



Challenges and Opportunities of Bellegprom Concern

Companies affiliated with Bellegprom Concern increased labor productivity 2.5 times in H1 2012

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Economy of Belarus Magazine

The light industry does not have it easy not least because it has to cater to virtually all the Belarusians. Everyone wants to get high-quality, stylish and reasonably priced goods. Therefore, some customers are extremely fond of Belarus-made clothing, footwear and textiles, while others express harsh criticism of domestic producers. What do producers think about it? How do they manage to meet rigorous demands of customers and survive the tough competition on the market? What are the major problems facing the industry now? These questions are addressed to Chairman of Bellegprom Concern Gennady VYRKO.





? *The light industry is often called a problem industry because of its low profitability and competitiveness and heavy reliance on imports. Nevertheless, Bellegprom Concern is dealing with many tasks successfully. How do you assess the performance of the companies in H1 2012?*

It would make sense to compare the performance of our companies with that of producers from Russia and the European Union. The index of production of the concern has been constantly growing since 2004 when it made up 103.2% as against 2000. In 2010 the figure stood at 120.7%, in 2011 at 125.9%. This year it is expected to reach 133.8%. In the Russian Federation, the production growth in the textile and garment industry in 2011 stood at 4.3% as against 2000; the production declined by almost 40% in the European Union. In H1 2012, the enterprises affiliated with the concern made \$703 million worth of goods; in H1 2011 the output was estimated at \$667 million.

Among our major achievements is substantial improvement of the financial and economic performance. The number of loss-making companies has decreased. In H1 2012 they accounted for only 9.5% of the total number. Six loss-making companies started working in the black in January-June this year.

The share of shipped innovative products rose to 6.8%, the annual target being 5.5-6.5%. The energy conservation index was minus 6.7%, with the 2012 target of minus 5%. The return on sales in 2009 was 6.4%, now it makes 16% on the average.

Bellegprom Concern maintains an unwavering focus on modernization. Five years ago, the depreciation of the active part of equipment in the industry exceeded 80%, while in 2011 the figure was 52.6%; the target for 2012 is 49.1%.

Overall, the year 2012 is going to be successful for the industry. The growth targets were set forth in the comprehensive industry development program for 2011-2015. However, I would like to note

that the Belarusian light industry depends on economic developments in the Russian Federation and the European Union. We lack working capital because of rising prices for raw materials and energy, fluctuations in demand coupled with the decreasing paying capacity of the population, the lack of qualified workforce. Therefore, we need to admit that we have failed to fulfill some targets set for H1 2012. In particular, the growth rate of capital investments was only 84-89% in January-June 2012. The export of goods in H1 2012 was up by 2% with the yearly growth target of 10%.

Despite the tough competition on the global market, the textile industry export rose by 3.3%, garment industry export by 5.2%, leather and footwear industry export by 1.9%. The export of wool fabric soared 2.1 times, leather by 24.2%, carpets by 16.2%, linen fabric by 13.4%, knitwear (except for legwear) by 9.7%, silk fabric by 7.4%. OAO Sukno increased exports 3.6 times, OAO 8 Marta 2.1 times, OAO Bobruisk Tannery 1.4 times, ZAO Kalinka



1.3 times. The companies affiliated with the concern exported to 47 countries worldwide in H1 2012.

? *Russia has always been a major export destination for Belarusian light industry companies. Is this situation going to change following Russia's accession to the WTO?*

We are now busy holding consultations with Russia and Kazakhstan regarding our work in the open market. It should be noted that Bellegprom Concern was Belarus' first industry concern to develop a new strategy taking into consideration the SES formation for the period until 2017. The strategy sets forth the national interests of Belarus, suggestions and ideas to minimize the impact of Russia's entry to the WTO on the Belarusian light industry.

The formation of the Customs Union and the Single Economic Space of Belarus, Russia and Kazakhstan as well as Russia's accession to the WTO have a considerable impact on Belarus' light industry, because the industry is export-oriented and heavily relies on imported raw materials. The formation of the SES gave us access to a big market; transportation-related paperwork was simplified; a unified commodity certification procedure and unified technical regulations were developed. This is expected to help Belarus expand its presence in the Russian Federation.

