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THE HUNGARIAN FOOTWEAR INDUSTRY IN GLOBAL PRODUCTION NETWORKS: THE CASE STUDY OF BERKEMANN HUNGARY

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Abstract
The highly internationalized, labour-intensive footwear industry showed two spectacular declines and significant restructuring in Hungary after the change of regime. In accordance with the approach the authors investigate, this phenomenon is associated with the integration ways and circumstances of the industry into global production networks. Sector-level assessment of the processes – including the changing geographical patterns of footwear industry which also indicate features of path-dependence – was performed in several previous works of the authors. On the basis of significant empirical fieldwork, recent study focuses on the current situation of an extraordinary foreign owned large company representing the challenges and development perspectives Hungarian footwear industry has to face with.

Keywords: global production network, path-dependence, footwear industry

1. Global production networks and path-dependence

Global production networks are globally organized structures of interconnected corporate and institutional functions / actions through which the production, distribution and consumption of goods and services – the so-called *second international division of labour* in the age of globalisation – are realized. According to UN estimations 80% of the international trade is conducted through these global production networks nowadays. On the other hand, the global production network is a *theoretical framework* rooted in the political economics which aims to describe, interpret and explain the spatial disparities of the world economy. The recently revised version of the theory (GPN 2.0) traces back the organisational and spatial development of global production networks to the mixture of *corporate strategies* emerging as a result of the interaction of *drivers* generally acting within capitalist economic conditions (cost-capability ratio, market development and financial discipline) as well as risks posed by the economic environment. As a result of the temporal variability of the factors standing in their background, these structures show significant *diversity* and *modify within the same industry or region* (Yeung – Coe 2015). From the aspect of changing and developing economies it is of major importance from the very beginning to put emphasis on the process of upgrading in the context of studying global production networks. Shifting towards higher-value added local activities

– which can be manifested in the efficiency of production process, in the product range as well as in the composition of functions within production networks – provides the *long-term involvement* in global networks and the attainment of *higher shares from revenues*, thus functions as a precondition for the modernisation and close-up of the economies concerned (Humphrey – Schmitz 2002, Kaplinsky 2004, Schamp 2008).

A remarkable result of the GPN research is the fact that *local endowments* can be *shaped more slowly* compared to the relatively rapidly changing demands of global systems. Examining *"strategic coupling"*, which is considered to be essential to optimize integration into international division of labour (Coe et al. 2004), justifies the approach of *evolutionary economic geography* and one of its key notions, the concept of path-dependence which focuses on long-term development processes. The notion of *path-dependence* – which is related to the cumulative causation model – aims to explain the spatially differentiated development of economic activities and the different flexibility of certain regions by emphasizing the influencing effects and impacts of past events and decisions on present and future development trajectories focusing on the orienting role of the already 'beaten path' instead of new ones. *Mechanisms of path-dependence* are manifested in three forms. (1) In the case of technological lock-in a chain of past events results in a specific technological trajectory which does not allow for leaving the established path despite the recently emerging alternative technologies. (2) Path-dependence might be strengthened by *agglomeration effects* and *positive externalities*; increasing returns generate positive feedback effects which reinforce the previously established developmental paths. (3) Institutional hysteresis also fosters path-dependence; the concept refers to the temporal self-reproducing features of formal and informal institutions, social structure and cultural characteristics, which help the stabilization and social embedment of certain activities (Martin – Sunley 2006, Martin 2009, Molnár – Lengyel 2015a).

2. Transformation of the Hungarian footwear industry

The concepts of global production networks and path-dependence offer an applicable theoretical framework for interpreting the transformation process of the highly internationalized Hungarian footwear industry after the change of regime. The *Hungarian footwear industry* has integrated into *global production networks* at the end of the 1960's in a supplementary way, as a subcontractor of western partners. In the 1990's – in line with the collapse of the eastern market relations and the exclusion from the domestic market – its structure was increasingly shifted towards subcontracting through global production networks (Laki 2005). After the Millennium the manufacturing of medium priced mass products became unsustainable due to the *unfavourable change of relative cost-capability ratios:* domestic companies acquired fewer subcontracting orders and some of the foreign companies left Hungary and relocated their production sites. The *decline* of the industry was coupled with *restructuring* allowing for the expansion of corporate strategies focusing on product quality, market resilience and manufacturing of own products targeting specific niche markets. *Features of path-dependence* can be witnessed in several elements of this transformation process: the i*nherited technological knowledge* has impact on the product range manufactured within the framework of subcontracting and then the establishment of own products. Footwear industry characteristically shows higher stability in the surroundings of rural – primarily Eastern Hungarian – *industrial concentrations*, where the knowledge base and the range of potentially cooperative companies are more available as local manifestations of agglomeration advantages. Finally, experience collected by the authors from the Martfű region which is home of the

largest former shoe manufacturer company in Hungary also justified the existence of *institutional mechanisms* pointing towards the sustainment of previous structures (Molnár 2013, Molnár – Lengyel 2015b).

