

Sectoral Development Study

**Bosnia and Herzegovina**

**Development Studies for Sectors with Potential  
Development Study for the Textile and Clothing Industry**

Draft

November 2001

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Financed by:

**Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung (BMZ)**

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Projektbearbeitungsnummer: 97.0795.1-009.00

## Contents

<b>1. Introduction.....</b>	<b>4</b>
1.1 Definition of the sector and methodology .....	4
1.2 International trends in the textile and clothing industry .....	4
1.2.1 Trends in production .....	4
1.2.2 Trends in sales.....	6
1.3 Factors determining the value-added chain .....	8
<b>2. Analysis of the Current Situation of the Textile and Clothing Industry in BiH .....</b>	<b>9</b>
2.1 Sectoral development and significance of the sector for the economy .....	9
2.2 Geographical distribution .....	16
2.3 Textile industry (fabrics, yarns etc.) .....	17
2.3.1 Products.....	17
2.3.2 Companies.....	18
2.3.3 Structure of the sales markets of the textile industry .....	19
2.3.4 State of technology and specific situation of the primary textile industry .....	20
2.3.5 Materials, findings and accessories: specialised service providers .....	21
2.4 Clothing industry .....	21
2.4.1 Products.....	21
2.4.2 Companies.....	22
2.4.3 Structure of the sales markets in the clothing industry .....	23
2.4.4 State of technology, managerial skills.....	23
2.5 Meso level.....	24
2.5.1 Training establishments and specialised service providers.....	24
2.5.2 Chambers of commerce and industry associations .....	25
2.6 Product input/output matrix in the clothing industry .....	26
2.7 Trading systems.....	28
2.7.1 Domestic trade.....	28
2.7.2 Trade with the EU .....	28
<b>3. Market opportunities .....</b>	<b>29</b>
3.1 National market .....	29
3.2 Regional market.....	30
3.3 The eastern European market .....	31
3.3.1 Hungary .....	32
3.3.2 Bulgaria.....	33
3.3.3 Romania.....	33
3.3.4 Czech Republic and Slovakia .....	33

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3.4 The EU .....	34
3.5 Competitors and benchmarking .....	35
3.5.1 Hungary .....	37
3.5.2 Bulgaria.....	37
3.5.3 Romania.....	37
3.5.4 Czech Republic and Slovakia .....	38
3.5.5 Ukraine.....	38
3.6 Market opportunities and prospects for the clothing industry in BiH.....	39
<b>4. Development strategy for the sector .....</b>	<b>41</b>
4.1 Objectives of the institutions concerned and the interaction between them.....	41
4.2 Strategic approach .....	43
4.2.1 Interaction between the micro and meso levels.....	44
4.2.2 Macro level.....	48
4.3 Measures to tap into the domestic and foreign markets .....	51
4.4 An opportunity for the primary industry: as local and regional suppliers.....	54
4.5 Selectivity in contract manufacturing and focus of efforts to tap into new markets .....	56
4.6 Promoting training and technology for the clothing and textile industry.....	58
4.7 Developing a local consultancy market.....	59
4.8 Building and developing services for the sector.....	60
<b>5. Initial promotional measures for the sector .....</b>	<b>61</b>
5.1 Immediate measures.....	61
5.2 Medium-term measures .....	62

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## Index of abbreviations

BiH	Bosnia and Herzegovina
CAD	Computer Aided Design
CAM	Computer Aided Management
CEE	Central and eastern Europe
CPD	Collections Premieren Düsseldorf
EBRD	European Bank for Reconstruction and Development
EU	European Union
FBiH	Federation of Bosnia and Herzegovina
FDI	Foreign Direct Investments
FIPA	Foreign Investment Promotion Agency
GDP	Gross domestic product
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit (German Technical Cooperation)
i.e.	that is
KM	Convertible Mark
OHR	Office of the High Representative
OP	Outward processing
PC	Personal computer
REFA	Reichsausschuß für Arbeitszeitermittlung (German Committee for Time Studies)*
RS	Republika Srpska
SME	Small and medium-sized companies
TTFSE	Trade and Transport Facilitation in Southeast Europe
USAID	United States Agency for International Development
USD	US Dollar
WTO	World Trade Organisation

## **1. Introduction**

### **1.1 Definition of the sector and methodology**

The study covers the textile and clothing industry in Bosnia and Herzegovina (BiH). The textile industry includes fibre manufacture, spinning, weaving, knitting and finishing. The clothing industry essentially encompasses the manufacturing or processing of textiles to make fashion products. The basic approach adopted in the present study was to conduct a systematic structural analysis of the sector in order to identify ways of developing it. The study addresses decision-makers in the political and the business spheres.

The objective of this study is to help create a vision for developing the clothing sector in BiH ("meta level") to which all the relevant decision-makers will feel bound. This vision focuses on successful companies, i.e. companies which are competitive in the medium to long term. The study therefore places great emphasis on proposals aimed at improving the situation of these companies ("micro level"). Having taken stock of the companies in this sector, the study goes on to develop a strategy for measures at the "meso level", and proposes domains in which targeted policies and measures could be implemented to aid the clothing sector. Two crucial aspects of our methodology are its medium to long-term perspective and the consideration that is given to interaction between the respective players in the sector (inherent or structural competitiveness). This has helped us identify choices of action at the political level ("macro level"), at the cross-company level ("meso level"), and at the level of the individual companies ("micro level").

In drawing up the study, we first of all analysed the available secondary material on the sector. This included systematically analysing the available statistical data on the textile and clothing sector in BiH. We also systematically analysed empirical experiences drawn from the sectoral consultancy project currently being conducted by the Deutsche Gesellschaft für Technische Zusammenarbeit (German Technical Cooperation) under the private business promotion programme; this proved especially useful for identifying market opportunities and working out sectoral development strategies. Discussions with ministers, international donors and national institutions at the meso level, analyses of international trends and the results of sector-focused workshops in July 2001, in which companies took part, also contributed to the information base used in this study.

### **1.2 International trends in the textile and clothing industry**

#### **1.2.1 Trends in production**

The international textile and clothing industry has an extremely heterogeneous structure both vertically (from fibre manufacture and spinning through to garment manufacture) and horizontally (from fashion productions to standard articles through to multiple technical and industrial applications). Owing to various local and national factors and widely divergent wage levels in the various economic zones, far-reaching structural adjustments have taken place in the past 25 years.

The clearest trend can be observed in the **clothing sector**. Here, work processes with high labour costs in proportion to overall value added (as is the norm in the clothing industry) have been transferred to low-wage countries. 95 per cent of all such processes have shifted to industrialised third-world and low-wage countries, and this trend can scarcely rise further. Outward processing is found primarily in garment manufacture, while ready-to-sell business is more usual in knitwear manufacture. Today, garment businesses of all types are focusing their investment and knowledge solely on collection designing, purchasing and sales marketing and logistics. Engineering know-how is no longer one of the core competencies of garment manufacturers, and is almost completely interchangeable, meaning that only limited resources are allocated to it. Labour costs combined with employee productivity are the decisive competitive factors for contract garment manufacturers in low-wage countries. In contrast, the typical success factors for western garment manufacturers are the product, the sales channel and the brand. To give one example of labour intensity: a workplace in western Europe can cost up to 50,000 convertible marks (KM).

Trends in the **primary textile sector** have been more varied. The conventional supporting textile industry (fibre manufacture, spinning, weaving, knitting and finishing) is highly capital intensive and therefore much more resistant to the lure of low wages. For example: a workplace in a spinning or weaving mill may cost several million marks. Business relocations aimed solely at gaining labour cost advantages are rare; relocations are for other reasons, mainly related to strategy and situation. The dramatic fall in the number of business units since 1970, while production figures have continually risen, can be explained by the fact that only those businesses with the highest capital assets have been able to meet productivity, investment and innovation demands. Many companies have been unequal to the challenge of structural change facing the sector, which requires on one hand productivity gains, and on the other hand fast lead times, product innovation in terms of fashion and engineering, as well as efficient logistics, for increasingly small product consignments. These structural changes have resulted today in a highly specialised "residual" industry which is extremely efficient and competitive and in which labour costs play only a secondary role. It is generally true of this sub-sector that the previously predominant vertical businesses have been "horizontalised", the key objective being to achieve greater product flexibility and improved logistics. In other words, the textile and garment manufacturing sector has been "disentangled", the textile companies being the principal suppliers to the garment manufacturers. Their success is due to a combination of efficient per item production costs and innovative products.

Development in the **industrial and technical textiles** sector has not been affected by the issue of location. This branch of industry supplies technical textile products for a wide variety of non-textile applications (the automotive and aerospace industries, medical and filter technology, landscaping, gardening and construction, etc.) The damaging economic fluctuations to which the textile and clothing industry is subject scarcely affect this sector, which is characterised by rapid technical innovation and application technology. As these companies are secondary suppliers and their costs make up only a small proportion of the overall costs of their customers, product quality and application technology considerations are more important than the costs of added value (and hence productivity).

There are no success factors common to all the sub-sectors. One may find in every sector companies which have succeeded in developing their own economic position in the face of

trends by establishing themselves in a niche market. There are highly profitable garment companies which manufacture 100 per cent of their products in their own facilities (e.g. Trigema), and successful vertical businesses side-by-side with industrial fabric manufacturers who are finding it impossible to survive despite favourable market conditions. As in all branches of industry, it is all a question of how well the management succeeds in exploiting the company's specific competitive advantages and overcoming its weaknesses.

### **1.2.2 Trends in sales**

#### **Move away from regular orders to short-notice "as needed" purchasing**

Seasonal differences in order volumes – a core organisational problem affecting the whole of the textile production chain – result in a fluctuating use of production capacity at all levels and, in the case of independent businesses, to frequently insurmountable cash flow problems, surplus production and cancellations owing to fashion changes. Even intelligent in-advance production is only appropriate to a limited degree because of the high risk of fashion changes; only well-established brand-name manufacturers (such as Boss) can afford to take the risks associated with this. In order to achieve their budget targets, weaker brands or no-names are obliged to accept short-notice orders, or to let market opportunities slip by altogether.

The timely availability of textiles is determined primarily at international fabric and garment trade shows, which are scheduled long in advance and which have been gradually brought forward over the last 20 years by around 2 months. Only the established brand-name manufacturers benefit from this, as they earn as much as 100 per cent of their turnover from regular or advance orders which they can manufacture ahead of time. Given the strong position of these brands, the sales risk can be shifted to the retailers, who can only afford to stock supposedly "safe" merchandise, primarily brand items. They purchase the remaining merchandise at short notice, as and when it is needed. Experience at the most recent CPD trade fairs has revealed that the percentage of comparatively "safe" regular orders has dropped from some 75 per cent in 1980 to at present barely 20 per cent of overall demand. The importance of western garment manufacturers can be seen in the percentage of known brands in regular orders. This decline in the volume of regular orders and the very costly consequences this has for logistics, stocks and scheduling are the principal trends in the textile production and distribution chain. An understanding of typical turnaround times from trade fairs to orders, from yarn to the finished goods, and an ability to recognise the opportunities and risks that are at play here, are fundamental conditions for success.

#### **Stagnation on the textile markets**

The predominant brands aside, the mood in the fashion garment manufacturing industry and the textile trade remains depressed. New colours and the awaited renaissance of jeans fashion, for example, are unlikely to bring the hoped-for upturn. The occasional announcements of a 3 per cent growth in turnover for 2001 rather sound like whistling in the dark. Many market players believe that a further decline by as much as 3 per cent, as in 2000, is more realistic. The reasons for this are numerous:



- a. Since only a few companies are able to keep pace with the faster rhythm and increasingly early seasonal deadlines (see above), many consumer wishes remain unfulfilled, since today people have the option of whether they buy a textile product or not.
- b. The percentage of overall expenditure by private households on clothing is continuously falling, having dropped from more than 8 per cent in 1994 to just over 6 per cent today. Higher household incomes have not, as hoped, made themselves felt in the retail trade, but have been swallowed up – especially in Germany – by administrative energy and petrol price rises.
- c. Virtually nowhere in the EU is it now possible to pass on costs for textiles to the consumer. Expenditure is more clearly than ever before focused on other products such as travel and electronics (mobile phones, PCs), etc.
- d. The conventional textile trade is losing market share to non-textile sales channels, such as food chains, drugstores, specialist coffee retail outlets etc., which are trying (with considerable success) to win customers by means of cut-price mass promotions, thus restricting value growth.

Critical market observers do not only view the consumer as being responsible for this at best stagnating demand. The downward pressure on prices which is being applied by an increasingly concentrated specialist retail sector – and this is not only true of the textile industry – has increased the number of low-quality, cut-price offers, damaging image and causing consumer disappointment. The retail trade is trying too hard to survive on the strength of cheap offers, instead of staking its chances on customer service and advice. The predominant feature of retail businesses in recent years has been the abandonment of customer service and advice by the major retail chains. The frequent consumer response to this is a refusal to buy (*cf. Karstadt/Quelle and C&A annual reports*).

The relatively stable business position of the principal fashion brands which are courted at great expense is not in contradiction to this, as here advice is largely being replaced by advertising, which is aimed at improving the situation in respect of regular orders. Also relatively unaffected by these developments is knitted outerwear, as new technologies have made this segment highly suitable for short-notice production runs.

Below are a few key figures on the most important and representative EU textile market – Germany – for outerwear, on which 80 per cent of the textile and clothing industry in BiH depends (underwear and knitwear businesses are of secondary importance in BiH). All production figures were down on 1999; only exports (of menswear more than women's clothes) and finished product imports (incl. underwear, knitwear, etc.) enjoyed a slight rise.

## Production and market supply in Germany, 2000 (in millions of KM)

	Menswear	Women's wear	Total
Production incl. contract manufacturing (1)	5,600	22,000	27,600
./. Exports (70% of which to EU countries)	2,200	7,500	9,700
= Gross supplies	3,400	14,500	17,900
+ Imports of finished textiles (2)	8,000	18,100	26,100
= Net supplies	11,400	32,600	44,000

Source: own data based on data from the Federal Statistical Office

- (1) Some 90% of production comes from low-wage countries  
 (2) incl. underwear, knitwear, etc. – import data does not differentiate between products

### 1.3 Factors determining the value-added chain

The structure-related adjustment away from conventional vertical production has now, a quarter of a century after it began, attained a sophisticated, near-perfect structure in terms of organisation and logistics. The capital-intensive production processes have remained in the industrialised countries, while the wage-intensive ones have been relocated to low-wage countries. This international structure of industry and trade is regulated bilaterally by agreed, product-specific laws on quotas, origin and preference status by means of "outward processing relations". While western companies view production facilities in low-wage countries as an extension of their workbenches and the solution to their problems of excessively high labour costs, low-wage countries have benefited by gaining additional knowledge of design, materials and technology, as well as from job creation. Their western partners take the fashion-related risks, provide the working capital and finance marketing. The western companies often also provide the means of production and bear the responsibility for management and quality.

However, this practice of supplying complete know-how and production means to the eastern European transformation states has also resulted in shutting them off from the export markets, a situation which persists today. While this "total supply" strategy was a welcome solution to the weaknesses and shortcomings of the outward processing businesses (e.g. their lack of working capital) in the initial years of relocation, today it is the core problem of companies in BiH, as they have not succeeded in remedying these weaknesses.

There are still no clearly structured, high-demand local markets. Garment manufacturers in eastern and south-eastern Europe are therefore being forced to develop house collections. This is a part of a strategy aimed at building outward processing relationships based on partnership, and there is no alternative to it. For eastern European manufacturers this represents a great challenge, as it addresses their weakest points; however, these products are still unsuitable for discriminating export markets. In the case of collections, the issue of low labour costs has virtually no bearing on their chances of success on the markets. Yet lucrative contract business, the economic *raison d'être* of which is not based solely on low labour costs, is today only feasible within loyal and long-term partnerships with western European customers.

