

GLOBAL PRODUCTION NETWORKS AND REGIONAL DEVELOPMENT: A CASE STUDY OF THE HUNGARIAN FOOTWEAR INDUSTRY

GLOBALIS ÉRTÉKTERMELÉSI HÁLÓZATOK ÉS TERÜLETI FEJLŐDÉS: A MAGYARORSZÁGI LÁBBELI-GYÁRTÓ IPAR ESETE

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Abstract

The industry in East-Central Europe has integrated into global production networks in the last quarter century. Modern reindustrialization is considerably expected in the region, meanwhile it has emerged that those works leaning on cheap labour do not provide close-up perspectives in the long run: the 'upgrading' has become the main objection, namely to join the international industrial diversification. This case study aims to present the current Hungarian footwear industry. The study, based on statistics data and interviews, as well as information collected at the Union of Leather and Footwear Industry, focuses on how the participants of the sector integrate into global production networks and what are its consequences.

Keywords: global production networks, reindustrialization, footwear industry.

Abstract

Kelet-Közép-Európa ipara az elmúlt negyedszázadban globális termelési hálózatokba integrálódott. Az újraiparosodáshoz komoly modernizációs remények fűződnek a régióban, miközben az is nyilvánvalóvá vált, hogy a szimplán olcsó munkaerőre épülő tevékenységek hosszabb távon nem kínálnak felzárkózási perspektívát: a nemzetközi ipari munkamegosztásba való bekapcsolódás varázsigéjévé a „feljebb lépés” folyamata vált. Jelen esettanulmány a hazai lábbeli-gyártó ipar helyzetének bemutatására vállalkozik. A statisztikai adatok mellett vállalati interjúk tapasztalataira, továbbá a Bőr- és Cipőipari Egyesülésnél gyűjtött információkra épülő írás az iparági szereplők globális termelési hálózatokban történő részvételének mikéntjére, illetve integrálódásuk következményeire fókuszál.

Kulcsszavak: globális termelési hálózatok, újraiparosodás, lábbeli-gyártó ipar.

INTRODUCTION

The *foreign direct investments* had a crucial role in the industrial restructuring process after the change of regime, which resulted an industry integrated to *global production networks* and an industry with large-scale export orientation in Hungary. This process entailed the

dramatically shrinking significance of industry requiring stock, energy and living labour, entailed also the appearing of heavy industrial distressed areas, as well as the considerable *decreasing of employment by light industry*, however, it was an important manufacturer previously on the peripheries (Barta – Czirfusz – Kukely 2008, Kiss 2010). The latter process queried the results of the industrialization, carried out after the World War II, for the sake of employing the labour force from the agricultural regions, while *these regions in question* have mainly *unfavourable positions* in order to be *selected as production sites* of modern economy.

This study aims to show the structural reshaping and its industrial results of the footwear production, which has a considerable role in the *industrialization of the rural peripheries*, and requires living labour, and which is considered as a significant employer beforehand. The main question of the study is whether the more and more globalized *footwear production* has *subsistence in Hungary*, where the local members have liminality between the industrial centres leading global production networks, pooling strategic functions and producing the highest added value, and the developing economies as sites of the cost-effective mass production and formatives of increasingly important competencies.

The article – beyond *statistical data* – is based on those semi-structured interviews, which mainly focused on the integration to the global production networks, and which were made at footwear manufacturing companies, as well as at the Union of Leather and Footwear Industry. The examined companies are Eastern-Hungarian small, medium-sized or large enterprises having foreign or home owners. They provide 35% of the sector employees. The sample is mainly appropriate for reconstructing of the progress of the large sector players.

FORCED PATH REPOSITIONAL ATTEMPTS

Toll manufacturing footwear industry

In the Social Era the Hungarian footwear industry involved *state enterprises* with specific technologies and *large production run*, which transacted export to the east supplied the local demand, as well as to the west from 1970s. While the former supply based on own products, the export to the capitalist countries was implemented by toll manufacturing. The western growing interest for the cheaper productions, as well as the Hungarian government in meeting its foreign exchange needs promoted the cooperation (Cseh et al 2002, Laki 2005).