At the same time, the formation of the Customs Union and adoption of the unified tariff resulted in lower import duties on a number of light industry products. It became easier for individuals to import personal use items. But it intensified competition both on the domestic and foreign markets. Therefore, we have to invest a lot of efforts to protect the interests of Belarusian producers on the markets of the SES member states.

Russia is indeed our major export destination and its role as our major customer is growing. In H1 2012 Bellegprom Concern shipped \$272 million worth of goods to the Russian Federation, or 102.9% as against the same

period in 2011. Russia accounted for 80.4% of our export. We have 42 commodity distribution facilities with Belarusian investments and 63 indirect commodity distribution facilities in Russia. Over the six months this year, the concern set up four new commodity distribution facilities with Belarusian investments there. We are going to keep it up.

However, the export expansion to the Russian Federation was constrained by a shrinking demand for consumer goods on the Russian market. In May daily consumer spending of Russians dropped by 4% compared to April. According to experts, the sale of summer wear in Russian retail outlets dropped by 20-25% in the monetary terms because of the cold weather and decreased paying capacity of the population.

? *What about the European Union, another major partner of Bellegprom Concern? What do you supply to the EU market today?*

The major exports of Bellegprom Concern to the European Union include clothing and knitwear, cotton and linen fabrics, leather. In H1 2012, export to this market ballooned by 89.9% as against the same period last year (9.3% of total exports). We shipped our products to 20 countries of the European Union out of 27. We increased the export to Hungary, Greece, the Netherlands, Poland, Romania, Slovakia, Slovenia, the United Kingdom, Finland, France, Czechia, and Estonia.

Although the EU generalized system of preferences was canceled for Belarus, the light industry products continue to be supplied to the European market. We can increase exports to the EU, for which, though, we need to improve the competitiveness of domestic products by creating a balanced marketing system. We need to form a product portfolio that meets the market parameters: assortment-design, price-quality.

? *How do you work with China, the key global competitor in the industry?*

In H1 2012 Bellegprom Concern companies manufactured \$703 million worth of goods





In January-June this year, foreign trade of Bellegprom Concern with China amounted to \$27.3 million, with exports totaling \$0.5 million, imports \$26.8 million.

In June 2012, Bellegprom Concern presented its products at the National Exposition of Belarus at the Harbin International Economic and Trade Fair. During the presentation customers praised high quality of linen fabrics, original design of products. Particular interest was shown in the footwear from flax made by Lida Footwear Factory. However, price remains the most decisive factor here. Retail prices for clothing and footwear in China equal selling prices of Belarusian enterprises. But we are interested in cooperation with China, and are ready to consider Chinese investment proposals.

? *What kind of raw materials do you purchase abroad today? How do fluctuations in the global commodity prices, in particular for cotton, impact your foreign trade and production costs?*

We mostly import cotton, wool, chemical raw materials and dyes. Yet I would like to mention that, according to customs statistics, import in H1 2012 dropped by 8.3% as compared to the same period 2011. This, in turn, improves the balance of foreign trade. Despite the fact that the industry is very dependent on imported raw materials, the foreign trade surplus in H1 2012 increased by 36.8% and amounted to \$104.1 million.

With regard to the growth of cotton prices on the international market, it affects the costs and competitiveness of the light industry throughout the world. In early 2011, the price for cotton reached its maximum having increased more than twice as compared to 2010. However, this price spike was followed by a downward trend. For 7 months in 2012 cotton prices reduced by 18% as against the January prices.

In addition the light industry uses chemical fibers and yarns, flax fibers. As the prices for fuel-energy resources are increasing, Bellegprom Concern has to raise prices for its products too, although

we realize that it affects the competitiveness of our products.