## **2. Analysis of the Current Situation of the Textile and Clothing Industry in BiH**

### **2.1 Sectoral development and significance of the sector for the economy**

There is a long tradition of textile and garment manufacturing in BiH. Before the war, this primarily SME-based industry (companies with workforces of 40 to 1,200) was a pillar of light industry. Bosnian garment manufacturers were viewed as the market leaders in outward processing and were a top address for western European customers seeking quality, reliability and productivity.

The war destroyed this favourable position. After the outbreak of the war, western European customers – including prominent brand-name manufacturers – redirected their production needs to other central and eastern European states. Today, the Bosnian textile and garment businesses are at the bottom of the league in the outward processing rankings in central and eastern Europe. The willingness of their former western European customers to resume business relations is – with some exceptions – low. The reason for this is the spare capacity in other low-wage countries, and the less favourable ratio of labour costs (which are higher than those in other central and eastern European countries) to productivity (which is lower) in BiH. The lack of productivity resulting from this absence of investment has left BiH lagging behind, as available investment – which is slight – has been used exclusively for reconstruction rather than for new technologies.

While employee productivity is today more or less identical to that in the Ukraine, Belarus and Slovakia, wages in BiH are 3 to 4 times higher than those in competitor countries. Although the investment shortfall and employee productivity are comparable, this cost disadvantage is currently not offset by other product or market advantages. The textile industry is currently some ten years behind in terms of technological advances and the investment which technological sophistication triggers (which is less crucial in garment manufacturing than in the primary industry). Moreover, the formerly routine transfer of know-how has come to a standstill because of the war. Western European customers today provide hardly any technical advice.

Many companies now only receive "reject" products which were turned down by other eastern European competitors. Unlike before the war, company managers are now largely having to solve problems single-handed. They are forced to accept every offer indiscriminately, sometimes almost gratefully. The result is small production runs, numerous product changes, and difficult, highly quality-sensitive articles which frustrate all efforts to raise productivity, force costs higher, and represent a high risk factor (high percentage of retouching required). Businesses are more or less back where they were in the 1970s, the difference being that their former customers are now nurturing relationships with serious rivals in other CEE states, and that earlier loyalties to Bosnian companies no longer exist – partly also because of the change of generations. The structural inferiority of companies in BiH owing to the war and the consequent relocation of capacity by western European

business partners is therefore the main reason for the economic situation of the majority of businesses in BiH, which is in some cases very poor.

When taking stock of this sector, it should be noted that the available database at the FBiH and RS Offices of Statistics is incomplete. The following statistical figures are therefore based primarily on international sources (USAID, EBRD) and on estimates from industry and BiH experts.

Despite a difficult background situation, the clothing industry plays a significant role in the economy of Bosnia and Herzegovina. Some 8 per cent of the country's entire workforce is employed in this sector, 78 per cent of these employees being women (38,559 in 2000, or 6 per cent of the working population). The high proportion of women employees in the industry is very significant for the economy as a whole; as a result of the war, women account for more than 60 per cent of the population. The number of women who have to make their own living is very high. 31 per cent of employees are under 30 years of age (15,479 in 2000). As the clothing industry accounts for around one-third of BiH's exports, this sector is vitally important to the country's balance of trade and its integration into the world economy. The share of the clothing and textile industry in GDP in the year 2000 was around 6 per cent, or some 551 million KM.

### Growth of GDP in BiH

	1997	1998	1999	2000 (estimated)	2001 (anticipated)
GDP in million KM	6,367	7,244	8,014	8,976	10,237
...share of the Federation	4,748	5,407	5,833	6,416	7,314
...share of the RS	1,619	1,837	2,181	2,560	2,917
<b>Share of industry in GDP (%)</b>		<b>5.8</b>	<b>6.1</b>	<b>6.2</b>	

Source: Federal Office of Statistics Sarajevo, Republic Office of Statistics RS Banja Luka,  
Monthly Statistics Review N°4 Banja Luka, Chamber of Commerce RS + FBiH

### Workforce numbers and structure in the clothing and textile industry

	1997	1998	1999	2000	2001 (estimated)
Total workforce in BiH		639,712	628,536	631,730	729,043
...share of the Federation		395,445	407,754	410,808	486,028
...share of the RS	201,788	244,267	220,782	220,922	249,146
Workforce in the clothing industry in BiH			40,849	42,060	
...share of the Federation	24,565	27,200	27,625	29,843	32,300
...share of the RS	12,006	12,197	13,224	12,217	

	1997	1998	1999	2000	2001 (estimated)
Workforce in the textile industry in BiH	6,129	6,623	6,851	7,111	
...share of the Federation	4,335	4,800	4,875	5,277	5,700
...share of RS	1,794	1,823	1,976	1,834	
Share of female employees in BiH altogether			37,233		
Share of female employees in the clothing industry	19,652	21,760	31,886	32,985	
Share of female employees in the textile industry	3,468	3,900	5,347	5,574	
Age structure of the workforce in the clothing industry					
...share of under-30s	7,860	8,704	12,754	13,194	
...share of over-50s	1,768	1,893	2,710	2,639	
Age structure of the workforce in the textile industry					
...share of under-30s	1,387	1,536	2,139	2,285	
...share of over-50s	343	370	495	499	

Source: Federal Office of Statistics Sarajevo, Republic Office of Statistics RS Banja Luka

The wage and salary structure in BiH is generally stable, rising slightly since 1997 to post a growth rate of around 4 per cent. However, forecasts for 2001 are for a sharp rise of over 10 per cent. It should be noted that wages in the Republika Srpska are below those in the FBiH.

### Wage and salary structure in the clothing and textile industry

	1997	1998	1999	2000	Net KM 2001
Average wage in BiH	231	249	295	355	
...in the Federation	350	329	374	412	433
...in the RS	112	170	216	299	
...in urban areas	-	-	-	-	-
...in rural areas	-	-	-	-	-
Average wage in the clothing industry					
...in the Federation	295	315	325	340	380
...in the RS	-	-	-	-	-
Average wage in the textile industry				292	
...in the Federation	295	315	325	340	380
...in the RS				245	

Source: Federal Office of Statistics Sarajevo, Republic Office of Statistics RS Banja Luka

Of the 71,572 business units in BiH in 1999 in all sectors of the economy, 60 per cent were located in the Federation. In 2000, 78 per cent of these were private companies. The number of privatisations in the textile and clothing industry is much lower than outside the Federation, as the following table shows.

### Percentage of private companies in the clothing and textile industry in BiH

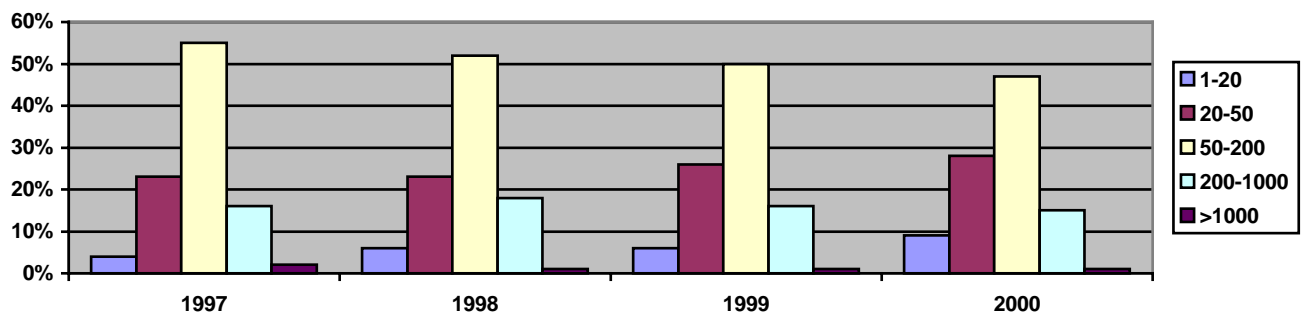
	CLOTHING INDUSTRY	TEXTILE INDUSTRY
FBiH	23%	22%
RS	81%	-

Source: Federal Office of Statistics Sarajevo, Republic Office of Statistics RS Banja Luka

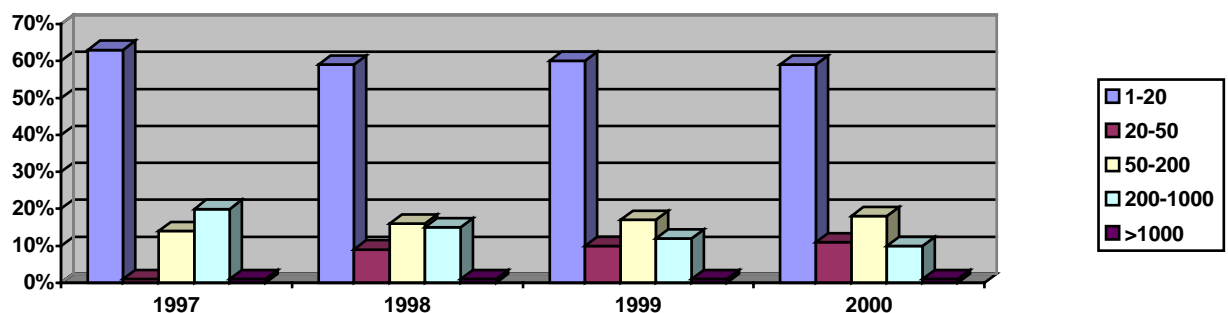
### Company structure in the clothing industry

An analysis of the company structure by category of size, based on the number of employees, shows that a gradual shift towards smaller businesses is already in progress. The number of new businesses in particular has risen in the past three years. The percentage share of small local and/or regional supplier companies is increasing in both the FBiH and the RS, the tendency being towards medium-sized companies (between 20 and 200 employees). Altogether, there are some 350 registered garment manufacturing firms in BiH.

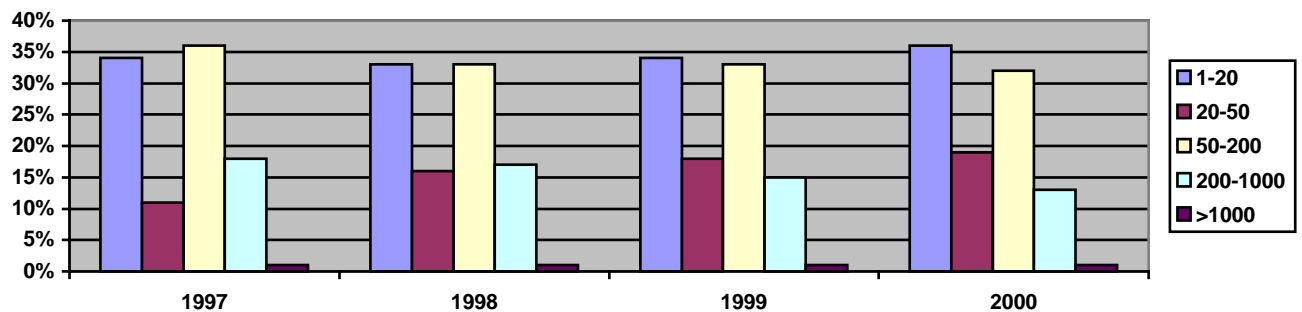
### Company structure in the clothing industry – the FBiH



### Company structure in the clothing industry – Republika Srpska



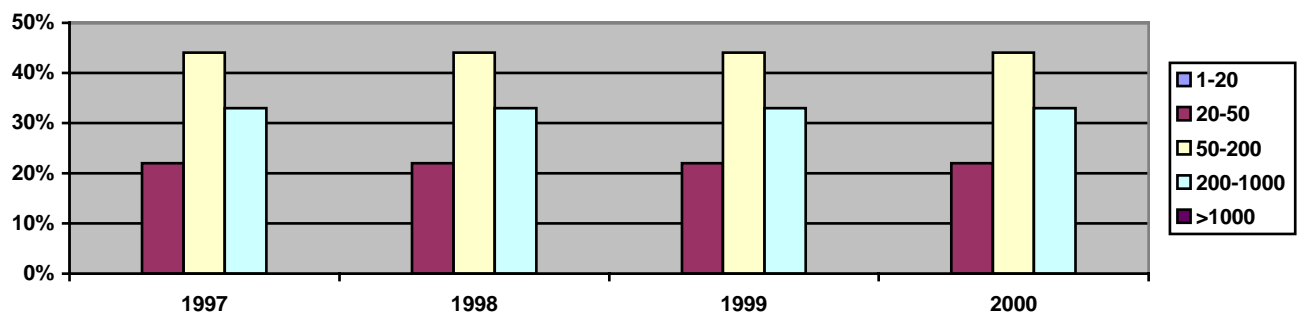
### Company structure in the clothing industry – all of BiH



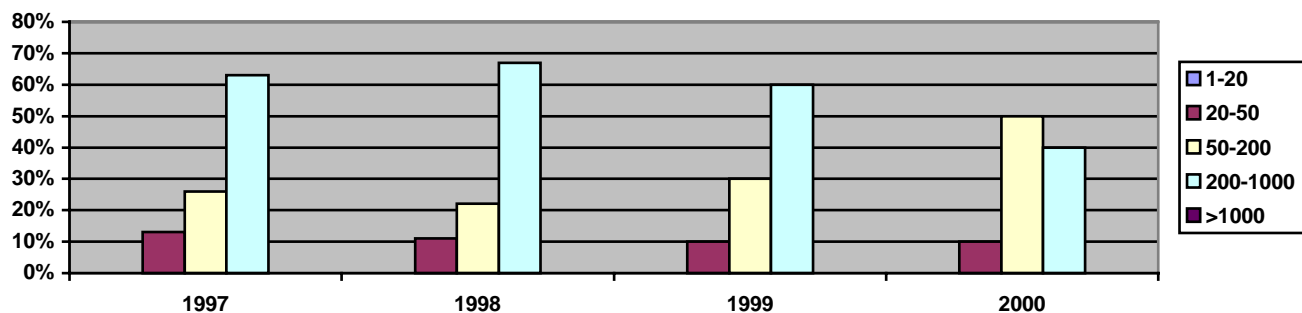
### Company structure in the textile industry

Medium-sized and larger companies with 50-1,000 employees form the backbone of the textile industry in BiH. The trend is increasingly towards companies employing up to 200 employees. However, the low number of textile business in BiH – around 20 – has to be taken into account in the analysis.

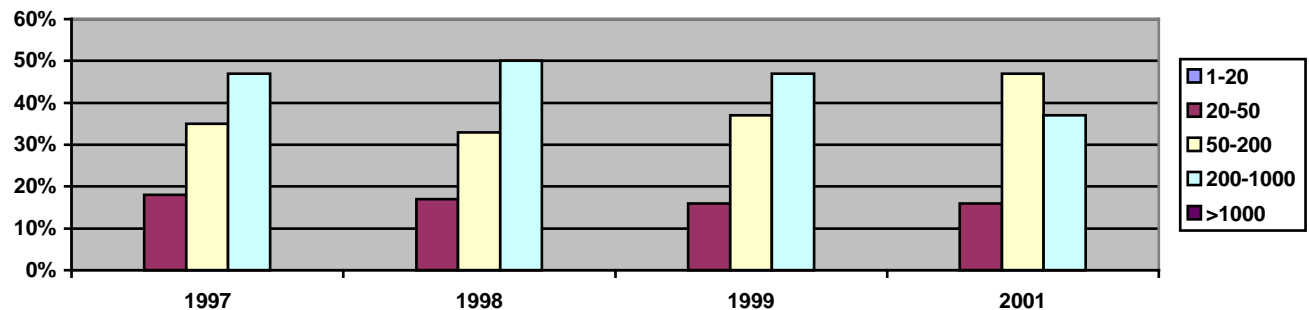
### Company structure in the textile industry – the FBiH



### Company structure in the textile industry – the RS



### Company structure in the textile industry – all of BiH (Businesses producing solely fabrics and yarn (no mixed textile + garment manufacturers))



Sources: Statistics offices of the RS and FBiH

### Development of direct investment in the clothing and textile sector

No reliable data is available on the growth of foreign direct investment (FDI) in the sector. Whatever the case, the level of FDI in BiH is very low in both absolute terms and in comparison to eastern European competitor countries. This is a clear consequence of the war and political events in the post-war period. It represents a substantial competitive disadvantage which is being exacerbated, for example, by hesitant privatisation.