The change of regime involved the transformation of the market economy, the orientation change of the foreign economy, and large effects of globalization in Hungary as well. Among these circumstances the Hungarian footwear production was considerably *thrown back on its western customers* due to the *less eastern marketing possibilities*, as well as the effects of the far east competition on the *shrinking domestic market*, which supplanted the local products.

Introducing their own products to the west had lack of market knowledge and the capital needs, however, the producers in the given countries were interested in exploiting strategies for having products made in the cheap Eastern-European sites. The falling out of Yugoslavia due to its civil war even resulted their growing interest (*Antalóczy – Sass 1998, Bertram 2005, Crestanello – Tattara 2011, Cutrini 2011, Roukova et al 2008, Schmitz 2006, Scott 2006*). Thus, as a possibility – lack of a better one –, the *toll manufacturing to the western procurers* left predominantly for the Hungarian producers.

Toll manufacturing is *relatively unrisky* (neither the consumer research nor the stock procurement are the employer's duties, but their firm finances the cost of production) and contributes to *lock up capacities*, as well as to support the employment. On the other hand, the wage worker is simply forced by this construction into a *manufacturer role*, and is *made to be dependent on* the procurer (which is especially asymmetric provided the toll manufacturer signs a contract with only one company and for certain production segments). They not only „dull” the firm *professionally*, but merely count on its labour force in such a sector where the source of the competitive edge – especially among products at a lower price – is the *cheapness of the living labour*. In the case of toll manufacturer it restricts the income opportunities, as well as the secession of the role. The negative effects of toll manufacturing were emerged *after the millennium*. Due to the raising costs of the Hungarian manufacture, the production moved to the east, and *the local footwear producers lost their orders one after each other*. Behind the process there were the increase in the minimum wage and the effects of the increase in net HUF, which caused a rapid decline in the sector in the second and third year after the millennium (*Cseh et al 2002, Laki 2005, Molnár 2013, Molnár – Lengyel 2016*). While 70% of the sector revenues (included the leather industry) came from the export around the millennium (*Tab. 2*), 85-90% of the footwear export was realized among the frames of lease-work. It shows the importance of lease-work and the effects of its decline.

The process of the *ownership restructuring* was also affected by the toll manufacturing relations as long as the foreign capital turned up as an owner besides the home enterprise sector: the former toll manufacturer bought a partial ownership or set up a new firm, which resulted – among others – that the Berkemann, Josef Seibel, Kennel & Schmenger, Legero, Marc, Salamander settled in Hungary. *Forming into subsidiary of the foreign company means stability* rather than ordering leasework, thus the partner's direct investments are treated as priorities by more home-based footwear enterprises. On the other hand, the presence of the *foreign capital* does not certainly mean *life insurance* in the long run, which – especially after the millennium – was shown by the enterprise liquidations of some owners (Marc), the production cutbacks of others (Legero) or forwardings of their subsidiaries (Salamander – Lorenz). Several years after the millennium declining wave (in 2012) 83% of the total

revenues of the leather and footwear manufacturing was from the foreign subsidiaries, the bulk of the footwear manufacturers (having at least 100 employees) is foreign owners.