? *The Belarusian manufacturing sector including the light industry is expected to create new high-tech production facilities. How is Bellegprom Concern doing on this front?*

I have already mentioned that for the past four years all enterprises affiliated with Bellegprom Concern have been busy implementing upgrade programs. In 2011, capital investments across all enterprises of the concern increased by 31.5% over 2010 to a total of Br503.4 billion. The active part of the fixed assets has been upgraded by 10.8%. Physically and morally obsolete equipment has been replaced by high-tech and energy-efficient facilities. Mogotex, Gronitex, Lenta, 8 Marta and many other companies are now advanced, well-equipped facilities boasting excellent working conditions.

But much, of course, still needs to be done. We expect that at the end of 2012, the depreciation rate





of the fixed assets will make up 49.1%. Thus, the industry is gradually reaching the world level of wear and tear of equipment which is 40%.

In H1 2012, capital investments made up 89.6% as against the volume of investments in January-June last year, or Br295.6 billion. Of them 62.5% was channeled into the acquisition of equipment (Br184.7 billion). The remaining 36.2% was spent on construction and erection works (Br106.9 billion). I would like to note that the enterprises use mainly proprietary funds to implement upgrade projects. They accounted for 72.2% of the total investment. They also made use of bank loans, budget appropriations and foreign investment.

For example, \$1.8 million of foreign loans was attracted to finance the investment project at Slonim Worsted-Spinning Mill in H1 2012. In pursuance of the instruction of the President of the country, we continue to monitor technical upgrade of Baranovichi Cotton Production Corporation and Orsha Linen Mill which are on the list of most important investment projects in Belarus.

? *Could you elaborate on the investment project at Orsha Linen Mill, which can be rightly called the hallmark of Bellegprom Concern and one of the most famous Belarusian*

brands on the international market?

Modernization of Orsha Linen Mill can really be considered a national project. The mill produces about 17 million running meters of linen fabrics per year. Since its founding the mill has produced enough fabric to wrap the globe along the equator more than 80 times.

The project is of social importance, too, as the company employs over 5,000 people, mainly women. Today it is a profit-making steadily-growing enterprise. The company is implementing technical upgrades within the framework of the Belarus President's decrees. The investment project launched in 2008 and funded with the help of the resources allocated in line with the President's Decree No. 282 of 19 May 2008 is slated for completion in October 2012. All necessary equipment under the project was delivered in March, including nine German TISS jiggers worth nearly €2 million. Four finishing machines worth over €527,000 are expected to be commissioned in October.

This year Orsha Linen Mill has announced the launch of the third stage of the upgrade in line with the President's Decree No. 663 of 20 December 2010. The company has held tenders to purchase 130 items of technological equipment worth Br45.8 billion. They included

dyeing formula makers, 75 weaving, sewing, washing and drying machines.

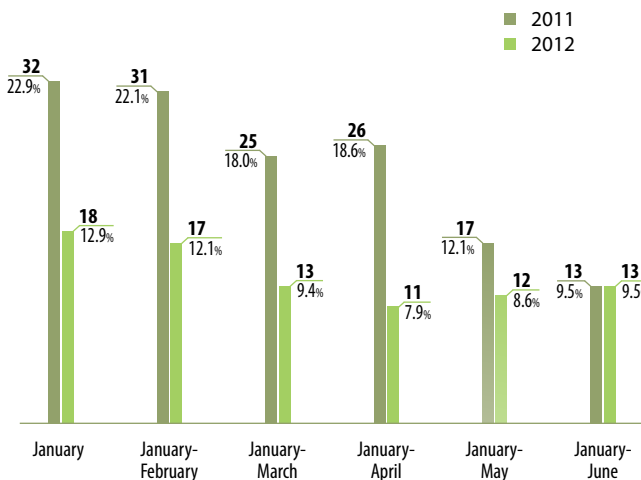
In 2009 the company received a government grant of Br57 billion. The funds were used to replace the outdated equipment and overhaul the sales and marketing system. The move helped raise the exports to non-CIS states by almost 70%.

Good foreign economic performance in 2010-2011 allowed us to alter some approaches to technical upgrading. We were supposed to take out a €85 million loan from the EurAsEC Anticrisis Fund. If we did this, interest payments on the loan would have made €44 million. Since the mill started earning foreign currency, it has decided to use its own funds for the technical upgrade.