### Foreign direct investment in BiH

	1997	1998	1999	2000
<b>Total, in million USD</b>	504	100	90	117*

\* Estimated

Source: EBRD

Discussions and surveys conducted for the present study have revealed a very low, indeed virtually insignificant, level of foreign direct investment in the clothing and textile sector. Credible estimates by companies working in the sector speak of a very low proportion of FDI. The figures only refer to the clothing industry. No direct investment worth mentioning seems to have been made in the textile industry.

### Estimated direct investment in the clothing industry in BiH 1997 – 2001

<b>Direct investment in 1997 – 2001 for the clothing industry overall:</b>	<b>3.0 mill. KM</b>
... share of the Federation	2.5 mill. KM
... share of the RS	0.5 mill. KM

The results of this survey show direct investment in the sector amounting to no more than 600 thousand KM/year and falling. These figures confirm the experience made in management consulting and in efforts to seek potential partners for BiH, in which apparently promising business talks with western European entrepreneurs have so far failed to bring any noteworthy foreign investment. The reasons for this are generally given as being the high investment risk and the uncertainty of the long-term success of investment; these are



the result of, in the view of potential investors, the prevailing economic and political situation in BiH, the current market situation in the region and in western Europe, as well as uncertainty as to the efficiency and reliability of business partners in BiH.

The Bosnian and Herzegovina clothing industry currently works almost exclusively for export – an estimated 90 per cent of total sales are exported. Overall, the clothing and textile industry in BiH is posting a massive negative balance of trade.

## 2.2 Geographical distribution

Studies from widely varying regions around the world have shown time and again that dynamic industrial growth is the logical result of industry clusters. We have therefore tried in this study to illustrate at least nascent industry clusters of clothing and textile companies.

### Geographical distribution of the textile and clothing industry in Bosnia and Herzegovina



Textile industry



Clothing industry

The companies of the textile and clothing industry are more or less evenly distributed between the RS and the FBiH. Taking the two sub-sectors together, 47 per cent of the businesses are located in the Federation and 53 per cent in the Republika Srpska. The textile industry businesses are traditionally raw material-based and are distributed across the entire country. However, a chart of geographical distribution can only provide a very approximate indication of a tendency towards industry clusters, and thus of possible starting points for cluster promotion.

The following two sub-sections provide data about the companies and the textile and clothing industry as a whole. They are based on an analysis of selected businesses working in the sector. The companies were selected according to their size (turnover and/or workforce size), or the specific features of their production ranges, and are intended to be a representative cross-section of the sector in BiH. They were not selected on the criterion of competitiveness. The choice of these businesses as examples should be viewed rather as the result of insufficient statistical data. For confidentiality reasons, the workforce figures are given in five size categories and the turnover figures, where available, in four size categories.

## 2.3 Textile industry (fabrics, yarns etc.)

### 2.3.1 Products

#### Fabrics and yarns – number of business units (incl. some mixed)

	1997	1998	1999	2000
<b>In BiH</b>				
<b>Spinning</b>	10	10	10	10
<b>Weaving</b>	11	11	11	11
<b>In the FBiH</b>				
<b>Spinning</b>	4	4	4	4
<b>Weaving</b>	5	5	5	5
<b>In the RS</b>				
<b>Spinning</b>	9	9	9	10
<b>Weaving</b>	5	5	5	6

Sources: statistical offices of the FBiH and the RS

#### Fabrics and yarns – workforce numbers in the FBiH

	1997	1998	1999	2000
<b>Spinning</b>	490	490	530	530
<b>Weaving</b>	450	495	535	570
<b>In the RS</b>				
<b>Spinning</b>	1,125	1,220	1,330	1,204
<b>Weaving</b>	790	840	868	850

(no figures available for the RS) -

Sources: Federal Office of Statistics BiH

### Other businesses in the textile industry – number of business units (incl. some mixed )

	1997	1998	1999	2000
<b>In BiH</b>				
<b>Knitwear</b>	11	11	11	11
<b>Carpet industry</b>	4	4	4	4
<b>Hosiery</b>	3	3	3	3
<b>In the FBiH</b>				
<b>Knitwear</b>	6	6	6	6
<b>Carpet industry</b>	2	2	2	2
<b>In the RS</b>				
<b>Knitwear</b>	67	70	74	72
<b>Carpet industry</b>	3	3	3	3
<b>Other</b>	7	9	9	12

Sources: statistical offices of the FBiH and the RS

### Other businesses in the textile industry – workforce numbers in the FBiH

	1997	1998	1999	2000
<b>In the FBiH</b>				
<b>Knitwear</b>	520	565	807	820
<b>Carpet industry</b>	-	-	-	-
<b>In the RS</b>				
<b>Knitwear</b>	5,350	5,667	6,142	5,240
<b>Carpet industry</b>	315	326	350	340
<b>Other</b>	430	483	510	517

Sources: statistical offices of the FBiH and RS

## 2.3.2 Companies

### Overview of major companies in the industry

	Company name	Sub-sector	Workforce	Ownership
1.	SANA, Novi Grad, RS	Knitwear, garment manufacture	over 1,000	State-owned
2.	BILECANKA, Bilece, RS	Carpet industry	over 1,000	State-owned
3.	KNE OPOLJKA, K. Dubica, RS	Weaving	200-1,000	State-owned
4.	VEZIONICA, Zvornik, RS	Knitting	200-1,000	State-owned
5.	TRIKO, Gradiska, RS	Knitwear, garment manufacture	200-1,000	State-owned
6.	DUBICANKA, K. Dubica, RS	Spinning	200-1,000	Private
7.	ITRIS, Srbac, RS	Knitwear	200-1,000	State-owned
8.	SVILA, Celinac, FBiH	Weaving	200-1,000	State-owned

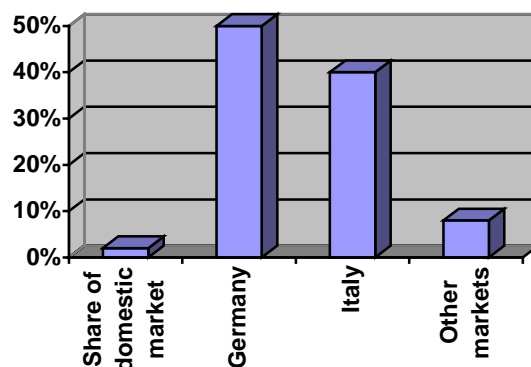
	Company name	Sub-sector	Workforce	Ownership
9.	BROTEKS, S.Brod, RS	Texturing	200-1,000	State-owned
10.	BELIRA, Banja Luka, RS	Texturing	200-1,000	State-owned

### 2.3.3 Structure of the sales markets of the textile industry

Analysis of the sales market structure underscores the lack of economic integration in the textile industry in BiH. Germany and Italy purchase 90 per cent of the FBiH's production. Bosnia and Herzegovina imports just under half of the RS' production. The RS textile businesses have a stronger regional network, that is, they work mainly with BiH and Serbia. This means that RS textile businesses have a relatively favourable starting position for efforts to raise sales through further regional and national market expansion, as they can at least build on existing business contacts and market knowledge.

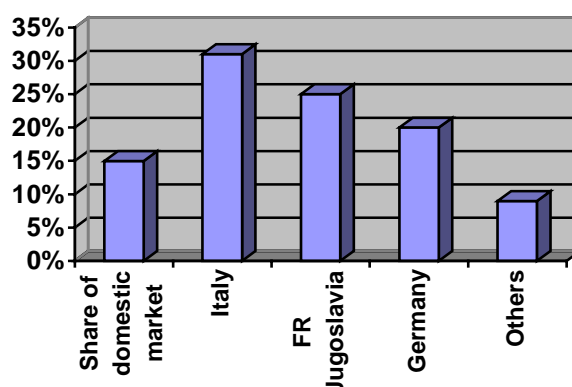
#### Structure of the sales markets of the Federation

Share of domestic market	Germany	Italy	Other
2%	50%	40%	8%



#### Structure of the sales markets of the RS

Share of domestic market	FR Yugoslavia	Italy	Germany	Other
15%	31%	25%	20%	9%



Sources: statistical offices of the FBiH and RS

### 2.3.4 State of technology and specific situation of the primary textile industry

In a typical Bosnian **cotton spinning mill**, (example TKM, basis: 3-cylinder ring-spinning mill), labour costs account for just under 50 per cent of all value-added costs (excluding depreciation and equipment). In a typical German cotton spinning mill (of similar size and product mix), this parameter rarely exceeds the 30 per cent mark. In Germany, for example, high per capita labour costs are more than offset by higher productivity. However, this difference is irrelevant when judging competitiveness. The costs of capital are virtually prohibitive: while a German spinning mill can easily obtain long-term loans for around 6 per cent a year, Bosnian borrowers frequently pay three times as much, and sometimes over 20 per cent, despite the fixed convertible mark. Before depreciation and interest, Bosnian spinning mills are competitive. This statement applies primarily to carded-cotton spinning mills.

Neither are labour costs relevant in judging the competitiveness of **weaving mills** (example: Livtex, basis: fully integrated cloth factory). Labour cost advantages do not result in overall cost advantages because – as in the spinning trade – any labour cost advantages are more than absorbed by residual costs (primarily cost of capital). The strategy of relocating production, which works so well for garment manufacture, is therefore unattractive to western European weaving firms, as any labour cost savings that could be made in BiH would be more than offset by high capital investment costs.

The impact of restrictive and protective regulations imposed by the industrialised states – which do not affect the outward processing which is currently widespread in garment manufacture – also has to be taken into account when judging the competitiveness of the primary textile industry. The absence of certification of origin for Bosnian semi-finished products has a particularly negative impact on trade.

Management is especially lacking in the following:

- Skills in opening up markets and an awareness of service concepts
- Costing and cost accounting skills
- Knowledge of how to generate cash flow, and how to finance working capital and investment needs.

While the clothing industry secures at least some jobs thanks to contract orders (however little impact these have economically), the capital-intensive primary textile industry (yarn and fabric manufacture) has been hit even harder by the withdrawal of investment over the past decade as a result of the war. A vertical structure, as was customary in many other countries, with the primary textile manufacturers supplying mainly domestic garment manufacturers in what is now Bosnia and Herzegovina, did not exist; instead, there was a strong focus on export owing to the division of labour in the former Yugoslavia. In addition, demand for local textile products was small as the sector was strongly geared to contract work. This "horizontal" industrial concept was successful economically, as the primary textile companies received relatively generous state funding and were thus able to supply high-quality standard articles on the international markets. Former Yugoslavian companies always ranked among the most competitive on the markets of today's transformation states. Yugoslavian spinning

and weaving mills enjoyed an outstanding reputation worldwide because they were extremely well equipped technologically; the quality of their products virtually matched western standards. These particular competitive advantages can no longer be used as an argument today when approaching potential investors because – and this is especially true of the FBiH – relations with the markets, i.e. with business contacts, have been severed and, even more importantly, there is no money to maintain and modernise businesses' capital stock.

As the western European countries and especially the USA protect their domestic primary textile companies to a large extent, the administrative obstacles to inter-state trade (for which clearly defined regulations exist for the garment manufacturing industry) are exacerbated by customs and quota barriers and, first and foremost, the lack of certification of origin. These requirements also hinder the contract work practised in garment manufacturing which provides a means of raising capacity use and thus of generating cash flow in the short term, which businesses can then use to gradually modernise.

### **2.3.5 Materials, findings and accessories: specialised service providers**

Bosnia and Herzegovina currently has neither the relevant accessory manufacturers nor specialised service providers. The sector unfortunately also lacks access to modern fabrics and materials. Owing to the earlier focus of the industry as described above, networking within the industry, with downstream production levels and specialised service providers, is low.

Raw materials and the necessary chemicals (viscose, polyester, polyamide, polypropylene, etc.) as well as all types of dyes are imported from western Europe (primarily from Germany, Italy and Switzerland).

The logistics and transportation sector still lacks professionalism; that is, there is no consistent procurement and distribution management system.

## **2.4 Clothing industry**

### **2.4.1 Products**

The available detailed data on the number of business units and employees, and therefore on the structure of the sector, cover only selected products, mainly heavy garment manufacturing, light garment manufacturing, children's clothes and leisure clothes, in the Federation. The structure of the clothing industry has remained more or less unchanged in recent years, indicating low level stagnation. The same also applies to the other sub-sectors of the industry, no details of which are supplied here.



### Number of business units in selected sub-sectors in the Federation

	1997	1998	1999	2000
<b>Heavy garment manuf.</b>	80	85	92	98
<b>Light garment manuf.</b>	40	45	47	48
<b>Children's clothes</b>	15	17	21	22
<b>Leisure clothes</b>	2	4	4	4

Sources: statistical offices of the FBiH and RS

### Number of employees in selected sub-sectors in the Federation

	1997	1998	1999	2000
<b>Heavy garment manuf.</b>	16,850	19,700	19,390	20,250
<b>Light garment manuf.</b>	8,470	8,960	9,120	10,050
<b>Children's clothes</b>	3,152	3,200	3,130	820
<b>Leisure clothes</b>	428	640	650	820

Sources: statistical offices of the FBiH and RS

## 2.4.2 Companies

### Table of major companies in the industry

Company	Town, entity	Sub-sector	No. of employees	Turnover in 2000 (in mill. KM)	Ownership
BORAC	PRIJEDOR, RS	Heavy garment manufacture	over 1,000	5,000-10,000	State
NOVOTEK S	TREBINJE, RS	Garment manufacture	over 1,000	5,000-10,000	Joint stock company
KULA	GRADACAC, FBiH	Garment manufacture	200-1,000	5,000-10,000	Private
MLADOST	M. GRAD, FBiH	Garment manufacture	200-1,000	-	State
BLIK	BANJA LUKA, RS	Heavy garment manufacture	200-1,000	-	State
ITRIS	SRBAC, RS	Men's underwear	200-1,000	-	State
SANA LINEA	S. KOSTAJNICA, RS	Light garment manufacture	200-1,000	-	State
TRIKO	GRADISKA, RS	Sports clothes	200-1,000	1,000-5,000	State
TIM	MOSTAR, FBiH	Protective clothing	50-199	under 1,000	State
EXCLUSIV	BANJA LUKA,	Women's	20-49	under 1,000	Private



COM	RS	underwear			
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- = no figures available

### 2.4.3 Structure of the sales markets in the clothing industry

Italy and Germany are by far the most important sales markets for the FBIH. This makes the Federation in particular extremely dependent on the development of business relations with partners from the West. By contrast, the sales market structure of the RS is much more diverse, although Germany and Italy still buy some 40 per cent of this entity's products. Serbia and Montenegro are major export markets for both the clothing industry and the textile industry.

#### Structure of the sales markets of the Federation

Share of domestic market	Italy	Germany	Other
2%	51%	41%	3%

#### Structure of the sales markets of the RS

Share of domestic market	FR Yugoslavia	Germany	Italy	Other
12%	28%	32%	18%	10%

Sources: statistical offices of the FBIH and RS

### 2.4.4 State of technology, managerial skills

The machinery and equipment in BiH are generally ten years out of date but in good condition. The low level of automation in the clothing industry is offset by a large input of human resources, for example in cutting and ironing.

Because of the high labour costs – one workplace costs several thousand KM – wage levels are the most important competitive factor. However, it is not the absolute cost of labour that is decisive for planned investment, but unit labour costs, which are calculated by multiplying labour costs by productivity. Unit costs vary from company to company, depending on product and quality, by +/-25-30 per cent. Unit costs could be substantially improved if companies were able to offer additional production stages, with the aid of flat-knitting technology, for example (better materials flow, shorter lead times, faster concept-to-product times).