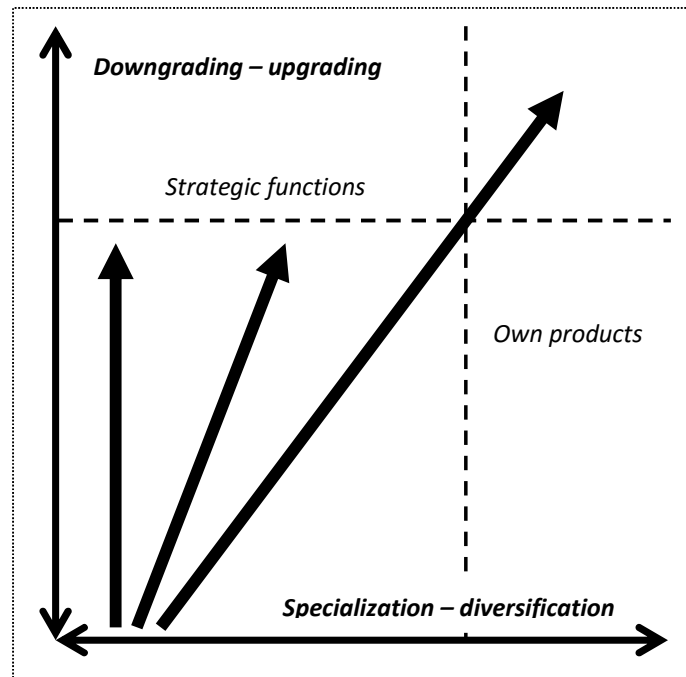
Categories of upgrading

The modus operandi of the integration into global production networks seems to be of primary importance regarding the chances of gainful activities, as well as the continuity of the system profit. It is one of the reasons for the significance of upgrading, which provides the increase in the relative importance of the added value and the players.

Giving up the own products manufacturing and *turning towards the leasework of the industry* after the regime change are interpreted as a *downgrade*, while – unseparatedly from the home industrial traditions – after some time the players' *upgrading* could be observed relatively fast in the global production networks defined by the leasework relations (*Fig. 1*). The shoe uppers producing, which requires living labour, gave place to the *proper production*, some players – beyond the direct production – gained *other functions* (sample shoes production, logistics) within the toll manufacturer's value chain in order to increase their contribution to the value of the finished product and *strengthen their position* in the system (*Humphrey – Schmitz 2002, Kaplinsky 2004, Szalavetz 2012*).

In the case of interests taken over by a foreign owner and *become subsidiaries* similar progress is observed. That home subsidiary has gained the highest position which also *controls the production* of the owner's plants in the neighbouring countries, and which does an independent – serving other plants in the region – *raw material management*, as well as which controls the *marketing agency* of the company in Hungary and in some other neighbouring countries. Opposite examples can be also observed: the given company started manufacturing higher welfare products, but at the same time it *gained downgrade regarding the functions* focusing its production on shoe uppers only. On a certain level of upgrading the *partial outsourcing of the shoe uppers production requiring living labour* also can be observed: among companies in question there were not any considerable players which did not take the advantage of this opportunity for the sake of flexible exploitation of cost-reducing or capacities, giving forward some parts of their work to Hungarian, Romanian, Ukrainian or Indian (!) producers. The toll manufacturers and subsidiaries have common upgrading ways regarding that – independently from the cost and diversification of their supplies – the *strategic functions* showing the most significant added value can be owned *partially at the most* by them (*Fig. 1*).

Figure 1 Upgrading and diversification: dominant movement directions of the Hungarian footwear producers within the global production networks



Source: own compilation

Due to the receding of Hungarian producing *after the millennium* the *unsustainability of the long-run survival strategies built upon leasework* outcropped, which was only temporarily extended by making relationship with more toll manufacturers. Although larger stability in case of leasework done related to high quality products, and partial return of orders formerly lost have been observed, in terms of *diversification* manufacturing *own products* has come increasingly to the front. The own product is not merely considered as diversification: only in this case we can state the wholesome forming opportunities of *strategic functions* (Fig. 1). The foreign subsidiaries and home toll manufacturers have in common that as segments of the global production network they both *depend on* the leading player of production. In case of the subsidiaries it means a dependence within the company's hierarchy. In case of the toll manufacturers it means a consequence of asymmetric power relations along the value chain (Gereffi et al 2005, Yeung – Coe 2015). The latter's success can be measured by (1) the *significance of their role* within the production networks leading by others, (2) their *integration into more production networks* leading by others, and (3) *making independent production networks* due to their own products. Among our examined home companies there were not any which had not shown upgrading in one of those cases above. All cases seem to be needed to get permanent success.

The Hungarian footwear producers attempt to make their own products, which clearly shows to aim at the *middle and higher cost*, specific *niche market*. This attempt is partially

influenced by their *technological duties*. Healthy footwear (shoes for kids with medical aims, products for diabetic people and other orthopedic goods), safe footwear, fashionable shoes, footwear in extreme size, as well as customized footwear production (basically small-scale production and flexibility) mean the main strategic directions, especially in such marketing segments where *mass production competition does not prevail or only less*.