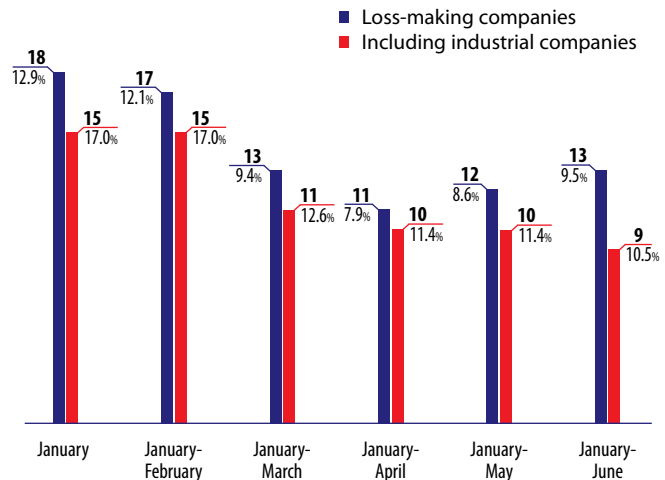
Increasing salability of the products testifies to the fact that Orsha Linen Mill has made the right choice in its development strategy. In H1 the sales of fabrics increased by 6.4%, exports went up by 16.4%. Foreign supplies accounted for 72.4% of the total output, up 6.2%. The share of innovative product shipments reached 14.1%.

? *What are the prospects for another light industry giant, namely Baranovichi Cotton Production Corporation that has been reincorporated into a joint stock company this year?*

Number of loss-making companies of Bellegprom Concern in 2012 as against the same period of 2011 (the share in the total number of companies)



Number of loss-making companies of Bellegprom Concern in 2012 (the share in the total number of companies)





The President's Decree No. 205 as of 25 April 2012 concerning the open joint stock company Baranovich Cotton Production Corporation envisages additional financing for the company. The funds will be allocated to finance the 2012-2015 investment project to replace deteriorating and outmoded machinery in the weaving, finishing and sewing shops and install its own energy generating facilities. In this way, the company will be able to launch the production of cotton and mixed yarn and fabrics meeting all international standards.

Sophisticated high-performance equipment will allow the company to enhance labor productivity, cut down on manual work, expand the lineup, reduce labor intensity and enhance comfort of its operation.

It should be noted that the company has already been considerably modernized. In 2009-2011 it installed finishing, sewing and accessory equipment purchased using the loans provided under the President's Decree No. 282. The company used its own resources to enhance competitive ability of its products through assortment expansion and quality improvement.

As a result, in H1 2012 the company's output in actual prices increased 2.5 times in comparison to the same period last year. Profitability of sales reached 9.2%.

Exports soared 87.7%. Operating profit exceeded Br19 billion, net profit Br5 billion.

The market research and the analysis of the company's performance show that the company will need to continue technical upgrade and will need government support with loan restructuring. To that end, we have developed a business plan for an investment project (through 2015) to purchase technological equipment via foreign credit lines under the guarantee of the Government of the Republic of Belarus. An opportunity of opening foreign credits by potential equipment suppliers is under consideration as well.

? *Among big investment projects is fundamental modernization of Minsk-based Kamvol. What is the status of its implementation? Do you have any plans to redeploy the plant beyond the city limits?*

We have decided to upgrade Kamvol at its present location. The new production premises will occupy 45,000 square meters (the current production floor makes up 84,000 square meters). The installation of up-to-date equipment will require a smaller area. The construction of new facilities will not interrupt the manufacturing process. As a

result, the output per employee will increase three times.