#### Example: Comparison of unit labour costs in garment manufacturing

Country	Gross labour costs	Productivity	Unit labour costs
BiH	3 KM / hour	0.75 production-hours/unit	2.25 KM/unit
Germany	30 KM / hour	0.35 production-hours/unit	10.50 KM /unit

Source Federal Statistical Office and own calculations

The key problems and shortcomings of management in clothing companies are in the following fields:

- Marketing and sales
- Knowledge of market development and trends
- Costing
- Internal organisation and process optimisation.

Design and creation departments are rare, and if they do exist, they lack a market focus and market culture.

## **2.5 Meso level**

### **2.5.1 Training establishments and specialised service providers**

There are very few basic or advanced training opportunities for the clothing and textiles sector in BiH. The universities and technical colleges run no basic courses in textile engineering or design, for example, nor any specialised courses in specific subject areas, such as textile marketing. Zagreb University (in Croatia) was formerly *the* place for training in technology and textile engineering. Even today, it is still the closest location for BiH students, especially those from the Federation. One university in Ljubljana (Slovenia) offers a design course. Otherwise, students have to travel to Italy, Germany or France.

It is therefore difficult to find recruits qualified for the textile sector. The sector as a whole is suffering from a lack of dynamic, skilled new employees. For highly qualified prospective employees, the clothing industry is an unattractive employment sector. It is difficult to find skilled workers in BiH even at the shop-floor level, (seamstresses, cutters, etc.). Employees are usually trained on the production line.

Although "specialised" courses exist in Sarajevo, Tuzla and Mostar, they attract few students and have little equipment at their disposal. The textile design faculty of the Academy of Arts in Sarajevo offers sector-related training, but this does not include training in the CAD/CAM techniques acknowledged and accepted by the industry, and there are no testing facilities. The result is a lack of basic, specialised services, and thus of industry-specific service providers. As the materials and accessories are purchased primarily abroad and the domestic textile industry supplies little fabric, there is little networking within the industry in the country.

### 2.5.2 Chambers of commerce and industry associations

The chamber network in BiH is sub-divided into five regional chambers in the RS, ten regional chambers in the FBiH, one chamber for each entity and one national chamber, which is to be developed into one foreign trade chamber. The chambers function as

- representatives of the interests of Bosnian companies at the political level
- providers of information about market and technology developments both nationally and internationally
- mediators and arbitrators within the economic sector
- employers' associations, with the corresponding functions regarding collective pay agreement drafting, etc.
- service providers, particularly in the fields of basic and advanced training, trade fair visits and attendance's, and making business contacts.

Many chamber representatives make no distinction between the work of the chamber and the work of the association, and accordingly do not see the development of associations as a primary task in the further development of viable cross-company structures at the meso level.

The textile sector is represented in the various chambers by a functional and sectoral sub-division of the work areas and responsibilities. A special feature in BiH is the split in the chambers between the two entities, with two overall chambers – reflecting the continuing two-way split in the economic area of BiH, restricting the opportunities for successful business with international partners.

The range of services offered, customer focus, and the personnel and training situation of the various regional chambers vary widely in BiH. As a result, it is not possible to provide a consistent picture of the efficiency and quality of the chamber of commerce structure. However, the standing of the chambers of commerce with the business community is generally not high, in particular with private SMEs. These are not convinced of the efficiency of these institutions, and in many cases take the view that necessary structural changes in the textile industry of BiH are not sufficiently supported by the chambers. Conversely, it is unclear to many chamber representatives why companies do not make greater use of the services of the chambers and why they are only prepared in a few cases to enlist the help of the chambers of commerce to jointly tackle issues or conduct activities of common interest.

In the meantime, there is evidence of some initial private attempts to foster the creation of interest groups and associations for specific fields, in addition to the chamber system.

## 2.6 Product input/output matrix in the clothing industry

It is impossible to conduct a consistent input/output analysis for the clothing industry in BiH, as the available statistical data is incomplete. It should also be pointed out that there is a high proportion of unofficial economic activity in BiH, so that the results of an input/output analysis based on official statistical data are not very meaningful. Moreover, the statistical data only shows some of the economic interrelationships, as these are partly based on non-monetary bartering which is difficult to evaluate. For this reason, the present analysis was conducted on the basis of a regional qualitative input/output matrix.

The input/output matrix underscores the difficulty experienced by clothing businesses in BiH, which have to import many pre-products from other – high-cost – countries to remain competitive, given the materials that go into production. The result is a segmentation of the market owing to the low level of integration of the domestic industry. The potential for rationalisation, which could be generated if the companies in one region were to bundle specific activities, is not exploited. As the companies do not work much together, although they know everything about their competitors in their own country they do not make sufficient use of opportunities for forming procurement and/or sales partnerships, or combining certain production stages. For example, they could make greater use of subcontractor firms at peak production times if the latter were more strongly and lastingly integrated into the company network.

BiH companies act as "satellites" in the international division of labour: they have "radio contact" with remote (and changing) customers and, as a result, less contact with neighbouring "satellites", that is clothing companies, in their own country. The local market plays no binding role; repercussions for the local market are frequently limited to informal business which, by its very nature, prevents the creation of a formal domestic trading system (see also the following chapter).

### Input/output integration in the clothing industry in BiH – qualitative overview

<b>Germany</b>	<b>Italy</b>	<b>BiH</b>	<b>TURKEY</b>	<b>SWITZERLAND</b>
<ul style="list-style-type: none"> <li>▪ Fabric, yarns</li> <li>▪ Chemicals (cf. 2.3)</li> <li>▪ Misc. raw materials</li> <li>▪ OP orders (cf. 1.3)</li> <li>▪ Accessories</li> </ul>	<ul style="list-style-type: none"> <li>▪ Fabric, yarns</li> <li>▪ Misc. raw materials</li> <li>▪ OP orders (cf. 1.3)</li> <li>▪ Accessories</li> </ul>	<ul style="list-style-type: none"> <li>▪ Misc. raw materials</li> </ul>	<ul style="list-style-type: none"> <li>▪ fabric, yarns</li> </ul>	<ul style="list-style-type: none"> <li>▪ Chemicals (cf. 2.3)</li> <li>▪ Dyes</li> </ul>

### SUPPLIERS



### MARKETS

<b>GERMANY</b>	<b>ITALY</b>	<b>BiH</b>	<b>FR Yugoslavia</b>	<b>Other</b>
<ul style="list-style-type: none"> <li>▪ Outward processing</li> </ul>	<ul style="list-style-type: none"> <li>▪ Outward processing</li> </ul>	<ul style="list-style-type: none"> <li>▪ House collections</li> </ul>	<ul style="list-style-type: none"> <li>▪ House collections</li> </ul>	<ul style="list-style-type: none"> <li>▪ Outward processing</li> <li>▪ House collections</li> </ul>

## **2.7 Trading systems**

### **2.7.1 Domestic trade**

One cannot talk of a trading system in BiH. No control is exercised over the distribution channels and no consistent distribution system exists. Trade missions are rare, and the role of "sales organisation" within the companies is assumed, if at all, by the management. Retailer sources are rarely transparent and the tax authorities exercise little control. As mentioned above, the black market is flourishing (30 to 50 per cent of turnover in the sector). The remaining state-owned companies mainly use their own shops as sales outlets, but with little success (poor presentation, questionable motivation, unsuitable merchandise, etc.).

As illustrated in the input/output integration chart, BiH has a very strong focus on outward processing for EU companies.

### **2.7.2 Trade with the EU**

EU quotas on outward processing were abolished on April 1<sup>st</sup>, 2001. This removed the final obstacles to trade, permitting the international exchange of goods free from administrative and customs restrictions. When the quota system was in force, it occasionally happened that orders were not completed, even though the overall quota limits were not reached, because customers did not have their "own" quotas. The abolition of quotas in BiH has only brought improvements in a few isolated cases; quota limits were rarely attained in any case.

No certificate of origin is required for outward processing. The EU no longer classifies apparel as "protection-worthy" because of the industry's labour intensity – garment manufacturing does not tie up any valuable workplaces.

Quotas for the primary sector were also abolished on April 1, 2001, but the lack of EU certification of origin restricts the export of yarns and fabrics. This means that customs duty has to be paid on these semi-finished products when they are processed outside the EU. Because of their high capital intensity, the EU views yarns, weaves and knits as "protection-worthy". As the share of non-EU production in garments is over 90 per cent, the certificate of origin system is a highly effective means of protection. It is not easy to bypass this system, for example, in the case of articles with lower non-EU production (underwear, flat-knit articles, knitwear articles). This is opening up niche opportunities for BiH businesses, for example for cotton yarns, as exports of this are not limited by the EU certificate of origin regulations.

However, the abolition of quotas has only had a theoretical impact on the flow of goods and opportunities for expansion. In the past, quotas were rarely attained – only 6 per cent of the quotas for cotton yarns were actually used, for example, despite the niche market potential.

### **3. Market opportunities**

#### **3.1 National market**

As already illustrated, there is currently no clearly structured, transparent national market in BiH. Purchasing power in BiH is still very weak. According to estimates by various industry experts, the actual sales market for BiH's clothing industry encompasses around 2 per cent of the population, that is, domestically manufactured products are purchased by some 70,000 customers. In terms of purchasing power per inhabitant in BiH, this gives an absolute market value comparable with that of a West German town of 300,000 inhabitants. Added to this, the section of the population with purchasing power and an interest in fashion tends to buy western fashions and products, partly because of the lack of comparable domestic products. Considering that some 15 per cent of BiH imports are of clothing and textile products, the domestic market potential could be substantially raised if fashion products from Bosnia and Herzegovina were to have a quality, trendy image. By way of comparison, clothes imports in more highly developed economies are generally between 2.5 and 5 per cent.

Another aspect is that the economic relations between the two entities are still in the development stage and are gradually being normalised. At the initiative of the chambers of commerce, for example, they are increasingly tending to look for overall solutions or arrangements. This is particularly true of the Republika Srpska, which was formerly very strongly focused on Serbia as a sales market, but is now being forced to explore new paths and open up to the FBiH.

The share of the black market in BiH is estimated at as much as 30 per cent, which is viewed by many players in the sector as a substantial obstacle to the development of a domestic market. Even today, little is being done to protect the domestic market. If the authorities succeeded in redefining and reorganising the trade structures and in further "formalising", there would doubtless be opportunities for local industry to develop. A black market with a 30 per cent market share means annual turnover losses of some 120 million KM. Moreover, the situation in neighbouring countries is the same: key indicators of this are a low domestic market share (10 per cent maximum) and a similar share of purchased smuggled goods. There is a general lack of "clean" distribution channels (including wholesalers), trade missions and sales departments in companies. State-owned companies usually use direct distribution channels, but the turnover they earn tends to be very low as their offerings are viewed as unattractive by the market.

The primary textile industry needs to restructure and to gear its offerings to a western market and western standards. At the moment, the clothing industry still purchases most of its fabrics abroad. For this reason, it is impossible to talk of a local market as yet.

### 3.2 Regional market

The recent history of BiH and the region as a whole has had a severely detrimental effect on trade within south-eastern Europe. In 1999, BiH saw its foreign trade largely collapse, mainly owing to the loss of its main trading partner, Yugoslavia, which accounted for some 80 per cent of BiH exports in 1998. This effect was even stronger in RS: In 1999, exports to Yugoslavia fell by half, to 43 per cent. Obstacles also exist in infrastructure problems resulting from the war and in bureaucratic processes. The existing customs and non-tariff trade regulations within the region have also raised the costs of intra-regional exports.

#### Background conditions of regional trade

FR YUGOSLAVIA	CROATIA
<ul style="list-style-type: none"> <li>• 10 per cent customs duty on all goods except pharmaceutical products, milk, fats and oils, as well as medical equipment.</li> <li>• 15 per cent sales tax. As Montenegro is trying to separate from the FR Yugoslavia, additional customs regulations are expected to be introduced.</li> </ul>	<ul style="list-style-type: none"> <li>• Customs duty averages 6 per cent. The maximum is 18 per cent.</li> <li>• The harmonised EU system exists here, as in BiH.</li> <li>• Existence of duty-free zones, including Zagreb and Rijeka (duty-free port).</li> <li>• Quotas are imposed on around 8 per cent of imported goods.</li> </ul>

It should be pointed out that the foreign trade difficulties facing the other south-eastern European countries are largely similar. The absence of or delays in structural reform and privatisation are preventing industry from becoming internationally competitive. Since the end of the war, trade flows have changed direction in eastern Europe, the EU having taken over the role of prime importer. At the same time, additional customs clearance posts have been set up at the new national borders. These bottlenecks are leading to long waits at border crossing points, rising transport and trade costs which are increasingly incalculable, and falling customs revenues, as well as smuggling and corruption. The direct consequence of this has been a dramatic fall in trade volume, either owing to high costs, or else a diversion of trade, both of which have lowered the attractiveness of these countries as trading partners.

In this context, the TFFSE project (*Trade and Transport Facilitation in Southeast Europe*) and the international donor community have an important role to play as catalysts in implementing measures for promoting trade in south-eastern Europe by means of aid programmes – especially as regards the reconstruction of an efficient transport infrastructure. Moreover, at the political level every effort has to be put into making the former Yugoslavia a free trade zone. This would greatly enhance regional market opportunities for the textile and clothing industry.

The future market potential for BiH companies is especially evident in Slovenia, Croatia and Serbia. A scale of values based on an industry-wide estimation of the BiH's competitiveness and its attractiveness for investors, as well as anticipated market developments in the respective target countries, clearly shows the relative market potential that the various regional markets represent for BiH (1: very good, 2: good, 3: good in principle, 4: only partial, 5: virtually none and 6: none).



### Anticipated future sales potential for BiH's clothing industry in former Yugoslavia

	1	2	3	4	5	6
SLOVENIA		X				
CROATIA		X				
SERBIA			X			
MACEDONIA				X?		
KOSOVO						X

Evaluation based on potential political and social stability, economic development, potential growth of market share, possible distribution channels and planned communications routes (infrastructure and logistics).

Companies in the region focus mainly on outward processing (ready-to-sell business in the case of Slovenia) in the EU. They do not have sufficient capacity to cover rising domestic demand. The countries in the region spend around 5 per cent a year of their total import revenues on finished textile goods and shoes. Textile products (mainly clothing) represent around one half, that is, some 2.5 per cent of this. 40 to 50 per cent of these products are from the EU, primarily Germany.

### Import volumes in the region

	1995	1996	1997	1998	1999
SLOVENIA	9,492	9,421	9,366	10,111	9,954
CROATIA	7,500	7,800	9,100	8,400	7,800
FR YUGOSLAVIA	2,666	4,102	4,826	4,849	3,296
MACEDONIA	1,718	1,626	1,778	1,913	1,990

Sources: various national statistical offices – figures in millions of USD

Multiplying total imports by the 2.5 per cent of finished textile imports gives a total volume of clothing imports into these countries of some 575 million USD. Here again, if investors were to combat black-market imports together with BiH (these represent around 30 per cent of the total turnover for the sector), additional market potential of around 3 billion KM would be created. A target market share of 5 per cent for BiH in the next three years would mean a potential market worth as much as 150 million KM. If, in addition to this, a new "regional" image were created, it would also be possible to win additional market share in relation to western imports, thus further raising BiH's market potential.

### 3.3 The eastern European market

The eastern European market holds short, medium and long term potential for the Bosnian textile and clothing industry. The latest market studies show that the market and consumer potential here, as well as the existing distribution, logistics and retail networks (from the sales perspective), can be classified from satisfactory to very good. Assuming that the rethink by local industry proposed in the present study actually takes place, the markets of Poland, the Czech Republic and Hungary will be highly interesting for the clothing sector in particular (upper middle to top price segment), as well as those of Russia and Romania.

