# Local Firm's Response to Global Financial Crisis: a Case of an Apparel Factory in Lao PDR

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**Abstract:** This study analyzes a small local apparel factory's strategic response to the recent global financial crisis in 2008 based on strategic approaches. Before the crisis, small Laotian-owned apparel factories operated mainly on a subcontracting arrangement with general contractors who produced based on orders from brand owners in abroad. The crisis broke down such subcontracting arrangements; thus, the apparel factory under study has turned to produce for local markets through enhancing its strengths, minimizing weaknesses, taking opportunities and hedging against threats. With increased trade liberalization, growing tourism industry and its growing strengths, this factory can also produce its own brand products for foreign tourists in Lao PDR as well as for export markets.
**Key words:** Apparel production business; Strategic approach; Response to financial crisis

## 1 Introduction

Businesses are subjects to many environmental changes which are beyond their control. Such changes can either be opportunities or threats to business firms. Firms have to innovate and change their business strategies in order to overcome and survive under such changing environment.

Demand shock started in the United States as a result of the collapse of giant financial institutions in September 2008 and, to firms it was one external change which caused the worst damage to the world economy since the Great Depression (Hui Tong and Shang-Jin Wei, 2008). Export sectors in developing countries were greatly affected as the demand for their products in developed countries (the former's major export markets) has shrunk. The Lao apparel sector has been no exception as it has been dominated by foreign factories which produce garment products for exports. Small Lao-owned factories were and some are still now subcontractors for foreign companies. The global financial crisis or the demand shock broke down many subcontracts as the general contractors suffered from export drops (Source ASEAN, 2011). Some large and small factories were closed down and many workers were laid off. Observing increases in local demand, small Lao-owned factories have shifted their business strategy from production for exports to addressing this increasing demand in the local market.

The existing studies on the Lao apparel sector after the demand shock are very limited and they do not deal directly with strategic changes at the individual firm level as the firm's response to the demand shock. For example, Kongmanila and Takahashi (2009) investigates the role of innovation in export performance and profitability of Lao garment exporters. Source ASEAN (2011) attempts to provide the effects of the demand shock on and provides a simple analysis of strengths, weaknesses, opportunities and threats of the Lao apparel sector. But, the business strategies developed based on such a sector-wide analysis will not be directly suitable for individual firms as firms are greatly differ. This study attempts to study a strategic shift of a small Lao-owned apparel factory in Vientiane Capital of Lao PDR based strategic management approaches in order to reveal the firm level's response to the demand shock.

## 2 Analytical Framework

This study is based on a premise of well known business strategic management theories which assume that a particular business will set its long-term goal and vision based on the business internal reality and the surrounding environments (Dess et al., 2007; Hanson et al., 2008). Business management is generalized as a process of managing the business' internal elements for implementing a set of activities towards desired results under the changing and uncontrollable external environments for fulfilling the business objectives in line with the vision. The business's ability to align its vision through its results is known as business effectiveness (McKinsey & Co, 2001).

Business effectiveness requires a set of managerial effectiveness at all levels of the firm at a particular time period. Over time, the firm has to grow, and the pace of growth is influenced by both its effectiveness and efficiency, which are determined by the firm's ability to perceive and adjust to the changing environments based on its internal reality. In other words, to maintain effectiveness and continuous success, firms have to know themselves, the surrounding environments, competitors, customers and sale channels.

Two tools which are widely used in analyzing internal and external factors of a particular firm are the X-Y axis analysis and SWOT analysis (Dess et al., 2007; Hanson et al., 2008; Fukuyama, 2011). In the X-Y axis analysis, the analyst chooses two uncorrelated factors which are most important to the business under analysis. For instance, product quality (low vs. high quality) and marketing approach (direct vs. indirect marketing), or production orientation (import substitution vs. export) and marketing approach can be used for defining dynamics in business domains of a wide range of firms including garment factories (Fukuyama, 2011). Dynamics here does not refer only to changes in business domains over time and future direction, but also includes revealing hidden business opportunities for the business under study.