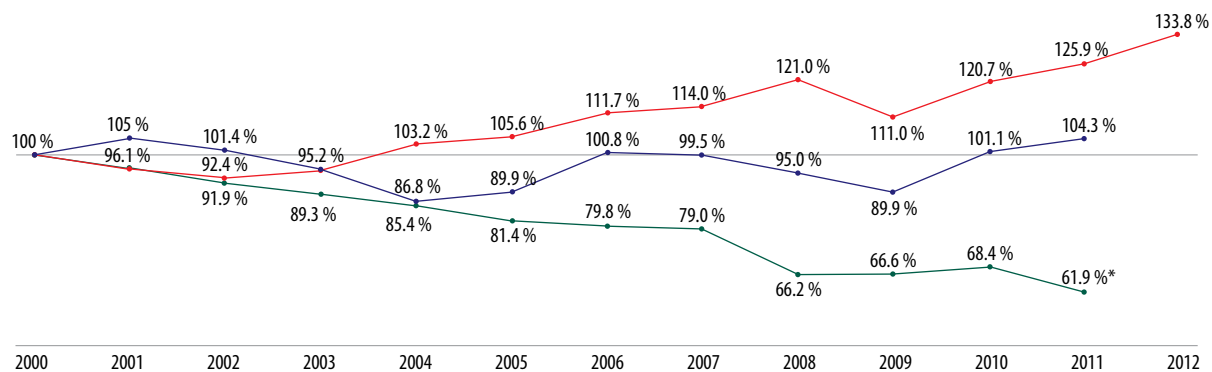
Loans have been also used to implement partial technical upgrade and purchase over 30 items of European equipment. The company needs fundamental modernization to ensure its stable operation in the future. A plan has been developed in this respect to construct a new high-tech enterprise with the annual output of four million running meters of fabric.

The project will cost €136 million. An estimated 85% of the sum will be received through foreign loans under the guarantees of the Belarusian government. It is expected that the new factory will be put into operation by 2015.

The business plan of the investment project passed an expert review at Bellegprom Concern and got an approval of the State Committee for Science and Technology. The relevant documents and the President's draft decree on Kamvol have been sent to the stakeholders for coordination.

? *Mr Vyrko, let us discuss the state of affairs in the footwear industry, its successes and problems. How much footwear do Bellegprom Concern companies produce for the local market? Do Belarusian footwear manufacturers dominate the market?*

Light industry production index in the European Union, Russian Federation and Belarus (in % as against 2000)



- Bellegprom Concern
- Eurorean Union (information by Eurostat www.epp.eurostat.ec.europa.eu)
- Russian Federation (information by Rosstat www.gks.ru)

* - January - September 2011



In 2012 Bellegprom Concern's footwear output will make up 12.9 million pairs of shoes. Some 14.7 million pairs of shoes will be produced in Belarus altogether. We do not take into account felt and rubber footwear. Nearly half of Bellegprom Concern's produce is exported. In 2011 the production capacity of Bellegprom Concern footwear manufacturers made up 15.7 million pairs of shoes. In H1 2012 the efficiency of these companies was 79.8%. Marko, San Marko, ActiveShoes, and Belwest operated with the highest efficiency (almost 100%). The performance of the joint venture Otiko exceeded 95%.

In H1 2012 the footwear output went up 3.5% over the same period last year to reach 5.7 million pairs of shoes in kind, including 151,000 pairs of felt and rubber boots. Some 2.8 million pairs of footwear were supplied to the local market (103.6% of the planned volume), including 603,400 pairs of child footwear (113.6% of the planned volume).

In line with global statistics, every year 1.9 pairs of shoes are bought per capita on the global average. People in Belarus annually buy 2 pairs of footwear, in Kazakhstan they purchase 2 pairs of shoes per year; Russians add from 1.4 to 2.2 pairs to their footwear wardrobes annually. Belarus-made footwear accounts for 64.2% of the retail footwear market in the country.

At present over 40,000 footwear designs are available on the Belarusian market. Footwear companies produce up to 9,000 designs. Moreover, they regularly refresh the lineup. Just to compare: in 1990 Belarusian companies manufactured only 500 footwear designs. However, they produced only 47 million pairs of shoes and had no problems with sale. Needs were different back then.

In general, Belarusian footwear companies operate steadily and continuously ramp up the output. Today their main objective is to satisfy the domestic footwear demand. We are not seeking to meet 100% of the needs on the local market. In our opinion, there should be all kinds of footwear to every taste. In order to make up for the import, which stands at 14.6 million pairs, we

In 2012 the depreciation of fixed assets of Bellegprom Concern companies is expected to make 49.1%. The industry gradually reaches the world level of equipment deterioration which makes up 40%

need to boost the output and sales of shoes by adding new designs in the amount equal to the volume of import.