It should therefore be kept in mind, when introducing aid measures for the sector, that Bosnian companies are stepping up their efforts to build and broaden their economic relations with eastern European countries, whether in the form of partnerships with local sales partners (agents, importers) or through participation in trade fairs.

Poland, Hungary, the Czech Republic and the Baltic countries represent promising markets for the BiH clothing industry in eastern Europe because they have populations with comparatively high purchasing power, while various other factors (e.g. geographical proximity, fashion preferences, economic development perspectives, existing distribution channels) make them potentially interesting targets for BiH exporters.

### Future market potential for Bosnia's clothing industry in eastern Europe\*

	1	2	3	4	5	6
POLAND	X					
HUNGARY		X				
CZECH REPUBLIC		X				
SLOVAKIA				X		
ROMANIA			X			
BULGARIA						X
BALTIC STATES		X				
UKRAINE				X		
RUSSIA					X	

\* Evaluation based on potential political and social stability, economic development, potential growth of market share, possible distribution channels and planned communications routes (infrastructure and logistics).

Scale of values (market potential 1: very good, 2: good, 3: good in principle, 4: only partial, 5: virtually none and 6: none)

An approximately 2.5 per cent market share for BiH's companies in the eastern European clothing market (excluding the former Yugoslavia) would correspond to a business volume of around 140 million KM.

### 3.3.1 Hungary

Hungary's domestic market is an interesting one for BiH, particularly for textiles, not least because of its high political stability, its generally sound economic development, well-developed distribution and logistics networks and, above all, its strong purchasing power compared with the rest of the region. Hungary is therefore a promising future destination for Bosnian goods. With some 11 million inhabitants and GDP at more than 50,000 USD, Hungary has obvious potential as a market for the clothing sector.

The following formula gives a realistic estimate of the market potential for BiH:

No. of inhabitants x 20% (target group: middle level) x 2.5% market share x 500 KM\* (per capita annual turnover)

\* Realistic flat-rate calculation: on average around 4% of consumers' annual budgets is spent on clothing in the eastern European countries annually (average 6 per cent worldwide, see chapter 1, *Trends*)

The resulting market potential for BiH in Hungary is 27.5 million KM

Overall, Hungary is currently a relatively unimportant trade partner for Bosnia, only accounting for 0.1 per cent of exports and 5 per cent of imports.

### **3.3.2 Bulgaria**

With GDP at just under 13,333 million euros for 8.3 million inhabitants, Bulgaria is a more relevant trade partner for BiH.

The following formula gives a realistic estimate of the market potential for BiH:

No. of inhabitants x 20% (target group: middle level) x 2.5% market share x 118 KM\* (per capita annual turnover)

\* Realistic flat-rate calculation: on average around 4% of consumers' budgets is spent on clothing in the eastern European countries annually (average 6 per cent worldwide, see chapter 1, *Trends*)

The resulting market potential for BiH in Bulgaria is just under 10 million KM.

### **3.3.3 Romania**

A weak local market and low purchasing power (below middle level) mean that Romania has little potential as a market for BiH (22.5 million inhabitants and a GDP of around 33,000 million USD in 1999).

The following formula gives a realistic estimate of the market potential this country represents for BiH:

No. of inhabitants x 5% (target group: middle level) x 2.5% market share x 48 KM\* (per capita annual turnover)

\* Realistic flat-rate calculation: on average around 4% of consumers' budgets is spent on clothing in the eastern European countries annually (average 6 per cent worldwide, see chapter 1, *Trends*)

The resulting market potential for BiH in Romania is around 1.4 million KM.

### **3.3.4 Czech Republic and Slovakia**

The future potential for BiH in these markets is high. In 1999 GDP in the Czech Republic stood at more than 53,000 million USD (for over 10 million inhabitants).

The following formula gives a realistic estimate of the market potential for BiH:

No. of inhabitants x 20% (target group: middle level) x 2.5% market share x 500 KM\* (per-capita annual turnover)

\* Realistic flat-rate calculation: on average around 4% of consumers' budgets is spent on clothing in the eastern European countries annually (average 6 per cent worldwide, see chapter 1, *Trends*)

The resulting market potential for BiH in the Czech Republic/Slovenia is 12.5 million KM.

### 3.4 The EU

The EU is fostering trade with BiH by maintaining unilateral preferential trade relations with it. The EU remains the country's most important trading partner.

This apparently favourable situation seems to be worsening from a medium and long-term perspective. Although demand for imports manufactured under contract is rising, especially in Germany, there is a strong shift in capacity away from "classic" production locations like Poland (where labour and production costs are rising) to countries like Romania, Bulgaria and, recently, the Ukraine and Belarus. The price war in the low-level range (nearly 80 per cent of outward processing orders) is forcing the leading customers in western Europe to turn more towards "cheap" countries – which, in this context, does not include Bosnia and Herzegovina. It is therefore likely that BiH will lose numerous low-level contracts in the next two years and – as in other "OP countries" working in the mid-level range – a strong decline in the volume of orders is to be anticipated in the medium and especially the long term. In other words, the EU as a sales market should be viewed rather in terms of market risk than market opportunities.

<b>Germany's contract manufacturing partners (in mill. KM) – 1999/2000</b>				
	<b>1999</b>	<b>2000</b>	<b>% change</b>	<b>% share</b>
Poland	1616	1540	-4.7	18.2
Romania	1367	1410	+3.2	16.7
Tunisia	674	624	-7.4	7.4
Czech Republic	458	487	+6.3	5.8
Hungary	416	376	-9.6	4.4
Slovenia	390	368	-5.6	4.4
Ukraine	297	348	+17.2	4.1
Slovakia	278	341	+22.7	4
Croatia	358	326	-8.9	3.9
Turkey	317	314	-1	3.7
Bulgaria	255	281	+10.2	3.3
Macedonia	257	260	+1.2	3.1
Morocco	263	222	-15.6	2.6
Lithuania	215	200	-7	2.4
Russia	135	130	-3.7	1.5
Belarus	60	66	+1	0.8
Other	1256	1168	-7	13.8

Source: Federal Office for Industry, Eschborn 2001

Increasing use is also being made of production capacity in south-eastern Asia (especially China), using regional fabrics and materials (Hong Kong, Japan), in what is known as the "ready-to-use" business. The strong downward trend in the former Yugoslavia will also affect BiH (cf. Slovenia, Croatia). The importance of the "classic" contract production countries of eastern Europe is therefore likely to decline progressively.

### **3.5 Competitors and benchmarking**

In analysing BiH's competitors, a distinction has to be drawn between:

- Competitors in the very short-term (within the next two years)
- Competitors in the medium-term.

It would be a serious strategic mistake to compare BiH with other eastern European countries in the long term. In the very short term, the key competitors are primarily contract manufacturing countries who currently share low-level German and Italian contracts with BiH, such as Bulgaria, Romania, the Ukraine, Poland and the Czech Republic. If it were to move up to the medium-level range, BiH would be competing for contracts with Greece, Spain, Portugal, Morocco and Egypt. Like Croatia and Macedonia, BiH will be unattractive to western partners in the medium and long term because of rising production prices (wages), uncertainty as to future political developments, and insufficient prospects for ready-to-sell business.

As for the companies' house collections, it is extremely difficult to name individual competitors, as each product offering appeals to the subjective instincts of customers. Turkey and Italy, the outright leaders on the western European market, spring to mind in this area.

BiH's main textile industry competitors (fabric, yarns, etc.) are still Italy, Turkey and Germany, owing to the higher quality of their products.

As in BiH, contract manufacturing is also predominant in eastern Europe. Experts estimate that eastern Europe's share in western European clothes imports is as high as 90 per cent. The eastern European states are also increasingly becoming one of the principal sourcing markets for EU ready-to-sell contract customers, and hence attempting to offset the drain of outward processing orders, to set up longer-term partnerships, and at the same time to raise companies' value added. There are wide divergences here from country to country, and these have to be taken into account when considering the eastern European states as BiH's competitors. The main features of the various locations and the types of competition are listed below for selected competitor countries.

## Overview of cooperation forms in eastern Europe

Form of cooperation	Type and scope of production
Simple outward processing – OP business	<ul style="list-style-type: none"> <li>• Assembly – cut, sew, iron, finish, package</li> </ul>
Extended OP business – cut, make, trim	<ul style="list-style-type: none"> <li>• Assembly (see above)</li> <li>• Procurement of materials</li> </ul>
Extended OP business – ready-to-use	<ul style="list-style-type: none"> <li>• Assembly (see above)</li> <li>• Procurement of materials (see above)</li> <li>• Procurement of fabrics, yarns, etc.</li> </ul>
Full-service OP business – ready-to-sell	<ul style="list-style-type: none"> <li>• Assembly (see above)</li> <li>• Procurement of materials (see above)</li> <li>• Procurement of fabrics, yarns etc. (see above)</li> <li>• Basic product development</li> </ul>
Collection	<ul style="list-style-type: none"> <li>• Assembly (see above)</li> <li>• Procurement of materials (see above)</li> <li>• Procurement of fabrics, yarns etc. (see above)</li> <li>• Development of collections</li> <li>• Product marketing and distribution</li> </ul>

## Comparative estimate of eastern Europe's potential as a service provider to the clothing industry

Country	Partnership criteria				
	Wages/price level	Production know-how/equipment	Reliability of delivery	Procurement situation	Communications and handling
<b>Bosnia and Herzegovina*</b>	<b>C</b>	<b>B</b>	<b>B</b>	<b>D</b>	<b>B</b>
Poland	C	A	A	C	A
Hungary	D	A	A	D	A
Czech Republic	C	B	A	D	A
Slovakia	C	B	B	D	A
Slovenia	D	B	B	D	A
Macedonia	C	B	B	D	C
Romania	B	B	B	B	B
Bulgaria*	B	C	B	C	C
Baltic states	B	B	B	B	B
Ukraine	A	C	C	D	D
Russia	A	C	C	B	D

Based on: Corporate Solution, "Bekleidung in Osteuropa, Market Guide 2001"; own estimates

\*Estimate by authors of study

\*\*Evaluation criteria: A: very low, B: low, C: rather high, D: high

\*\*\*Evaluation criteria: A: very good B: good, C: rather bad, D: bad

### 3.5.1 Hungary

Despite continuing high inflation and unemployment, the situation in Hungary is considerably better than in most of the other eastern European countries. Since 1990, the country has been able to build up its economy without any political setbacks. There is no supporting textile industry in Hungary, and wage and price levels are becoming less attractive for ready-to-sell business with the EU. Clothes exports to Germany, for example, stood at around 770 million KM in 1999, with a downward tendency. There has been a similar decline in contract manufacturing business.

Comparative competitive strengths	Comparative competitive weaknesses
↑ Generally sound economic growth and rising purchasing power	↓ Virtually no supporting textile industry, resulting in high prices for ready-to-sell business
↑ Approach and imminent accession to the EU	↓ Falling competitiveness for contract manufacturing
↑ Good potential for the development of house collections	

### 3.5.2 Bulgaria

Unlike Hungary, Bulgaria is a traditional textile-producing country. Besides infrastructure problems for transportation and logistics and its relative distance from the EU markets, the country also suffers from insufficient quality and supply of fabrics and yarns, and needs to invest heavily in machinery and production technology. It looks very likely that Bulgaria will be forced to concentrate on low-level contract manufacturing in the medium term, and should therefore not be viewed as a direct competitor of BiH for quite some time.

Comparative competitive strengths	Comparative competitive weaknesses
↑ Quality and availability of fabrics could be improved	↓ Need for heavy investment in the sector (machinery, employee training)
↑ Stable political situation	↓ Distance from EU markets and poor infrastructure in places

Bulgaria's principal trading partners are Russia and Germany, but the trade balance is extremely unfavourable: 4.8 per cent exports against 20.6 per cent imports with Russia, and 9.9 per cent exports against 15 per cent imports with Germany. With GDP at just under 12,000 million USD for 8.3 million inhabitants, Bulgaria is not a suitable partner for BiH.

### 3.5.3 Romania

The situation and outlook are slightly different here, even though Romania cannot be regarded as one of BiH's future competitors. Romania is poised to become the leading market for contract manufacturing with Germany and the entire EU in the low to medium price segment. The companies there are generally well equipped, and the country offers a generally sound climate for investment by foreign companies.

Romania's future lies in ready-to-sell business, thanks to its "mature" textile industry (fabrics, yarns and materials), especially knitwear. The weak local market and low purchasing power mean that even in the future, Romania will not play an important role as a sales market for BiH (22.5 million inhabitants with GDP at around 36,600 million euros in 1999).

Comparative competitive strengths	Comparative competitive weaknesses
<ul style="list-style-type: none"> <li>↑ Very good prospects for ready-to-sell business owing to existing textile industry</li> <li>↑ Businesses often very well equipped and possessing specialised production skills</li> <li>↑ Healthy climate for investment by foreign companies</li> </ul>	<ul style="list-style-type: none"> <li>↓ General risk of instability in the Romanian economy (currency, domestic debt)</li> </ul>

### 3.5.4 Czech Republic and Slovakia

The Czech Republic and Slovakia are traditional textile-producing countries and contain highly specialised clothing manufacturers. As a result of their above-average economic development compared with the rest of the region, wages and thus prices are substantially higher than in neighbouring countries.

Comparative competitive strengths	Comparative competitive weaknesses
<ul style="list-style-type: none"> <li>↑ Sound mutual potential for opening up new markets for both countries</li> <li>↑ Geographical proximity to western Europe</li> <li>↑ Economic and political stability</li> </ul>	<ul style="list-style-type: none"> <li>↓ Becoming less competitive for contract manufacturing</li> <li>↓ Virtually no supporting industry, resulting in difficulties in responding to ready-to-sell orders.</li> </ul>

### 3.5.5 Ukraine

The Ukraine is viewed as one of the most important future markets for contract manufacturing. It should therefore be considered, at least in the short-term, as one of BiH's competitors .

Comparative competitive strengths	Comparative competitive weaknesses
<ul style="list-style-type: none"> <li>↑ Favourable price/performance and capacity</li> <li>↑ Geographical proximity to the EU, especially once Poland, the Czech Republic and Slovakia join.</li> </ul>	<ul style="list-style-type: none"> <li>↓ Strong need for modernisation and therefore heavy investment in the clothing industry</li> <li>↓ Uncertain economic prospects</li> </ul>



### 3.6 Market opportunities and prospects for the clothing industry in BiH

A characteristic feature of BiH companies is that they are still trying to consolidate their contract manufacturing business, primarily with German and Italian customers. This is against a background of relatively high wages in BiH. At the same time, the virtually total absence of a supporting textile industry offering the requisite capacity and quality makes it nearly impossible to offer ready-to-use or ready-to-sell business. The market opportunities for the sector can therefore be expected to worsen rather than improve unless the industry succeeds in exploiting new potential for development by means of a gradual change of strategy. Measures for achieving this are outlined in chapter 4 of this study.

To conclude, a profile of the clothing industry's strengths, weaknesses, opportunities and risks based on the above analysis of BiH's key eastern European competitors is provided below, summarising market opportunities and development prospects.

