

- [European Industrial Relations Dictionary](#)
- [EurWORK publications](#)
- [Working life country profiles](#)
- [Case studies](#)
  - [Attractive workplace for all](#)
  - [Ageing workforce](#)
  - [Workers with care responsibilities](#)
- [Database of wages, working time and collective disputes](#)
  - [Dispute resolution](#)
- [News](#)
- [Events](#)

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## You are here

- [Home](#)
- [Observatories](#)
- [EMCC](#)
- [ERM](#)
- [Restructuring in SMEs](#)
- [H&D, Czech Republic](#)

## H&D, Czech Republic

- Type of restructuring:  
Internal restructuring
- Employees before restructuring:  
50-249
- Employees after restructuring:  
10-49
- Nace/Sector:  
Retail
- Country:  
Czechia
- Date:  
08/03/2012
- Keywords:  
Recession/Crisis

## Abstract

Czech textile firm H&D decided to offshore production to China because of increasingly high labour costs in the Czech Republic, which made the firm less competitive. This way of optimising costs was sought as it was assumed that the competition in the industry will further increase due to the introduction of vertical production chains and the weaker negotiation power of SMEs (compared with larger firms) towards suppliers.

## Organisational profile

The joint-stock company H&D a.s. is a clothing manufacturing company. Originally established as a cooperative association in 1990, it was transformed into a joint-stock company in 1995. Ivo Havel, who is the company's current director, privatised the state-owned Galeko a.s. Prostějov within the voucher privatisation programme and then purchased the majority share in that company (voucher privatisation is a privatisation method where citizens are given or sold a book of vouchers which represents potential shares in any state-owned company.). Today Mr Havel and his wife are the sole owners of the company. In this way, Mr Havel obtained the current premises of the company, as well as two retail networks of the Oděvy Hradec Králové and Oděvy České Budějovice companies which used to be parts of the state-owned Galeko a.s. Prostějov. Gradually, all the shops of the two above-mentioned companies were sold out as a consequence of declining sales.

As far as the manufacture of clothing is concerned, between 1995 and 1997 the company had eight separate operations with approximately 40 employees each. In 2012, they have only one workshop with 10 people. Starting in 1994, all production operations were gradually relocated to Southeast Asia. Due to ever-increasing pressure in the textile industry, the company has been progressively changing its focus since 2008 and is shifting to the manufacture of home accessories and furniture marketed under the H&D Home Design brand. Nevertheless, the manufacture of clothing still makes up the majority of operations. The company currently has two brand-name shops in Prague and Prostějov and two Internet shops (one selling clothing and the other furniture and home accessories). In addition, the company runs its own guest house in the Jeseník Mountains.

When it was first established, H&D had 400 employees. With the passage of time, as more and more production activities were relocated to Southeast Asia, the employee headcount decreased (the company had 180 employees in 2004, 150 by 2006, 75 by 2008 and only 65 by 2010). At the beginning of 2012, the company had 45 employees in total in the production division (only a minor share of the employment as the employees focus only on the repair of imported furniture and clothing, not on their production), the creative division, the furniture and textile warehouse, and the accounting department. Other than the designers and top management, who have university degrees, the majority of the employees have completed a vocational education. The company does not have a documented human resource development strategy or a social responsibility strategy. There are no works council and no trade union in the company.

Ivo Havel, who is a qualified engineer, is the company's owner and director. He has abundant experience of the textile production industry. For many years, he was the deputy director of the state-owned OP Prostějov s.p. clothing manufacturer. After the change of regime in 1989, he was the director of the state-owned Gala Company for a short time.

Mr Havel classifies the company as an international enterprise, not only because it outsources production to China, but due to its export activities. The METRO Group, which is represented in the European Union, the Ukraine, Kazakhstan, Greece, Romania, Serbia, Bulgaria and Hungary, is the main export intermediary. The company exports 40% of its total production volume through this chain. Only a minimum of production output is purchased locally.

Starting in about 2000, the company's annual turnover was approximately CZK 200 million (€8 million). The maximum turnover was achieved in 2008, when it reached CZK 275 million (€11 million). Since that time it has been decreasing – it was CZK 140 million (€5.6 million) in 2009, CZK 98 million (€3.9 million) in 2010, and in 2011, it was only CZK 90 million (€3.6 million, including VAT).