At the beginning mainly *home marketing* is typical among the enterprises, although in many cases outsourcing to the *foreign markets* (Austria, Germany, Italy, Romania, Russia, Ukraine, also Denmark, Finland and Japan) can be observed, in which cases several players – if they are not competitors – are *supported by their toll manufacturers*. As a dominant strategy, the middle-sized and large domestic enterprises mostly mix the *toll* and their *own products' manufacturing*, but the latter products – in their volumes – are effaced beyond the ones from toll manufacturing at the large enterprises.

RESULTS OF RESTRUCTURING

General industrial features

The restructuring resulted spectacular consequences. The systemic frames considerably changed: the large enterprises fell apart, then the strong fluctuation of the newly-appeared footwear players was considered. Before the change of regime the Hungarian footwear production involved 11-12 state footwear companies with more premises, industrial associations, and industrial side-lines of the agricultural large plants. Within the code register data from 1998, approximately 280, and from 2013 – in accordance with tendency of the sector's shrinking – about 120 footwear joint companies, which employed at least 5 workers, were registered. The cut-back resulted in a considerable change, and in *an increase in the rate of the micro- and small enterprises* (Molnár – Lengyel 2016).

The footwear production showed also shrinking in the beginning of 1990s, and then increasing in the second half of the decade, similarly to data of the industry. Shrinking and increasing of its employment are in agreement in their size with indexes of the industry as a whole, however, its production and export already declined at that time, and then it showed a little increase. After the millennium the moderate employment shrinking of the industry as a whole came off with – blocked by the crisis occurred in 2008 – the increase in production and export, however, the footwear production (due to the reasons above) was supposed to be shrinking again in employment, producing and export (Tab. 1).

Table 1 Dynamics of some indicators of the footwear industry and the industry as a whole after the change of regime – in percentage of the value in 1989

Year	Footwear production			Industry		
	Production value	Export revenues	Number of employees	Production value	Export revenues	Number of employees
1990	88	88	88	92	91	95
1995	52	56	57	68	82	56
2000	64	79	63	117	261	62
2005	25	61	27	151	419	56
2010	27	96	21	155	535	50
2014	50	170	21	178	660	52

Source: own compilation based on the data of Hungarian Central Statistical Office; dynamics of footwear export – lack of full particulars – counted of the leather and footwear production.

In 2014 the number of 7000 employees of the industry is only the one-fifth of the value in 1989, its production is – based on real value – about half of it. All in all, the export revenues passed the level of the time of the regime change, except that the data involves the data of leather and footwear production as a whole, in which case the leather-producing companies, which produce for the upgrading automobile industry, considerably contributed to resulting higher values (Tab. 1). According to the data of Tab. 2 the picture of a living labour needed (having relatively low production value per employee), showing a *large-scale exportorientation* due to its producing to the global market, as well as – among the limits of toll manufacturing – producing a *low* (and mostly decreasing) *intellectual employee-rate industry* can be described (Tab. 2).

Table 2 Some structural features of the footwear industry and the industry as a whole after the change of regime

Year	Footwear production			Industry		
	Production value per employee (1000 HUF)	Rate of export revenue (%)	Rate of intellectual employee (%)	Production value per employee (1000 HUF)	Rate of export revenue (%)	Rate of intellectual employee (%)
1990	628	41	16	1 504	26	22
1995	1 165	56	11	4 445	33	23
2000	2 604	68	9	13 164	51	22
2005	2 951	68	11	21 216	52	24
2010	4 671	81	9	30 368	55	25
2014	9 721	90	8	36 648	63	26