#### Summarised profile of strengths, weaknesses, opportunities and risks

Strengths		Weaknesses
		✖ Absence of supporting textile industry – limited quality and capacity means that fabrics, etc. have to be purchased abroad
✖ Experienced, skilled workers		✖ Lack of new recruits in some specialised fields of textile industry (textile marketing, design, etc.)
		✖ Insufficient knowledge of modern management methods
✖ Relatively easy to procure materials from Italy or Germany		✖ Experience of marketing and knowledge of potential sales markets low to nil
✖ High manufacturing quality		✖ Absence of management culture and lack of middle management staff
✖ Long years of experience of clothes manufacturing in BiH (traditional activity)		✖ No experience of and little information about design trends
✖ Motivated management		✖ Potential investors view general investment climate in BiH as highly unattractive (see also FIAS study)
		✖ Low productivity
		✖ Absence of a national marketing system, insufficient distribution structure
		✖ Insufficient financing potential; industry has little working capital and the trading sector has none
		✖ No foreign language skills

Opportunities		Risks
☛ Strengthening and expansion of the local market through general improvement of the economic situation and the creation of a national trading system		☛ BiH is becoming less attractive to foreign business partners owing to rising production prices and wage levels
☛ The success of some exemplary companies proves that good development opportunities exist for a limited number of quality, dynamic companies		☛ Many potential investors view future political development as uncertain
☛ Greater regional integration and linkage in a regional system consisting of supporting textile companies and garment manufacturers		
☛ Renewal of former contacts and distribution channels (especially in former Yugoslavia and Germany)		
☛ Expansion into the markets of neighbouring countries		☛ Wages, and therefore prices, are continuing to rise
☛ Geographical proximity and similar taste to key western European markets (especially Italy)		
☛ A more structured market would improve planning and thus open up possibilities for lowering prices		☛ Bureaucratic obstacles are hindering business activity and investment
		☛ Corruption and black marketeering
☛ Optimised production processes and restructuring would increase productivity		☛ Insufficient capital input/investment limit competitiveness

## **4. Development strategy for the sector**

### **4.1 Objectives of the institutions concerned and the interaction between them**

The textile and clothing sector should take pride of place among the objectives of economic policy, since the enormous social and economic importance of its export share, as outlined in the present report, makes it a major foundation stone of BiH's long-term economic upswing.

The development strategy for the textile and clothing sector forms part of the Stability Pact drafted by the international community, under the auspices of the World Bank and the EU. It is geared to the fundamental objectives of the Stability Pact, namely:

- To introduce economic reforms aimed at modernising and restructuring industry and at raising the competitiveness of businesses in BiH
- To create greater regional integration among the south-eastern European states in order to better exploit the region's potential for development
- To identify and implement ways of gradually strengthening the integration of BiH's economy into that of the EU states. To do so, the EU has created the Stabilisation and Association Process, which provides a contractual basis for the accession of the south-eastern European states to the EU. No Stabilisation and Association Agreement so far exists with Bosnia and Herzegovina.

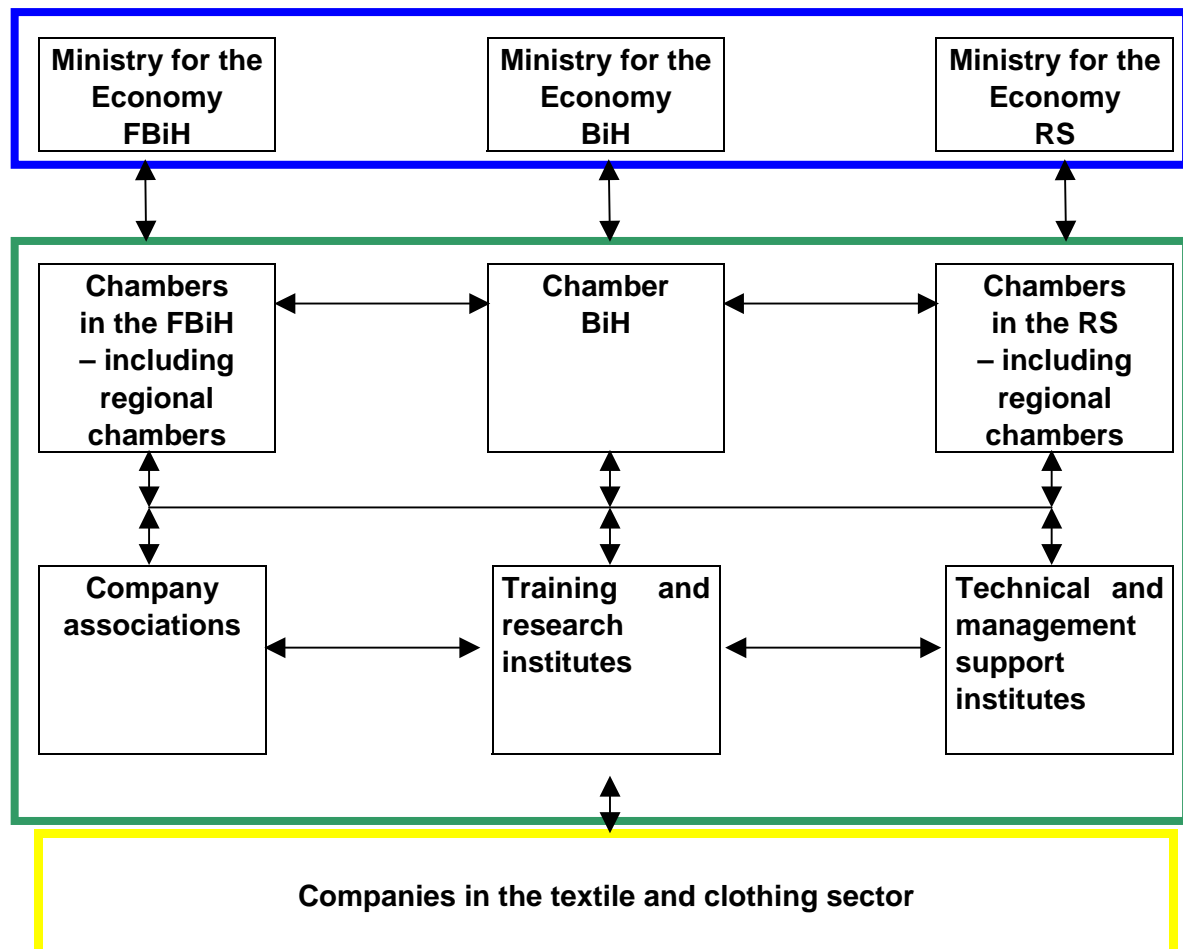
Under the Stability Pact for Southeast Europe, three specialised, cross-state "Working Tables" were set up. These include Working Table 2 on economic reconstruction, development and co-operation, which covers the field investigated in the present sectoral development study. Under the Dayton Peace Accords, the Office of the High Representative (OHR) monitors the country's political and economic development on behalf of the international community. The OHR and other umbrella institutions (such as FIPA and the Office for Statistics) thus monitor and support promotional measures designed to aid this sector.

This study is also part of current measures by the ministries concerned to aid development in this sector.

In order for the sector to continue to develop, the various state and private-sector institutions have to work together at the macro and meso levels. At the meso level, the chambers of commerce, cross-company representative bodies and other organisations are responsible for initiating and implementing individual measures. As partners of policymakers on the one hand and of companies on the other, these institutions must act as catalysts and sponsors in order to strengthen the competitiveness of the clothing industry. The responsibility for creating suitable background economic conditions for industry as a whole and for the clothing industry in particular lies at the political level.

Measures aimed at promoting the development of the sector have to be based on the principle of subsidiary, that is, they have to be initiated and implemented as far as possible by the companies themselves, or by institutions at the meso level. The role of the ministries should be restricted to supporting measures; the degree of detail of the measures has to diminish from the bottom up, that is, from the company level up to the ministry level.

### Co-operation between institutions at the macro and meso levels



The fundamental prerequisite for implementing a sectoral development strategy is that the respective institutions at the political level and those at the meso level (associations, chambers of commerce, etc.) should:

- clearly define, delimit and agree with other institutions on the responsibilities within the relevant institutions, but also between them
- devise political measures that are transparent and calculable on the basis of an intensive dialogue with the affected companies from the textile sector
- are open for dialogue and for external proposals concerning how to improve the industry's situation
- work constructively on the implementation of measures to enforce the Stability Pact.

In the interests of the country's rapid development, the **OHR** – as the highest monitoring body of the international community – should aim to:

- support the ministries in developing realistic visions and implementing a co-ordinated economic policy
- build up an independent, professional statistics structure/statistics culture for BiH
- increase the budget of the FIPA (Foreign Investment Promotion Agency) with the aim of promoting BiH abroad more effectively in the short term
- step up discussions with the donor community with a view to establishing a financing system in BiH which would also represent a genuine source of funding for industrial companies. The existing credit/financing system is not relevant to the companies considered in this study for a wide variety of reasons. The path which companies are currently pursuing (search for potential investors) holds little hope for success for the textile and clothing industry, at least in the next three years or so, for the reasons stated above.

## 4.2 Strategic approach

The fundamental approach behind the development strategy which we propose for the clothing sector depends very largely on the micro level: the first step is to pave the way for a long-term realignment of the sector by means of strategic decisions at the company level, aimed at opening up new sales markets in BiH and abroad. Policy-makers have to continue improving the existing information base on the actual situation of companies in BiH, and therefore of the sector, in order to provide a realistic estimate of the sector's future potential. It is important that the political authorities draw up a joint programme to develop the sector by means of a close dialogue with stakeholders, rather than by imposing measures "from on high".

In consequence, the present study focuses strongly on improvement measures that have to be initiated at the micro level – that is, by the companies – so as to provide a basis for sectoral development. On the basis of this, conclusions are drawn as to the measures which need to be taken at the meso level. The proposed measures at this level form the starting point for a further, detailed dialogue between policy-makers and the industry. The proposals should be regarded as a springboard for further, more detailed discussions: they are complementary, but can also be implemented as separate packages.

Every effort has to be put into ensuring that all the levels – the companies, the institutions at the meso level and policy makers – work constructively together to develop the sector. Any obstacles that may arise from actors continuing to pursue personal interests have to be consistently removed. It is crucial to implement improvement measures rapidly. In current market conditions, it is difficult to catch up lost time in connection with competitors. The clothing and textile sectors of some competitor transformation states in eastern Europe are already realigning: the textile sector world-wide is undergoing a difficult process of consolidation, and the fight for markets is tough. Moreover, Serbia too is likely to become a competitor.

Restructuring policy should be seen as the common task of both public and private players, whose objective is to continuously raise the efficiency and competitiveness of the clothing sector. There is thus a need to moderate and steer complex opinion-shaping and agreement processes in this field. Given the prevailing political situation in BiH, this could paralyse the implementation of actual aid measures for the sector if this were to take place at the national level. It is therefore recommended to implement policy through regional initiatives. The seeds of sectoral development need to be sown according to the interests, strengths and the will to implement measures of the players in the respective regions, in the hope that they will have a knock-on effect on other regions.

This regional restructuring policy reflects the overall economic interest of fostering the development of clusters of industry rather than an even distribution across the country. This would also increase inter-regional competition, encouraging regions to seek to emulate each other.

Experience has shown that selective aid measures obtain the best results, all the more so since public budget resources are scarce. A "strengthening the strong" approach, focusing on dynamic, timely development measures, is preferable to a blanket approach. In concrete terms this means, for example, that timely regional development measures conducted primarily by individual companies, business associations or regional chambers of commerce should be given priority over blanket subsidising of interest payments on investment. For example, it would be better to aid the creation of a textile engineering college if the lack of such colleges is inhibiting development in the sector, rather than to subsidise debt-ridden businesses with public funds.

#### **4.2.1 Interaction between the micro and meso levels**

Any sectoral development strategy has to start by solving the various structural problems and weaknesses of the textile and clothing industry by improving integration within the sector, thus enabling it to exploit its strengths, opportunities and competitive advantages to the full. In doing so, the different success factors applicable to the textile and the clothing industry have to be taken into account. Without an efficient local or regional supplier textile industry, the clothing sector will not succeed in gaining greater self-sufficiency.

Given the current situation facing the sector, a "nothing new" scenario could result in a dramatic rise in unemployment, especially in the labour-intensive garment manufacturing industry, and in the loss of virtually all the jobs in the textile industry. Only a handful of garment manufacturing companies would manage to survive by creating a niche economy and offering tailored products and services. In BiH's clothing sector, a core of 20-30 companies, with above-average potential for development in the medium to long term, is expected to develop.

Any sectoral aid policy has to focus on these businesses with measures aimed at developing production chains and creating greater linkage in the sector. A market for the BiH clothing sector will only emerge in the medium to long term if the following conclusions concerning a development strategy for the sector are respected (further details later in this study):

1. The sector has to rapidly leave the low-level outward processing category, in which BiH businesses have a weak negotiating position, thereby potentially giving foreign business partners an unfair advantage
2. "Intelligent" contract manufacturing which offers a major share of service (middle level) and elicits customer loyalty is called for.
3. Companies need to develop house collections or labels (brands).

Good examples of this are Italy and especially Turkey. Both countries were formerly major contract manufacturing partners of Germany. In recent years, they have successfully developed house collections or brands, primarily in the mid-price range. Turkey's turnover in Germany in 1999 as a result was 1.77 billion KM, and Italy's 1.4 billion KM.

The justification for realigning and moving away from a low-level OP strategy is that:

- The pricing practised in cheap, exchangeable OP business is geared to the countries where wages are lowest and has reached a level which is no longer commercially justifiable, neither in terms of the national economy, nor given the comparatively high wages in BiH.
- The earlier argument that this export business was good for the foreign trade balance is increasingly invalid, as overcapacity in the CEE states is causing value added to shrink; in some cases, export does not even cover labour costs.
- Transfer of know-how or knowledge is virtually nil, as overcapacity on the part of other potential contract manufacturing partners means that customers do not need to maintain long-term relationships.
- The unfavourable prospects for wage rises in outward processing keeps local purchasing power weak; this makes the sector unattractive for skilled workers.
- Consumer demand for textiles is catered for by legal and illegal imports which eat away at foreign exchange; the value added disappears abroad, the result being that the clothing sector contributes little to the economic growth of the country compared with other industry sectors .

## Possible ways of overcoming obstacles to the implementation of the new strategy

Problems related to sectoral development and possible ways of overcoming them	Leadership/activity		Support from macro level
	Company	Meso level	
➤ The proposed strategy calls for skills which are undeveloped in Bosnia's garment manufacturing industry. There is thus a need for training and consultancy measures aimed at building up knowledge of the markets and products, fashion experience, international specialist engineering and market know-how, purchasing and sales marketing skills, knowledge of logistics, understanding of business management issues (costing and cost accounting).	X	XX	Yes – by creating or strengthening universities and specialised training institutions
➤ The local markets (including the sub-markets in former Yugoslavia) are still badly structured (no recognisable rhythm of seasons and orders, no market focus, no clear trend indicators). The share of the black market is large owing to weak purchasing power; the (low) market share of high-price textile purchases is catered for by foreign brand-name products (some of which are purchased abroad). – A national trading system and a regional network need building up.	XX	XX	Indirect – creation of the requisite background conditions, e.g. checking black market business
➤ There is a lack of good-quality local suppliers in the primary industry (spinners, weavers, knitters). Companies in BiH have no access to good foreign suppliers of woven and knitted fabrics because of their lack of credit-worthiness, or suppliers sell them fashion surpluses at inopportune times. No garment manufacturer in BiH has rapid access to international sources. Bosnian garment manufacturers are not among the target customers of leading, quality weaving firms in Italy and Germany. The means of remedying this is to promote the supporting textile industry in BiH or regional integration with businesses in former Yugoslavia.	X	XX	Yes – for example, by prohibiting imports of second-hand goods – for details, see sub-section 4.4



Problems related to sectoral development and possible ways of overcoming them	Leadership/activity		Support from macro level
	Company	Meso level	
➤ Business partnerships with brand-name garment manufacturers are extremely limited (bad image of BiH owing to the war, small, unattractive home market). Companies have to continue to contact potential partners directly and convince them by means of high-quality sample deliveries. Only targeted, selective searching for partners succeeds (for instance, Austrian partners regard BiH less critically than other European partners owing to their traditional links).	XX	X	Yes – help in improving BiH's overall image
➤ There are possible ways of getting out of the low-level contract manufacturing market, e.g. by concentrating on less price-sensitive sports and functional garments, which are less subject to fashion trends and rhythms	XX	X	Yes – by providing general market information

XX: Responsibility for activity/initiation of activity

X: Support /assistance

The following subsections explain the implementation of the above strategy components in greater detail.

