooperation in Poland. The country implemented the external customs tariff and market protection instruments that are obligatory for EU member states. Another momentous occasion was the end of 2004, which saw the end of a 10-year transition period during which the Agreement on Textiles and Clothing signed in Marrakesh in April 1994 had been in force. Clauses protecting trade in this group of goods were thereby abolished, and textiles & clothing articles were subordinated to the WTO rules. What was

the influence of external determinants on the volume of clothing production in the pre-accession period?

In the year 1995, a critical time for the Polish clothing industry, its production sold amounted to 6,330 bn zloty in current prices. The final years of the examined period show a significant increase in the industry's production sold (see Table 1). In 2001, the production was estimated at 9,054 bn zloty (baseline prices). A year later, in 2002, its value went up to 9,251 bn zloty. A similar situation occurred in the next two years. In 2003, production sold was valued at 8,868 bn zloty, and in 2004 at 9,586 bn zloty. However, the record-high increase in 2004 was followed by a large drop in 2005, when the value of production sold sank to only 8,091 bn zloty [9].

It is noteworthy that the production volumes presented in Table 1 were obtained owing to a growth in labour productivity estimated at 164.6% between 1995 and 2005 (measured by the growth dynamics of production sold per worker [9]). The statistical data and observations of the industry in 2006 give hope that the situation in the clothing industry has stabilised. The process can be attributed to the following factors:

- the substantially modified ownership structure (99.9% of the enterprises are now in the private sector) [9], and
- the expansion of clothing enterprises driven by the transition processes in the economy which have resulted from Poland's membership in the Single European Market (SEM) and her integration with the EU.

The growing importance of SMEs (which account for 99.6% [9] of all Polish clothing producers) has been observed in the EU since the 1980s. Their positive influence on the economy arises from [2]:

- high flexibility of operation, which makes them easily adjustable to market needs,
- high effectiveness, despite lower productivity,
- lower production costs,
- employment growth,
- their ability to cooperate with large enterprises,
- their positive influence on regional development.

The SMEs surveyed confirmed that dynamically expanding firms had started to strengthen their position in the EU markets by developing export activities.

The level of rates that the Common Customs Tariff applies to clothing articles is lower than that operated by the Polish tariff before the country integrated with the EU. In the Community, the average consolidated tariff rates on textiles and clothing are 7.9%, whereas Poland used to charge 13.1% [1]. These lower rates, together with the consequences of the events discussed and the international agreements which Poland became an active member of, encouraged many domestic enterprises either to start exporting their products or to boost their export activities. A higher diversity of available markets provided firms with growth opportunities.

A research sample including 29 clothing enterprises was divided into those that export the following products (Table 2):

- clothing manufactured in a full production cycle,
- clothing manufactured by so-called outside processing services,
- their own products, as well as outside processing services.

In the examined sample, only two enterprises (7%) traded exclusively in the domestic market. The remaining twenty-

seven firms (93%) viewed market diversification as an opportunity to expand. Thirteen firms (44.8%) only exported the outside processing services. Another seven firms (24.1%) provided such services to both domestic and foreign customers, in addition to the export of their own clothing articles. This more demanding form of export was the only type of export activity pursued by the next seven enterprises (24.1%). The enterprises had mainly been investing in the expansion of their own sales network; in the survey period, the profitability of sales exceeded 30%, compared to the clothing production profitability, estimated at 6-7% [3].

The decision to enter a foreign market is partly forced by dropping domestic sales. Polish producers are being crowded out by foreign companies. Nevertheless, they are not afraid of foreign competitors when they enter foreign markets. To explain this apparent contradiction, they indicate the high attractiveness of their products (designs and quality) and their price competitiveness. The Polish clothing industry has just begun to win shares in foreign markets. Like exporters of the outside processing services for the high-end market segments, who are not apprehensive of losing their customers, the producers of original products believe in the competitiveness of their products, and that the expansion of distribution networks will gradually increase their export sales. The research did not find a single instance of a foreign shop being closed, or a representative office being wound up.