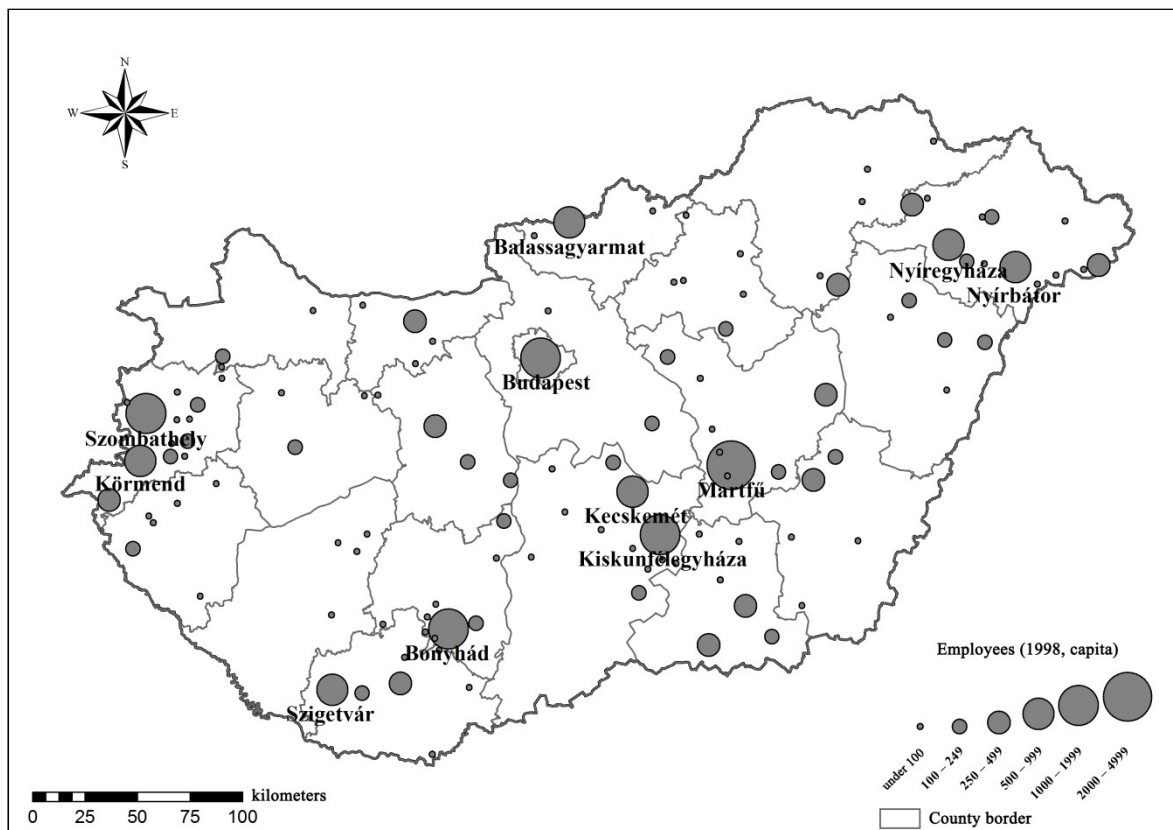
Source: own compilation based on the data of Hungarian Central Statistical Office; rate of export marketing in 1990 – lack of full particulars – counted of the leather and footwear production.