The clothing sector basically has potential for development in the medium to long term, as certain garment manufacturers have the entrepreneurial capability to develop their own solutions to numerous shortcomings. They have to be carefully selected for further aid; otherwise market forces will decide their future. At the same time, despite numerous obstacles, the local markets will develop and restructure, albeit slowly, geared to fashion, products and services. The better performers will succeed in taking advantage of this and – in the best cases – will help co-determine structural trends.

The most important partners for implementing a restructuring policy are the bodies at the meso level, such as the further education institutions and trade missions, and especially the chambers of commerce at all levels (national chambers, entity chambers, regional chambers and the bodies representing the companies, i.e. the industry associations). In BiH, these structures have plenty of scope for development compared with other countries, as this analysis has already shown. In other words, the basis for implementing a restructuring policy is still very weak in BiH.

The conclusions for policy are as follows: much more has to be done to promote and develop chambers of commerce and industry associations as well as cross-company, private-sector initiatives. Another aspect of this is the need to foster networking between companies, as described elsewhere in this study.

One first step towards achieving this would be to continue and intensify efforts to build a transparent chamber of commerce structure (including foreign trade). The ideal structure would be a two-level hierarchy consisting of regional chambers and one umbrella chamber. Existing modernisation initiatives and sound development measures already being undertaken by the various chambers have to be fostered and supported (e.g. aid for planning and undertaking foreign business trips, participation in trade fairs, etc.). Conversely, consistent steps need to be taken to eliminate elements of the chamber structure which are hindering structural change in the clothing sector, owing to backward thinking and obstructiveness. Here again, a focus on regional initiatives is recommended, in order to involve the chambers in questions of motivation and development potential. To strengthen the chambers, a demand-focused range of services has to be developed that the companies will regard as genuinely beneficial, while the chambers have to put an end to their practice of exerting politically motivated pressure on companies. The range of services offered by the chambers must underscore their role as a link between industry and politics, as initiators and providers of specialised training courses, and as a hub of contacts with foreign chambers of commerce, especially in former Yugoslavia and eastern Europe, and with companies.

The chambers of the FBiH and the Republika Srpska are already actively working to develop the sector. For example, at the initiative of Mr Brajkovic of the FBiH chamber, they have drawn up a joint protocol (ref. PKF – 498/01, of June 20, 2001) containing proposals for development measures, including possible political measures. This initiative deserves full support, not least for political reasons, as communication between the two entities has often been lacking.

In order to accelerate structural change in the chambers, private companies – in working groups dealing with specific issues, for example – need to be encouraged to take complementary initiatives. The state could accelerate this process by organising round tables and similar opportunities for discussion. The workgroups could then develop into private-sector industry associations independent of state bodies. State influence on companies should not be exercised through cross-company associations, but through legislation only; otherwise, these associations will lose all credibility in the eyes of business people and will ultimately fail to be an effective tool for implementing policy.

#### 4.2.2 Macro level

Policymakers must support the sectoral development strategy outlined above by introducing a package of general measures for industry, as well as more specific measures for individual sectors. Beyond the items specific to the clothing sector listed in the previous sub-section, the **economics ministries** could implement general measures for the sector aimed at:

- stepping up communication and co-operation between the ministries of the entities: to achieve success, everybody needs to look in the same direction
- fostering initial contacts and helping to intensify and systematise these contacts with neighbouring countries (former Yugoslavia and eastern Europe) through political channels, until a regional free-trade zone is created.

The task of the political institutions is to implement free-market reforms with sufficient critical mass to drive structural change in BiH's clothing industry. The role of the industry ministries of the FBiH and the RS should by no means be limited to that of more or less passive assistance in privatisation and liberalisation measures. Rather, the ministries' room for manoeuvre in matters of sectoral development will increase with each success achieved thanks to the development of industry associations and services at the meso level. The core challenge facing the ministries is to act as catalysts in this strategic realignment of the sector: first and foremost, this involves throwing the old ways of thinking in terms of production figures and volumes overboard, and giving priority to raising value added instead.

The industry ministries have to recognise and promote any potential for networking with other sectors and clusters – which naturally also includes the shoe and leather industry. They also need to work together with other ministries, such as the education, finance and foreign ministries, in their search for joint solutions for the sector. In other words, they have to help build a network within the sector by implementing appropriate measures. For this purpose, cross-institutional workgroups need to be set up.

The fundamental prerequisites for improving the background conditions for industry as a whole are detailed in the FIAS study entitled "Commercial Legal Framework and Administrative Barriers to Investment", issued in March 2001. The following macro-level political requirements extrapolated from this study are also extremely relevant to the development of the clothing industry:

- SMEs will play a key role in BiH's economic development because, compared with large-scale companies, they have good potential for innovation and productivity growth. This applies to the clothing sector as well. In consequence, any measures aimed at promoting the sector have to be closely co-ordinated with general measures aimed at promoting SMEs. We view the adoption of economic policies aimed at facilitating access for SMEs to finance, the simplification of administrative procedures and tax systems, greater legal security and the abolition of corruption, as well as greater efficiency on the part of institutions at the meso level, as the fundamental means of fostering SMEs. Any aid measures for SMEs have to be based on exclusively economic and competition-focused criteria. Politically-motivated criteria are not an effective basis for bringing about structural change in the clothing industry.
- Transparent and consistent legal and regulatory frameworks geared to long-term planning.
- The average customs rates in BiH are some 7-8 per cent below those of the other states in south-eastern Europe. However, the customs provisions include numerous special regulations which leave scope for protectionist measures. There are major differences in the customs policies of the two entities, which results in undeclared goods entering BiH. BiH's accession to the WTO is still a long way off, which does not improve the country's competitive position in relation to the more highly developed transformation states. In all these fields, policymakers have to strive to gradually dismantle BiH's "special status" in this respect and to establish it as a fully-fledged, industrialised nation within the international community.
- Improvement of BiH's statistical data basis: foreign investors have access to data on market developments and industry structures, etc. from neighbouring countries in south-eastern Europe and from BiH's competitor countries, indicating their

attractiveness for investment. The available statistical data on BiH are extremely sparse; moreover, they generally apply to the two entities separately. This could result in potential investors' simply ignoring BiH, since there is no basis of information for taking such a crucial decision.

- Dismantling structure-preserving labour legislation. Maintaining "waiting lists" at the company level shifts social costs from the state to business. This is acting as a brake on structural change, making companies unattractive to potential investors. Social policy has to be conducted outside companies.
- Public tenders: current regulations permit agents and/or dealers to take part. These charge dumping prices and carry out production abroad (e.g. in China). Any potential orders for the clothing sector (army, post office, etc.) bypass domestic producers; the resulting loss is substantial. Legislation must in the future encourage the participation of *manufacturing* companies in public tenders in this sector (possibly also by means of local content regulations).
- There is an urgent need to simplify visa procedures for company managers, especially visas for Italy, Germany and Austria. Current regulations still all too frequently hinder the development of business contacts.
- A solution is needed for the problem of debt. Since the end of the war, the Federation has owed money to numerous businesses. These debts should be publicly declared and repaid, possibly in the form of barter (power bills, phone bills, municipal services, etc.)

The privatisation of state-owned businesses urgently needs to be accelerated to enable BiH's economy as a whole to develop. The frequently inflated evaluations, based on fixed assets, in the run-up to privatisations are illusory: both domestic and foreign investors evaluate businesses by weighing the anticipated profits against the liabilities they are assuming. Logically, the privatisation of the clothing businesses should be viewed primarily as a political measure to trigger and accelerate structural change in the sector, and less as a source of revenue for the State.

### 4.3 Measures to tap into the domestic and foreign markets

#### Integration within the sector and business partnering

It is especially difficult to tap into fashion markets as they are dominated by international brands, and business success is often influenced by subjective factors. Understanding fashion, the trade fairs and events that determine trends, the rhythm of "long-notice" regular orders and "short-notice", one-off orders, complicated purchasing marketing and the complexity of the distribution channels represent an enormous challenge. The number of alternative solutions is therefore low.

One solution would be to create individual, better quality, more attractive offerings or collections geared more strongly to domestic needs. This could help raise the domestic market share of BiH manufacturers and reduce purchases of high-quality foreign textile products. We are talking here about the *middle to high level* of the clothing sector. However, the secondary effect of this would be numerous domestic clothing businesses all working on a small domestic market with a correspondingly small market share. Of course, the same applies to the international market, although the problem would be magnified exponentially. Each and every business which decides to go along with this solution would have to bear high structural, marketing, communications and distribution costs, while making extremely low profits. Our advice is therefore not to follow this course.

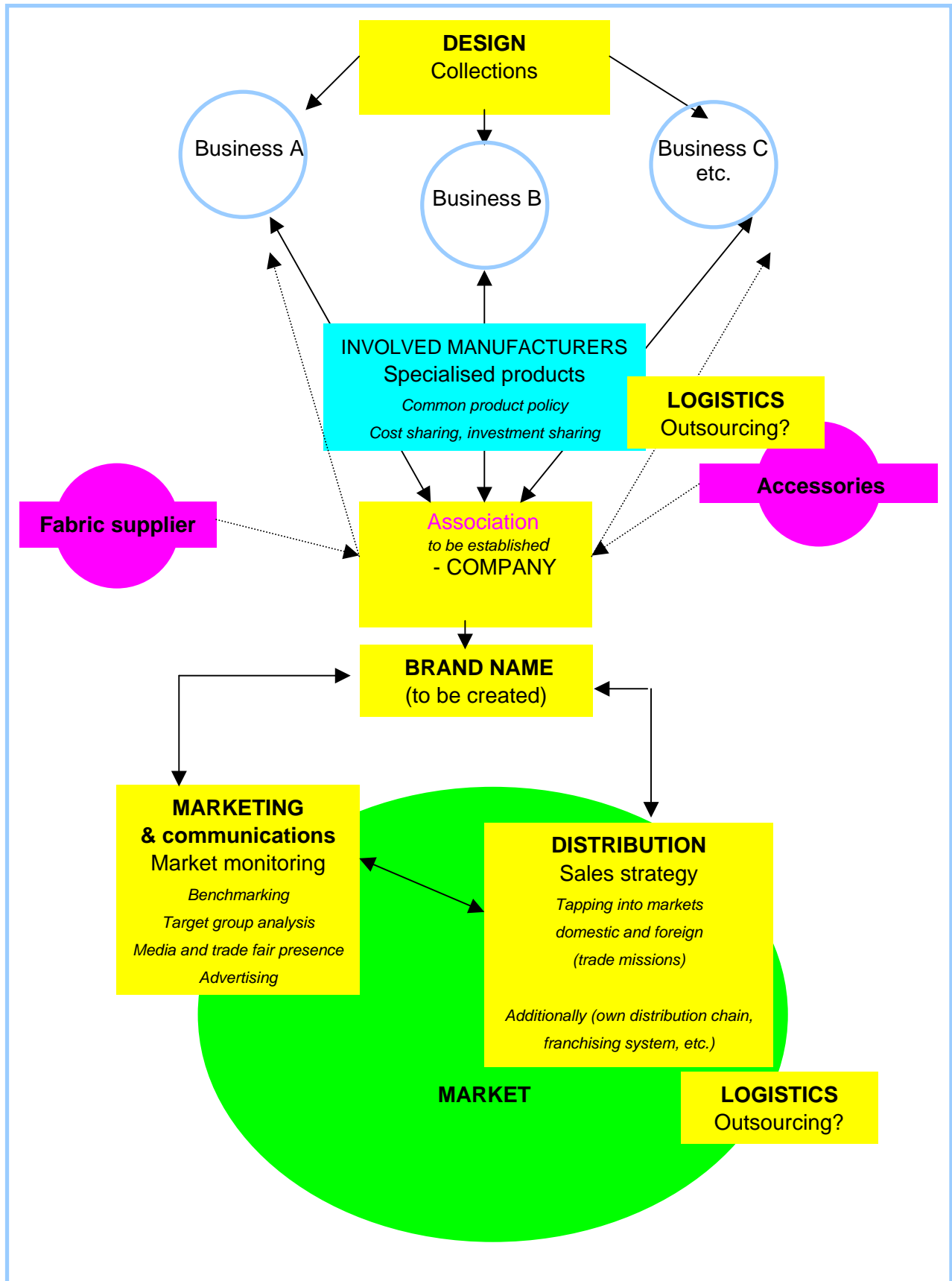
We recommend instead the following solution, aimed at distributing the structural, marketing, communications and distribution costs across companies:

- ☛ The creation of joint structures (i.e. an association, limited liability company or joint-stock company, for 10 to 15 selected Bosnian businesses each) to accomplish the following tasks: global procurement, developing a joint brand name (design, development of collections and families of products by all those involved), definition and implementation of a joint marketing and communications strategy (target group focus, cf. also product positioning, location analysis, marketing mix, etc.), implementation of a strict sales policy, logistics, etc.

This would result in:

- greater investment potential thanks to the distribution of costs
- the possibility of acquiring greater know-how – which is lacking in BiH – by bundling resources, for example in design and marketing
- eventually, a stronger, lasting identity for garments from BiH
- the possibility of increasing BiH's presence on the domestic and international markets
- much better potential for conquering markets
- the first step towards a proper trading structure at home and abroad (distribution chain and/or franchising).

## Concept for creating cross-company partnership structures



### Building a trading system in BiH and networking regional markets

Building a trading system in BiH would make distribution channels easier to supervise and thus easier for companies to control. Establishing sales units in businesses would make the entire marketing chain more professional. This would make retail sources more transparent and inspections by the tax authorities more effective. Creating and developing trade missions would promote regional partnering and enhance BiH's presence on the key target markets.

#### Summary: strategy to tap into markets

Measures	Leadership/activity		Support from macro level
	Company	Meso level	
➤ <b>Networking and partnering between companies (initial steps)</b>	XX	XX	X
➤ Set up a workgroup of interested companies	XX	X	
➤ Define a partner strategy and assign responsibilities, tasks, financial contributions	X	XX	
➤ Institutionalise partnering	X	XX	
➤ <b>Build a trading system in BiH and network the regional markets</b>		XX	
➤ Promote marketing and sales skills on the domestic market by holding training events on trends, materials, etc.		XX	
➤ Round tables between manufacturers and trading partners	X	XX	
➤ Definition and implementation of requisite accompanying measures at the political level, in order to strengthen the trading system in BiH	X	XX	XX
➤ Continued creation and development of trade missions in the most relevant target markets	XX	X	
➤ Tapping into the markets of neighbouring regions – making contacts at trade fairs, etc.	X	XX	

XX: Responsibility for activity/initiation of activity

X: Support/assistance



#### **4.4 An opportunity for the primary industry: as local and regional suppliers**

The spinning and fabric manufacturing businesses have to focus more strongly on their role as suppliers to the domestic garment manufacturing industry (including former Yugoslavia). Their mission should be to support local and regional garment manufacturers' efforts to realign themselves and become more self-sufficient; they thus constitute the "missing link" in the vertical textile market. Whether or not it proves possible to exploit the industry's potential for ready-to-sell business depends very largely on the efficiency of the local and – in the case of BiH – regional textile industry (fabrics, yarns, materials).

This strategy is new, as the textile manufacturers in BiH were traditionally geared to global exports. It is crucial to maintain a selective primary textile industry, at least for partial supply, in order for the local garment manufacturing industry to develop towards ready-to-sell business, in the interests of employment and because of the impact it would have on the economy as a whole (substitute for imports, reduction of black-market business, maintenance and expansion of technological know-how). Aiding the local textile industry would send out a strong signal and would carry strategic weight, stabilising textile supplies. The economic benefits of this new strategy for the textile industry would be not so much its effect on employment as the growth in value added arising from the difference between the value of imported fibres (synthetic fibres, wool, cotton) and the value of imported fabrics. It would enable ready-to-sell business to develop in BiH.