We believe that setting up a holding company to produce leather goods and footwear will make the task reachable. The holding company will facilitate management of subordinate companies, raise the output and diversify the lineup by means of the unified assortment policy. The holding company will bring together companies that have a broad commodity distribution network, good development prospects, and abilities to attract direct investments.

As for the problems, first of all, the footwear industry needs more Belarus-made leather. Only 3.5 million pairs of footwear are made from local leather. To produce more shoes the companies have to import leather and materials. Because of heavy workload and personnel deficit, they have to subcontract the production of uppers. So, we believe that a tannery will help the holding company consolidate the manufacture of leather goods and footwear.

The deficit of qualified personnel in the footwear industry is an urgent problem, too. This issue has already turned into a national problem. In 2011 vocational schools trained 2,600 people for the footwear industry. Only 1,130 graduates were employed by footwear companies. In 2011, 2,294 people took up jobs at Belarusian footwear companies, while 2,335 people quit. So you see the personnel issue is very pressing.

? *Is privatization of Bellegprom Concern companies going smoothly? Last year several companies were privatized. Do you have interested investors today?*

The concern submitted a proposal to the State Property Committee regarding the terms of selling government-owned shares of 21 joint stock companies of Bellegprom Concern.

It is worth saying that about 40% of Bellegprom Concern companies do not have shares owned by the state, i.e. they are 100% private. A number of companies have a small



part of state-owned shares. For example, the government owns as little as 0.18% of Luch's shares. The rest of shares are owned by other legal persons and individuals who bought them earlier using Property vouchers.

Last year Baranovichi Cotton Production Corporation was reorganized into a joint-stock company. Orsha Linen Mill will follow suit soon. We are in favor of wise privatization. We are not going to sell state-owned shares at a low price.

It is noteworthy that investors are interested in the light industry, especially in small factories. Last year they bought shares owned by the government and individual enterprises at auctions. We thoroughly study the investor's proposals and long-term plans, and make sure that the project is in keeping with our policy.

? *Salaries in the light industry are traditionally low. What is the growth rate and how does it correlate with labor productivity?*

In H1 2012 the nominal average monthly salary in Bellegprom Concern made up Br2.623 million. In June it made up Br3.101 million. The salary growth target was beaten by 1.3%. The average monthly salary in Bellegprom Concern's manufacturing organizations made up Br2.607 million in H1 2012, including Br3.097 million in June.

Bellegprom Concern takes measures to raise salaries and hit the 2012 growth target. Thus, 40 organizations of the light industry raised the first-class wage rate (from 15% to 300% on average) in H1 2012. However, wages are still low in spite of the high growth rate.

We understand that we have to raise salaries to attract new employees. And it is not because there is a wish for that. Salaries should be earned. There are no other sources. We have defined ways and mechanisms to raise salaries. These are technical upgrade of production facilities with a view to raise labor efficiency, value added, output per one employee and creation of high-productive jobs.

Another way is to develop brands as one of the sources of added



value. For instance, Milavitsa and Elema manufacture branded goods. The average salary at Milavitsa is already equivalent to \$500. Elema's salaries are close to this level. This also pertains to other big Belarusian companies.

Factories located in small towns are dealing with more difficulties. Yes, Puma and Adidas have their products sewn in Belarus. It seems to be prestigious, but... Companies do not get any value added. Therefore, the output of a foreign company reaches \$60,000, while Belarusian plants get much less. Today we use European practices of placing orders and outsource to

other markets where these services are cheaper.

Bellegprom Concern companies draw much attention to the growth of labor productivity when raising salaries. One of obligatory conditions in labor contracts is that the growth of labor productivity should outstrip the increase in real wages.

And we try to strictly follow this rule. Thus, in January-June 2012 the growth rate of labor productivity was 255% as against the same period of 2011, while the target for 2012 was 155%. The growth rate of production was 265.4% in selling prices, while the growth rate of wages made up 115.3%. ■