The only factor curbing the growth of export beyond Poland's eastern border is producers' concerns as to whether the debts which arise will be collectible. Nevertheless, the size of the eastern market, some firms' long tradition of cooperation with the market and its proximity make it attractive for Polish clothing manufacturers.

The most important factor that boosted the export of Polish clothing was the growing demand for Polish products abroad, as confirmed by the existing shops. The list below provides some examples of clothing shops that Polish manufacturers have opened abroad in recent years:

- The Bytom clothing company opened a men's suit shop on a very prestigious street in Berlin (Kurfürstendamm 163) on 1 May 2004. Versace, Armani

**Table 1.** Production sold of the clothing industry, years 2001-2005; **Source:** author's calculations based on Central Statistical Office (GUS) data.

Year	1995	2001	2002	2003	2004	2005
Production sold, million zloty	6330	9054	9251	8868	9586	8091
Production growth against 1995, %	100	143	146	140	151	128

**Table 2.** Sample breakdown by export type; **Source:** developed by the author based on the conducted survey.

Sample size	Only own products	Only outside processing services	Both	Only domestic production
29	7	13	7	2
100.0%	24.1%	44.8%	24.1%	7.0%

and Boss sell their clothing in the same area.

- Sunset Suits has opened men's suit shops in Stockholm, Prague, and Vilnius.
- LPP plans to increase the share of export in total sales from 20% to 25% in 2007. The company has 86 shops selling the brands Reserved and Gropp Town in Russia, the Czech Republic, the Ukraine, Hungary, Lithuania, Latvia, and Estonia, and is looking for other locations.
- The Kan company, based in Łódź, has opened its Tatum brand shops in Moscow, Vladivostok, Berlin, Leipzig, Prague, and Budapest. It has signed a contract to open a shop in Sankt-Petersburg. More shops will be open in Kiev, Kharkov, and Dnepropetrovsk in April.
- The Hexe Line has had a shop in Prague since 1999.
- Monnari Trade has plans to establish a chain of 40 shops in the Ukraine, Germany, Ireland, the Czech Republic and Kazakhstan. The first of them will open in August 2007.
- The Łódź-based company Próchnik established a shop in Lvov and wholesales clothing to Russia. The company has found five new sites for its shops in Kiev, Donetsk, and Odessa.
- The Łódź-based company Redan sells its clothing brands Top Secret and Happy Kids in Russia.

The presented list is by no means exhaustive, as the area of research still shows dynamic changes.

### Final comments

Determinants discussed in the article suggest that the effectiveness of Polish clothing manufacturers largely depends on external factors. The most important of them are:

- liberalisation of foreign trade arising from:
  - the implementation of the Common Customs Tariff in Poland, with the average rates on textiles and clothing being 40% lower than they used to be in the national tariff,
  - the termination of the Agreement on Textiles and Clothing, with the consequent abolition of protective clauses applying to the group of products under investigation, and their subordination to the GATT rules.
- competition in the Polish clothing market that made enterprises restructure; the process helped them grow and

improve the productivity of labour. In the years 1995-2005, the growth dynamics of labour productivity as measured by the increase in clothing industry's production sold per worker was 164.6%.

- export growth, which has been the major factor behind the internationalisation of clothing enterprises. The survey's results allow us to draw the following conclusions:
  - up to 93% of Polish clothing firms are exporters (24% of firms export their own brands only, and 45% provide outside processing services exclusively; 24% of organisations deal in both types of business),
  - only 7% of the domestic clothing manufacturers concentrate on the domestic market.
- entrance into foreign markets by way of non-proprietary distribution channels, but also by firms' own shops and outlet chains. This approach suggests that the producers have long-term plans.

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e-mail:

[ibwch@ibwch.lodz.pl](mailto:ibwch@ibwch.lodz.pl)

[infor@ibwch.lodz.pl](mailto:infor@ibwch.lodz.pl)

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