Despite the destruction caused by the war, the industrial structure remains in parts intact technologically, with cotton and carded-cotton spinning mills, knitting mills, cloth factories and finishing plants. The technological knowledge and production skills have been preserved and are available. However, the danger is that they will not always be available and that this technical know-how will be lost. At the same time, there is little hope of regaining the global export markets that were lost because of the war, which has been defined as the primary alternative strategic goal, in the face of competition from high-tech Italian and German suppliers.

Domestic garment manufacturers have little chance of becoming major customers of the leading western European fabric suppliers. They will not be able to get access to the same quality and quantities of modern fabrics (e.g. stretch fabrics, microfibre fabrics, etc.) and market information as their western European competitors in the foreseeable future. They are more likely to succeed in closing the gap with their western competitors over the long term with the aid of home-produced fabrics.



## Possible ways of overcoming obstacles to the development of the supporting textile industry

Obstacles/possible ways of overcoming them	Leadership/activity		Support from macro level
	Company	Meso level	
➤ Strengthen skills in product development, understanding of markets, product quality and product engineering	XX	X	
➤ The new strategy of the textile and clothing industry, with its focus on vertical integration, demands investment running into tens of millions, especially for yarn and fabric manufacturing – the financial bottleneck in BiH therefore needs to be eliminated	X		XX
➤ Current import and customs regulations are not conducive to the new industry structure. Customs regulations must therefore be adapted to suit the interests of the sector – e.g. low or no customs duties for machine imports, scaled customs duties on fibres, yarns and fabrics, and possible customs exemption for key imports.			XX
➤ Strategic partnerships with foreign investors are likely to be indispensable when implementing the strategy. This makes it crucial to improve the investment climate in BiH.			XX
➤ The strategy will only take effect in the long term. It will have to be backed up by targeted, selected export activities in order to maintain economically viable volumes. Potential target markets have to be tapped into in the region in order to achieve this (countries with no notable supporting textile industry).	XX	X	X

XX: Responsibility for activity/initiation of activity

X: Support /assistance

The number of businesses suitable for implementing the new strategy is limited. They need to be identified and earmarked for further aid on the basis of their entrepreneurial capability to develop their own solutions to overcome the numerous shortcomings. These businesses have to be selected on the basis of the product needs of the surviving garment manufacturers. They include, primarily:

- cotton-spinning mills to supply to knitwear and underwear manufacturers
- cloth factories for women's and men's clothing, fashion yarns for knitting mills
- manufacturers of medical textiles.

## 4.5 Selectivity in contract manufacturing and focus of efforts to tap into new markets

A focused approach to the market represents first and foremost a chance for companies to identify and exploit market opportunities. Nevertheless, it should also be seen as an integral part of any sectoral development strategy, because consistently exploiting this potential could be a fundamental factor of success. Political bodies at the national and regional levels have to actively promote this selective aid strategy for BiH companies as part of their efforts to build regional industry clusters.

The costs and risks of developing house collections are, in general, underestimated. The requisite know-how is largely lacking in BiH, because design and distribution were formerly left to the state-owned bodies, which kept the manufacturers at a distance. A glance at the value-added chain of a textile article from the yarn to the finished product is indeed tempting, since – to give an example – the manufacturer will find an article on which only 3 KM was earned (or less) selling at 69 KM (or more) at the retailer's. However, comparative profitability calculations have shown that the cost of the value added (fixed and variable production costs, sales and distribution costs, risk) can far exceed the value added actually achieved in the selling price. The results of some such comparisons show that even "bad" contract orders are more profitable than business with house collections.

The consequence of this is that rash diversification into house collection manufacturing leads to an economic dead end in 90 per cent of cases, especially when companies try to operate independently. In contrast, well-prepared campaigns can be highly successful, as some examples show. The prerequisite for success is a watertight business plan in which the share of contract and house collection manufacturing is well balanced and the specific fixed costs are correctly allocated. The following example shows the breakdown of value added in a manufacturing business which has successfully diversified into house collection manufacturing:

### Example: Comparison of the value-added structure of house collection and contract manufacturing (in KM\*)

Type of business	Variable production costs	Fixed costs** (sales & distribution/ collection)	Value added (price in KM)	Profit margin (in KM)
House collection	0.118	0.072	0.250	0.070
Contract manufacturing	0.118	0.000	0.139	0.021

\* KM per minute of production

\*\* additional fixed costs which can be allocated exclusively to collection design

Firms with a fashion focus have the best potential. Analysis of specific firm profiles shows that BiH businesses could potentially tap into markets in the following areas:

### Development of technical textile markets (medical textiles)

The breadth of available products and per capita needs for the out-patient and in-patient medical market and for care and hygiene products in BiH is almost comparable with that of western Europe. It is therefore possible to talk of a stable domestic market for this type of product, which can be accessed rapidly, as the only company working in this field produces high-quality, innovative products. It is also competitive on the international market and in terms of costs. While conventional textile articles\* are subject to fashion trends, and sales are suffering from the country's extremely weak purchasing power, medical textiles satisfy an indispensable and immediate need. This need must either be met by foreign supplies or not at all – which would be detrimental to the quality of healthcare. Per capita needs are more or less identical to those in western Europe:

Product group	Per capita need	Converted into m <sup>2</sup>
Compresses	Approx. 50 million items, based on 10x10x8**	4 million m <sup>2</sup> approx.
Swabs, plugs	0.25 m <sup>2</sup> approx.	1.2 million m <sup>2</sup> approx.
Miscellaneous dressings, abdominal pads, gauze for plaster casts	0.5 m <sup>2</sup> approx.	2.5 million m <sup>2</sup> approx.
Bandages	1.5 bandages (4 – 5 m, 6 cm wide)	1.5 million m <sup>2</sup> approx.

\*\* Total need for approximately 5 million inhabitants (= 10 compresses per head).

The domestic market represents a fairly constant need; there is also plenty of potential on international markets.

### Functional textiles for sport and work

Functional clothing (high-quality work clothing, e.g. fire-fighting clothing, cut-resistant clothing, uniforms, etc.), including functional clothes for sports and leisure (skiing and walking), is an example of how contract manufacturing for export can be profitable. Unlike fashion clothing, the typical conditions of "intelligent contract partnering" apply here: service focus, strong, long-term customer loyalty, unmistakable speciality (e.g. Goretex licence). Besides profitability, specialist garment manufacturers are usually also characterised by the relatively high salaries they are able to pay their employees, and by the fact that they market a part of their production themselves. At the same time, these firms are also potential buyers of high-quality fabrics which can be manufactured in BiH.

#### 4.6 Promoting training and technology for the clothing and textile industry

Despite the small number of training institutes in BiH, it should be noted that most companies have very highly qualified staff but are suffering from a lack of skilled new recruits. Basic and further training in design with a slant on fashion and fashion collections is virtually non-existent (students have to go abroad to study these), but demand is so low that it is questionable whether or not it is economically worthwhile trying to set up such courses. A practical solution would be to provide grants enabling students to attend foreign universities, especially in Croatia, Slovenia, Italy, France and Germany. Certain training institutes might be interested in setting up "branches" in BiH or in other countries in the region which the up-and-coming generation could then attend.

As illustrated above, there is a lack of skilled marketing, distribution and management (middle and high-level) staff in particular. The universities should be able to offer marketing courses (analysis, export marketing, market strategy, etc.) geared to western standards: in BiH, this would be a branch of study with a future, as the needs of trade and industry are going to increase over the next decade. Demand from businesses, especially those in design, is high, but not high enough to justify setting up specialised training institutes in BiH. Efforts should be made to build up contacts with the respective universities and to simplify study paths for prospective students.

It is also crucial to promote foreign languages. In the textile industry, Italian and German and, to a lesser extent, French, are a must. English is also necessary. The state must foster foreign language teaching at all levels of education, as well as in the companies. The future of the country will be decided in part by its capacity to communicate internationally.

Efforts to promote technological development in this sector should be aimed primarily at disseminating knowledge of cutting-edge developments, quality assurance measures and organisational concepts. They should be geared to the following basic principles:

- Promotion of specialised training at universities with the creation of vocational courses in textiles (textile engineering, leather-working, design, etc.) and practical application of these courses. Further aid is needed for the Sarajevo Art Academy's textile design faculty, and possible contacts could be made with other training institutes/courses to gear training more strongly to the needs of the domestic industry.
- Fostering the spread of technology – through information and consultancy centres, Internet portals, industry demonstration centres – e.g. introduction of computer-aided design (CAD), computer-aided management (CAM), companies offering apprenticeships, REFA courses (train-the-trainer), quality management.
- Promotion of research and development, and stimulation of creative potential at the company level, e.g. through technology competitions, tax incentives for investment in development by companies, consistent information about BiH businesses and support for them in public tender procedures, etc.
- Stricter controls on existing bodies, such as those for merchandise quality control, which fulfil cross-industry tasks. Surveys have shown that some institutes which are currently registered and tolerated have neither the equipment nor the relevant competencies.

Experience from other transformation states shows that the success of research and development institutes tends to increase according to their level of specialisation. Bodies with a clear strategy or alignment geared to specific fields are better placed to disseminate practical know-how. The conclusion that can be drawn for promotional policy is that, when in doubt, it is preferable to promote specific, application-focused institutes which are in direct contact with companies, rather than general research projects, for example at universities. The more directly a research institute is able to contribute to solving acute problems experienced by companies, the more willing these companies are to help finance the research institutes.

A concept aimed at promoting technology in the sector needs to be drafted. It is outside the scope of this study to detail the individual aspects of such a concept, especially as the aim of promoting technology is to create favourable background conditions conducive to research and development in companies, universities and private research institutes, for all sectors of industry. In the light of the four principal objectives named above, the following points need to be defined in order to implement promotional measures for technology:

- The financial scope and means for providing financial incentives/promotional measures
- The institutional framework and distribution of roles between the micro, meso and macro levels
- How promotional measures for the sector will link up with general measures for promoting R&D in BiH
- Emphasis on regions (clusters) and/or sub-sectors.

#### **4.7 Developing a local consultancy market**

The consultancy services offered by domestic consultants are not highly regarded by companies in BiH, who often hire the services of university professors and former senior managers as external consultants. They fail to take into account the fact that external consultants who have an in-depth understanding of the free-market approach – not only in business management, but also in production technology – can make a genuine contribution to an enterprise's business success, even without long years of experience in enterprise. Given the enormous task facing them, companies in BiH urgently need support which, for reasons of cost and volume, ought to be transferred from international consultants to local ones.

For this reason, a census has to be made of the qualified consultants who specialise in the textile industry. Entrepreneurs must then be convinced of the benefits of their services, and need to be coached as to how to successfully work with consultants. The chambers of commerce in BiH could very well fulfil this task: they should stop viewing consultants as competitors, but rather as vehicles for conveying know-how and issues of general entrepreneurial interest to businesses regardless of sector. The consultants could also be used as a means of further improving the image of the chambers of commerce in BiH. Drafting concepts for building consultancy businesses and centres lies outside the scope of

this study. Various donor bodies, including USAID and the Soros Foundation, have developed methodologies and sample projects for this purpose.

Whereas – as has been illustrated above – technology development institutions need to be geared more specifically to one industry or to specialised fields if they are going to be of use to that industry, the scope of consultancy skills should instead cover all industry sectors. The reason for this is that the medium to long-term objective in building a consultancy market must be to create consultancy companies that will be capable of establishing themselves on the market in the long term. Restricting consultants to one or a small number of sectors severely limits their potential customer base. Experience in other transformation states has shown that the consultancy firms which are best able to assert themselves on the market are those which are leaders on the national market in terms of professionalism, and *not* in terms of specialisation in any particular industry. Examples are IT training and consultancy centres, auditors with a strong emphasis on management consultancy, secretarial training institutes (basic and advanced training), consultants in modern accountancy and cost accounting techniques, etc.

The strong presence of donors in BiH has led to a relatively broad spectrum of consultancy fees in the country. In promoting the textile sector, policy-makers and institutions at the meso level need to approach international donor organisations concerning the issue of qualified consultants. Policy-makers have to urge international donors to concentrate more on *training* local consultants in order to make them available for the local market as swiftly as possible. A situation in which BiH consultants are paid solely by international donors for a lengthy period must be avoided – this will raise consultants' expectations and lead them to demand fees which the private sector industry in BiH is unable to pay.

#### **4.8 Building and developing services for the sector**

As in numerous other essentially industrial states, the economy in BiH will develop towards services. Tasks that have been fulfilled in-house up to now will be outsourced and conducted by smaller, flexible service units. This process should be fostered by policy-makers, as it will accelerate the modernisation of the economy and make production methods more efficient. For example, why should cutting companies not work as fully independent suppliers to garment manufacturers? The state therefore needs to foster private enterprise – and not prevent people from setting up their own business by erecting unnecessary bureaucratic barriers.

For example, modern, productive cutting companies working as service providers for BiH manufacturers could help raise productivity and so lower overall production costs. The existence of specialised, efficient logistics companies and mechanical engineering service providers would additionally help minimise companies' costs and be beneficial for all types of manufacturing business.

## 5. Initial promotional measures for the sector

To enable the individual measures to be implemented in a consistent and methodical way, the relevant ministries need to set up steering committees to co-ordinate and continuously monitor the process together with the stakeholders and sponsor institutions concerned. The steering committees should supervise individual working groups, each of which will be trained in one specific subject area. The working group leaders should sit on the steering committee.

The schedule below purely focuses on short-term measures, since any longer-term measures need to be worked out by the partners concerned. Nevertheless, we propose some medium-term measures which follow on logically from the short-term measures, or which are already evident in the light of the present situation.

Working groups need to be formed for the clothing and textile industry to work out the details of the development measures proposed in the section above. They must jointly define the fields in which measures are required and then specify the individual measures.

### 5.1 Immediate measures

Measures need to be implemented immediately so as not to waste any more valuable time and to avoid the risk of the sector's being "overtaken" by the development trends described in the present report.

- ☛ A round table should be established at the initiative of the relevant ministries working closely together with the chambers of commerce of the entities. The participants should be OHR, the ministries (of economics, of BiH, the FBiH, the RS), the regional chambers (of BiH and the RS), FIPA and specialists in the sector.
  - Joint declaration of priority: the textile and clothing sector of industry takes top priority in the Bosnian economy owing to the important role it plays in it.
  - Creation of a permanent work commission (consisting of the above participants) with the following mission: to improve general background conditions in the sector, to search for possible means of financing, to define a marketing or communications strategy for the country (cf. support from FIPA), quality standards, etc.
  - Definition of a schedule for the above.



<b>Timeframe</b>	<b>from end 2001 to end 2003</b>
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☛ **The economics ministries of Bosnia need to implement an efficient, coordinated communications policy and a *joint strategy for the sector*.**

- Links between the above-named commission and other ministries (finance, education, and/or social ministries or authorities), cf. sections 2.6 and 4.4
- Making contacts in neighbouring countries, etc. (free trade zone among the countries of former Yugoslavia, etc.)

<b>Timeframe</b>	<b>from end 2001 to end 2003</b>
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☛ Ditto for the **chambers**

In the *short term*, co-operation and collaboration between the state, the entities and the authorities has to be stepped up. Moreover, policy-making benefits from permanent contact with the grassroots. At a later point in time, local specialists or associations have to be involved in the system.

☛ **Hosting of workshops for entrepreneurs in the textile sector by the chambers of commerce of the entities or regions**

- Subject: marketing, management, export, organisation, etc.
- Subject: presentation, motivation and moderation, or creation of a joint venture, as proposed in 4.3.1.2
- Subject: setting up a service provider company (cf. 4.7)

<b>Timeframe</b>	<b>up to March 2003</b>
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☛ **Intervention by OHR to accelerate privatisation**

<b>Timeframe</b>	<b>to end 2002</b>
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## 5.2 Medium-term measures

☛ **Pave the way for and establish an appropriately structured textile association in BiH**

<b>Timeframe</b>	<b>to end 2005</b>
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☛ **Training measures for local consultants (marketing, restructuring, costing, etc.)**

<b>Timeframe</b>	<b>to end 2005</b>
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