Regional sector dynamics

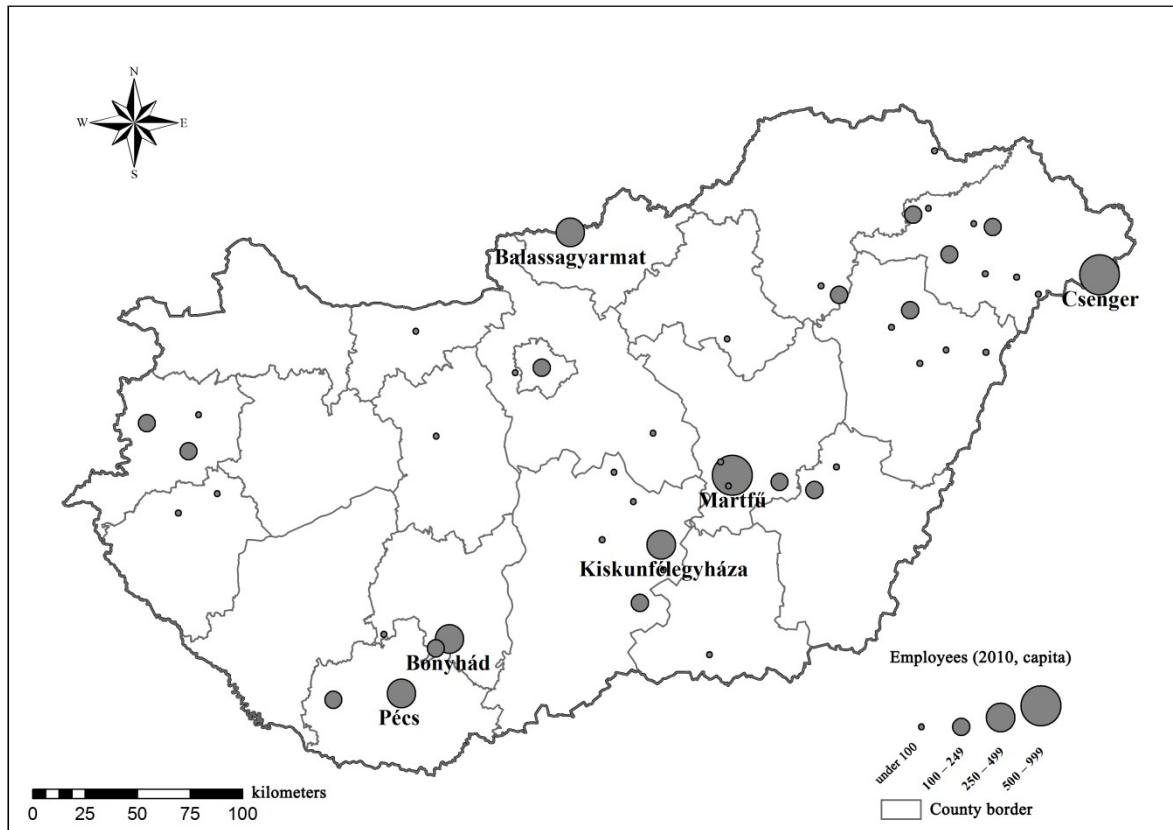
The *shrinking waves* selectively affected the regional development of the industry. In the following decade *after the change of regime* the footwear was considered as an important manufacturer in the rural area *receded into four regions*. Besides Western Transdanubium (Szombathely, Kőrmend), Southern Transdanubium (Bonyhád, Szigetvár), Central Plain (Martfű, Kiskunfélegyháza, Kecskemét), as well as North-Eastern Hungary (Nyíregyháza, Nyírbátor), Budapest even kept its important position, just like Balassagyarmat which employs prisoners in its penitentiary (Fig. 2).

In the next decade *after the millennium* the capital lost its considerable weight in the industry, the outsourcing of the important foreign enterprise resulted the *drastic shrinking of the Western Hungarian footwear industry*. Almost in all industrial centres the number of employees decreased, while in North-Eastern Hungary – due to the strengthening of Csenger, later Tiszakeszi – there were *considerable biases* (Fig. 3). The regional influential role of the footwear significantly decreased; only in some regions considered as "last mohawks" it has an important role in the local economic development.

Figure 2 Employment of the footwear industry in Hungary, at the end of the 1990s



Source: Hungarian Central Statistical Office company code register data with added premises 1998/1

Figure 3 Employment of the footwear industry in Hungary, at the end of the 2000s

Source: Hungarian Central Statistical Office company code register data with added premises 2010/4

SUMMARY

After the change of regime the Hungarian footwear industry, which integrated into global production networks, and was considered as an important manufacturer, has experienced *two big shrinking waves*. Beyond the first wave the unsustainability of the former producing volume was, which was resulted by the *partial loss* of the traditional markets. The second shrinking wave in the *home footwear production*, which was forced to become *toll manufacturer*, was caused by the increasing costs of production after the millennium. More and more procurers (foreign plant owners) *took their production to the east*, which led to the *shrinking* of several local toll manufacturers (subsidiary). The remained players are not merely procurers' partners (owners' concerns) who compete for costs: their marketing strategies are based on *upgrading* and *diversification*, whose most complex form is the *appearing with own products* and aiming at mainly specific niche markets avoided by mass producers. Decreasing of the sector's influence also implies the loss of its influential role in the regional processes: it is considered as an *important constituent of the local economy in some key regions*.

Back to the main question: however, the long-run functional chances of the mass production are limited, the *qualitative footwear production built upon flexibility*, and *aiming the specific market segments*, seems to be sustainable in Hungary. Nevertheless, the profit-producing and manufacturing impact of these activities depends on the features of their integration into the global production networks, as well as the size of the local added value.

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