In the SWOT analysis (the analysis of strengths (S), weaknesses (W), opportunities (O) and threats (T)), the analyst will conduct external analysis and internal analysis in details. The external analysis involves collecting information on surrounding environment of the business and examining positioning of the business concerned in the business field. It reveals positive changes in the external environment which will bring opportunities to the business as well as negative future changes in the external environment which will threaten business success. In contrast, the internal analysis involves examining the business' available resources which give the business competitive advantages (strengths) as well as revealing internal constraints (weaknesses) of the business. In other words, through SWOT analysis, the analyst can grasp positive and negative factors that may affect the business under study, both in the present and the future (Fukuyama, 2011). Based on both X-Y axis analysis and SWOT analysis, the firm can define or reshape its vision, mission and strategy. A good strategy should allow the firm to enhance its strengths, minimize the weaknesses, utilize the opportunities and prevent the threats so that the firm can operate competitively along its business domains dynamics and towards fulfilling the vision. These two analyses are used in this study in order to define strategic responses to the recent global financial crisis (demand shocks) of a small Laotian-owned apparel factory in the Lao PDR.

## 3 Global Financial Crisis and Its Impact on the Lao Apparel Industry

The recent financial crisis resulted from the Lehman bankruptcy in the third quarter of 2008 through the first quarter of 2009 brought the worst recession to the world economy in the post-war era. Growth of the world economy fell by 6 percentage points from its pre-crisis peak to its trough in 2009 (Moghadam, 2010). Developing economies faced economic hardships in various degrees due to the externally driven collapse in trade and financial volatility. During such period, while some developing economies could increase their output growth by one percentage point, a number of other developing countries had real output contraction by about 11 percentage point (Moghadam, 2010). Countries with growth dominated by manufacturing exports faced the worst output contraction while the natural resource commodity exporting countries could maintain stable economic growth as the world demand for natural resources did not decline significantly and the natural resources prices kept increasing. The Lao PDR was among the latter group and it could enjoy GDP growth of 7.2-7.5 percent per year in 2008-2010 (ADB, 2010).

However, the apparel sector is the sector which was negatively affected by the global financial crisis as it has been dominated by foreign investments which produce garment products for exports. Small Lao-owned factories are subcontractors for foreign companies. In 2007, FDI companies created 13,703 jobs (63% of garment jobs), purchased 9,130 machines (59% of the total for the garment sector) and produced 28.9 million pieces (58% of the total) in the export-oriented garment sector (Source ASEAN, 2011). The apparel sector as a whole has been of great importance to the Lao economy since the late 1990s. In 2003, garment exports, valued at US$115 million, accounted for approximately a third of total exports, second to electricity (World Bank, 2005). The European Union is the main destination for the country's clothing exports, though shipments to the United States have grown recently. In 2008, the European Union accounted for 79% of total exports, the United States 14%, Japan 2%, Canada 2% and other countries 3% (Source ASEAN, 2011). As the recent financial crisis started in the United States and spread quickly to Europe (and the other parts of the world), the apparel exports from Lao PDR to United States and European Union greatly reduced.

Therefore, although the Lao economy as a whole was not greatly affected by the Lehman bankruptcy, the apparel sector suffered from a severe damage. The exports greatly dropped from US$189.7 million in 2008 to US$79 million in the first six months of 2009 and a major portion of the subcontracting relations among large foreign apparel factories and small Lao-owned factories has broken down (Source ASEAN, 2011). In response, a number of small Lao-owned factories have changed their production and marketing strategies towards local consumers and establishing long-term contracts with large organizations and projects which need to procure uniforms for their employees. At the same time, as one of the forty-nine least developed countries, Lao PDR continues to enjoy duty-free and quota-free market access to certain developed countries under the generalized system of preferences (GSP). Therefore, Lao garment factories will be able to increase their exports after the demand shock effects in the developed countries. China, a major world garment exporter, has recently faced increasing production costs (Vientiane Times, 24 August 2010). As a result, Lao PDR will gain more comparative advantage in the garment export markets. In sum, Lao garment factories have to seek to maximize the use of cheap labors while seeking ways to improve labor productivity, reduce employee turnover and lead time, and to overcome fierce competition from cheap but high quality import products from neighboring countries. At the same time, the industry needs to implement a product diversification strategy with the introduction of products in the medium to higher market segments and develop sufficient production inputs.