Recent study demonstrates the transformation process and development perspectives of the Hungarian footwear industry after the change of regime through the case study of a *German-owned large company* based on the results of *semi-structured interviews* carried out in 2014 and 2016. Selecting this (family-owned) company is underlined by several reasons. (1) The company is *one of the largest and oldest*, still existing foreign shoe manufacturer in Hungary, where production is mostly dominated by German and Austrian – and to a lesser extent Italian – actors. (2) The Hungarian subsidiary – as a representative of the upgrading process – performs *more complex activities* within the internal division of labour of the company compared to other similar foreign subsidiaries. (3) While the Hungarian footwear industry experienced significant decline after the Millennium due to the relocation of companies focusing on cost reduction, the *development* of the examined company is still considerable.

3. Location choice of the Berkemann / Bauerfeind company

The German company *manufacturing comfort shoes* and *orthopaedic medical appliances and equipment* has already conducted *subcontracting* orders to Hungary in the early 1990's: back then the company's production was carried out in several European locations. In 1994, the medical appliance and equipment manufacturer Bauerfeind family bought and acquired the Berkemann company – which was on the edge of bankruptcy in those days – driven by the intention to develop their medical product line by getting involved in footwear manufacturing. In 1997 they established an *own subsidiary* – based on the formerly accumulated knowledge – in Hungary (in Kiskunfélegyháza) where the production (and technological competences) from the location of *Berkemann* in Hamburg was relocated to. Nowadays products with Berkemann brand name are only produced in Hungary. The own products of the owner Bauerfeind family are basically manufactured in two locations in Germany, only *shoe-related medical appliances and equipment* are produced in Hungary. *Bauerfeind* family also acquired other brands which went bankrupt (Meisi, Solidus, Theresia Muck): they produce the *Solidus comfort shoes for women* in significant volume in the minority-owned factory of the corporate group located in Croatia.

The Hungarian subcontracting orders and the establishment of a subsidiary was motivated by *cost-reduction efforts*. However, cost reduction is not the only element in the corporate strategy: avoiding competition by focusing on niche markets stands in the centre of the company's operation. Both Berkemann and Solidus products are *premium quality high priced products:* they are manufactured in small series by using diverse technological background, and their common feature is the rapid reaction to market changes. Since the organisation of *resilient* production and shipping also has geographical constraints, it is not incidental that the main market of both brands is Germany. The German sales constitute 40-50% in the case of Berkemann, and 60-70% in the case of Solidus products, but Russian and Hungarian markets in the former brand and markets of the Benelux States in the latter are also remarkable. Due to the market positioning of the products (resilient supply of the innovative, quality European markets, environmentally conscious production) the management *has not considered seriously Asia* (with differentiating production cost) *or* the "newly-discovered" *Africa* (strongly characterized by deficiencies of industrial traditions) *as relocation options* so far.

4. Upgrading of Berkemann Hungary

Initially, the Hungarian subsidiary began its operation as a simple *subcontracting* location: the production of Berkemann shoes was started in 1997 with German technologists and by channelling the labour of a factory located in the adjacent town and which was previously the subcontracting partner of the German company. In 1999 the production was shifted from subcontracting to *own production,* which necessitated own raw material procurement, storage capacities and introduction of quality assurance systems, thus enhanced the responsibility of the location. *Production activities* were *expanded vertically and horizontally* in the course of time: the manufacture of cork socks, foot care and medical appliances and equipment, soles and slippers made of wood, leather printing, manufacture of products related to Meisi and Theresia Muck brands as well as the manufacture of products supporting ankle joints by using high-frequency welding technology for Bauernfeind Orthopädie constituted the main steps of this significant expansion. Although the polyurethane sole production site of the corporation was established in Zeulenroda (Germany), *the German party lost its production competencies* due to the relocation of the aforementioned functions to Hungary. This is clearly indicated by the fact that while the sales directors of all manufactured brands and even the economic and logistic manager are German, a Hungarian manager is responsible for production and product development at corporate group level.

Since the Millennium, *functions* of the Hungarian subsidiary *exceeding direct production* have gained more and more importance. The *development of Berkemann products* (not only the modelling and production planning) are performed in Hungary with the involvement of a German designer. What also increase the efficiency is that product development and *raw material procurement* are combined in the case of the Hungarian subsidiary. The weight of the latter function was further enhanced by the fact that the supply of Berkemann and Solidus brands was concentrated to the Hungarian location in order to facilitate the efficiency of raw material procurement (economies of scale). The *sales of the products* are managed from Germany, but the Hungarian party is responsible for managing the Romanian, Bulgarian and domestic market. Product development is largely supported by this function of the Hungarian unit, since the subsidiary established direct relations with the end markets. Based on its production competencies, the Kiskunfélegyháza unit is also responsible for *organizing the efficient production* of the newly acquired brands. This not only means the operation of the Hungarian subsidiary employing 330-340 employees, but also includes the supervising of subcontractors (some 100 employees) employed by the surrounding smaller enterprises as well as the production management of the factory in Croatia (185 employees) which accounts for the manufacture of Solidus products.