## 4 Strategic Response at the Firm Level

This section deals with factory-level analyses for one Laotian-owned apparel factory (DV) in Vientiane Capital of Lao PDR in order to see how the factory responded to negative effects of the global financial crisis of 2008. DV is the author-created name for the factory under study in order to avoid stating its real name for confidentiality purpose.

**4.1 Business domain**

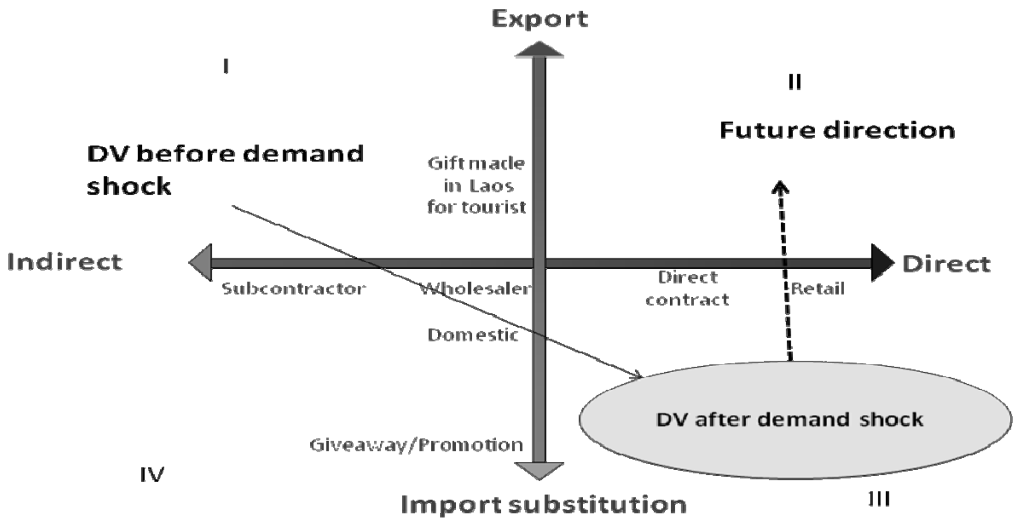


**Figure 1 The X-Y Analysis of DV Apparel Factory**

Figure 1 shows changes in the business domains of DV based on the marketing approach (indirect vs. direct marketing) and markets (domestic vs. export markets). Since its incorporation in May 2006 until the outbreak of the global financial crisis or the demand shock, DV had operated as a small subcontractor for a large foreign invested garment factory (general contractor) whose outputs are for exports. Under the subcontracting arrangement, DV produced brand-name products designed by the brand owners in abroad and it exported all its products through the contractor. This means before the demand shock, DV's business domain was in Quarter I of Figure 1; it produced for exports markets through an indirect marketing approach.

The demand shock broke the subcontracting arrangement. In response, DV has turned to produce its own products for domestic markets and has entered into direct contracts with large projects and companies (Quarter III of Figure 1). Such a shift in business domain has been accelerated by growing sale promotion activities of large companies (including telecommunication companies) as part of their marketing strategies intended for overcoming fierce competition and increasing the sales. Garment products such as T-shirts and caps (among others) are commonly used as giveaway products by such large companies. DV has been actively penetrating into this promotion market and has received orders on a constant basis.

Mining and hydropower companies are also an important market for DV. These companies require their large number of staff and workers to wear uniforms and safety wears at work. DV has entered into a long term contract with one mining company for producing safety coats. Under the contract, DV does not only produce according to the design given by the mining company. Instead, DV proposes several design options. The company in turn selects the design out of the available options.

With proactive attitude and design innovation of the DV owner, DV may be able to develop its own brand products for both domestic retail markets and exports. This means that DV can possibly move into the business domain depicted in Quarter II of Figure 1.

**4.2 SWOT analysis for DV**

Table 1 outlines strengths, weaknesses, opportunities and threats of the DV apparel factory. On the positive side, DV is endowed with a skillful management team with a long experience in the apparel sector and reasonably good production facility. Due to such two basic strengths, DV could gradually improve its product quality up to the quality standard of Thai products. DV is also in the process of developing its own product brand. With such strengths, DV could effectively utilize opportunities imbedded in the process of economic growth and growing sale promotion activities of large companies in Lao PDR. The booming tourism sector has drawn in a large number of tourists to Lao PDR. DV can choose to develop its brand for the tourist market in the future.