The prominent role of the Hungarian subsidiary was partially underlain by *incidental commitment*: the son of the owner spent considerable time in Hungary and gained significant experience of the local culture which facilitated the efforts to cope with the challenges and mistrust arising from the differences. Not only was he the only one who promoted the development of the Hungarian location, but also the local leader reigning at that time who designated the attainment of wider range of competencies and greater autonomy as desirable objectives. Initially, the raw materials, machinery, technologists and even the production and product development manager came from Germany. The *quality of work* performed in the factory (tasks accomplished in accordance with the expectations and meeting the deadlines, implementation of projects undertaken by diligence and reinforcing the parent company) convinced the management to settle new functions to Kiskunfélegyháza

and let the unit operate relatively individually. What indicates the significance of *externally channelled knowledge* in this process is the fact that the Hungarian subsidiary – as a member of the Bauerfeind group – was given a chance to learn from a larger and better organized foreign company for several years, which resulted in the adoption of the German patterns and models in management, controlling and project management. In the improvement of their position within the corporate group the German and English language skills and the academic degree of the *current manager* in economics played a decisive role in addition to his continuous and persistent intention to develop the unit ("Be more, than a shoe factory our colleagues are familiar with!"). With the decline in the production competencies of the German party, he is the only non-German member of the *corporate group's top management*.

5. Future plans, human background of Berkemann Hungary

Definite future *growth* plans were formulated in the development strategy of the company aiming to construct the *shoe factory of the 21st century*. In order to manage this process remarkable organizational improvement were taken place under which new colleagues (new school leaver entrants as well) were taught the principles of the company's culture as well as senior leaders in economy and logistics were invited from other fields of industry to exploit the possibility of adapting external experience. The most important key resource of the company is the knowledge of the employees who are able to manufacture premium quality products, therefore the management actively acts within its capabilities in order to *enlist and retain this workforce*. Although Kiskunfélegyháza is located close to a dynamic city (Kecskemét), the main challenge in terms of retaining the workforce is the labour migration to foreign countries as well as the seasonal workforce-absorbing effect of the polytunnel cultivation as a part of the traditional agricultural profile of the region. One of the tools for maintaining the employees is the *wage policy*. In the last ten years – in line with the most important employers of the town – the company carried out an annual wage increase of 4-5%, while fringe benefits constitute 20-25% of its employee's income. On the other hand, *efforts of community-building* should not be underestimated: widespread communication of corporate decisions, organized joint programs (corporate outings, Christmas celebrations) or providing support for workers in case of private life or health problems are all serving this goal. The relative success of the Hungarian management was reflected by the *moderate fluctuation of employees* (especially white collar workers), which not only prevails in local dimensions, but also outstanding compared to the parent company which further fosters the position of the Hungarian company representing continuity within the corporate group.

6. Conclusion

The case study of Berkemann Hungary serves as a spectacular example of the *upgrading of the Hungarian footwear industry within global production networks.* The market positioning of products, the applied corporate strategy and the expanding functions arising from the particular position of the Hungarian subsidiary within the corporate group all play an important role in the fact that the subsidiary of the Berkemann *represents long term growth* contrary to most actors of the domestic footwear industry. While *mechanisms of path-dependence* can be observed in the circumstances of emergence of the company as well as in the positive externalities which can be traced back to industrial traditions prevailing in the Kiskunfélegyháza region, in the context of the corporate group the *externally channelled knowledge* plays a decisive role in making these frameworks more plastic, in other words in enhancing the upgrading of the Hungarian company within global production

networks. *The example of Berkemann Hungary,* however, *cannot be generalized* according to the authors' experience: the company's competencies within the group largely exceed the average that Hungarian and East-Central European subsidiaries of foreign companies / subcontractors are characterized by Bertram 2005; Crestanello – Tattara 2011; Roukova et al. 2008; Schmitz 2006; Scott 2006. One might assume that on the basis of *production competencies still existing in the region*, a more complex engagement will become widespread which can be witnessed in global production networks manufacturing highly positioned products. On the other hand, while examining the Hungarian footwear industry the authors faced with the *real danger of loss in footwear manufacturing knowledge and skills* which – unfortunately – reduces the possible realization of this scenario (Molnár – Lengyel 2015b).

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