**Table 1 SWOT Analysis of DV Apparel Factory**

| Strength | Weakness |
|---|---|
| Quality level equals to import products<br>Production facility<br>Brand “DV”<br>Skillful and experienced management | Staff turn-over<br>Sub-contractor position/dependency on general contractors<br>Staff communication skills |
| **Opportunity** | **Threat** |
| Promotion/Giveaway market<br>- T-shirts<br>- Cap<br>- Bag<br>Economic growth/ Income increase<br>Tourism | Economic/financial crisis<br>Imports after trade union/ASEAN integration<br>Chinese cheap but high-quality products |

On the negative side, DV has to minimize its internal weaknesses and overcoming threats imbedded in its surrounding environment. The recent financial crisis drew DV away from the subcontracting arrangement. It can now work more on direct contracts with local companies. Staff turn-over is a major problem facing the garment industry in Lao PDR. DV also used to suffer from this problem. But, recently it can dramatically reduce the staff turn-over problem through offering appropriate staff motivations and incentives as well as making sure that all the employees share DV’s canons of “growing together” and “mutual trust”.

Apart from minimizing its weaknesses, DV has to seek ways to overcome fierce competition brought about by the ASEAN integration process, particularly the ASEAN trade agreement which is coming into force from 2015. Chinese cheap but high quality imports will also be an important threat for DV as well as the Lao garment industry as a whole.

**Table 2 Critical Success Factors of DV and Their Intended Effects**

| *No.* | *Critical Success Factor* | *Intended effect* |
|---|---|---|
| 1 | Client retention | To maintain existing customers and maintain market share |
| 2 | Scheduling | To increase operation effectiveness and efficiency and to meet customers’ expectation |
| 3 | Staff productivity | To improve competitiveness and to increase profit |
| 4 | Lead time | To improve competitiveness and to increase profit |
| 5 | Management team | To obtain complementary effects of management members’ skills |
| 6 | Design capability | To keep up with growing market demand |
| 7 | Brand | To create own market segment and customer loyalty |

**4.3 DV’s strategic directions and critical success factors (CSF)**

Based on the above discussions, three key strategic direction options for DV include:

Direct sales/contract in promotion/giveaway market to replace imported products and clients retention (CRM)

Basic casual ware of own brand (setting up a DV T-shirts (made in Laos) shop for tourists)

DV garment products for exports

So far, DV has taken the first option as its strategic response to averse effects of the global financial crisis. This strategy is a resultant of financial crisis (threat), growing promotion/giveaway market (opportunity), and all strengths of DV. With increased trade liberalization, growing tourism industry and its growing strengths, DV can implement the second and third strategic options in the future. To advance along with the strategic priorities mentioned above, DV needs to do right the seven critical success factors shown in Table 2. The intended effect of each critical success factor is also shown in the table.

## 5 Conclusions

Up to the global financial crisis caused by the Lehman bankruptcy in 2008, the apparel industry in Lao PDR was generally characterized by subcontracting arrangement among the general contractors, which were mainly large foreign invested factories, and the small Laotian-owned factories. A majority of the products were exported to the European Union, the United States and others. Since the Lehman Bankruptcy started in the United States and spread to European Union and other countries, the Lao apparel sector experienced a significant export reduction, and some general contractors could not maintain the subcontracting arrangement with their existing subcontractors. DV apparel factory used to be in such subcontracting arrangement. The breakdown of the subcontracting arrangement forced DV to reconsider its business strategy. It has turned itself towards producing for domestic markets through entering into direct contracts with large companies in Lao PDR. DV's future strategies involve producing its own brand for both domestic and export markets. DV has a vision of making itself the top brand in Indochina and has a mission of providing customers with the high quality basic casual ware. The study confirms that the use of strategic approaches and tools, a small business like DV could overcome negative effects of the Lehman Bankruptcy. DV could come up with business strategy options through enhancing its internal strengths, minimizing weaknesses, taking opportunities and hedging against threats in the surrounding environments.

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