## **Background to restructuring events**

The main initiating factor behind the restructuring changes that required the offshoring of production to China is the high cost of labour for line production. As an example, Mr Havel described the situation of the Czech Republic, when in 2004 the personnel costs for one employee were approximately USD 200 (€160) per month. Due to increasing wages and the weakening of the dollar in relation to the Czech crown, these costs have increased to USD 600 (€490). As a result, the workforce lost its competitive strength in comparison to countries such as China. The company began outsourcing the production of its products to China in 1994 and all of its production operations have gradually transferred there. In Prostějov, where the company is situated, their products are only designed.

Although the company had a record turnover in 2008, the management was certain that the competition in the textile industry would continue to intensify, particularly due to the arrival of vertical production chains – international chains that sell their products in their own international retail networks, but do not purchase their product portfolio but produce it themselves in countries with lower labour costs, for example H&M, Kik, C&A, and Inditex, which operates stores such as Berschka, Massimo Dutti and others – in the Czech Republic. When ordering production in Asia, medium-sized enterprises do not have as strong a negotiating position as large companies and thus cannot attain the same level of quantity discounts. According to Mr Havel, China is currently also becoming expensive and Mr Havel is looking for somewhere else to relocate his sewing shops, possibly to Bangladesh.

2010 was the most difficult year in H&D's history due to the confluence of several negative factors. In addition to the overall global crisis, which was reflected in a decrease in consumption and consequently in the demand for the company's products and reduced deliveries to hypermarkets, other negative trends also started to appear. The first was a continual increase in the price of cotton on the world's markets. The company, as a manufacturer of leisure clothing, uses primarily cotton or cotton blend materials. Another negative factor was the increase in costs associated with production in China due to the reduction in subsidies provided by the Chinese government for the export of textiles. This was combined with an increase in the wages paid to workers in this industry. All of the above were reflected in increased costs associated with the manufacture of clothing.

As a reaction to the decreasing sales in clothing, due to the very capable and experienced employees in the import section (they have language skills, knowledge about corresponding legislation, established contacts), Mr Havel decided to look for new import opportunities in order to diversify the production of the company.

## **Restructuring processes**

As a result of various influences on the competitiveness mentioned above, in 2010 the company was forced to implement measures aimed at creating internal sources of cost savings. These measures included increasing the effectiveness of production outsourcing management, primarily in the phase during which all of the components required for the manufacturing process are ordered and completed.

Another measure used to counterbalance the pressure in the textile industry was to gradually diversify production and to shift from the manufacture of clothing to the manufacture of furniture and home accessories. For these reasons, the company has been undergoing an internal restructuring process since the autumn of 2008 in relation to the portfolio of products it manufactures. The company is gradually changing its focus and is shifting to the manufacture of home accessories and furniture manufactured under the H&D Home Design brand. The competition is not as stiff within this particular segment as it is in the clothing industry – in 2011 the sales of furniture and home furnishings accounted for a turnover of CZK 15 million (€600,000), as compared to CZK 7 million (€280,000) in 2010. The original focus on retail sales of this particular group of products has thus far not generated any significant results. For this reason, the company would like to become a supplier for hotels, restaurants, golf clubs, spas and

bakeries.

In addition to changing its product portfolio, the company also attempted to decrease its overhead costs. It installed more energy-efficient lighting and other measures to decrease the overall use of energy.

As far as the restructuring period is concerned, according to Mr Havel it is still underway. The share contributed to turnover by furniture has been increasing continually since 2008, to the detriment of clothing. In the case of off-the-rack clothing, the volume is becoming lower and lower and the company recently abandoned the manufacture of women's off-the-rack clothing because of weak demand. The volume of clothing produced develops according to demands of clients of the company. In a case of urgent demand for clothing the company is prepared to increase its production.

The company has never had – and still does not have – any cohesive restructuring plan. However, for the purpose of receiving bank credit, it must prepare two-year business plans. According to Mr Havel, these two-year plans are sufficient. He claims that, within the textile industry, it is not worthwhile to plan for a longer timeframe due to the rapid ageing of production. The situation with furniture is different – it has a longer physical and functional useful life. In addition to Mr Havel, the company's sales director and financial analyst also participate in decision-making about restructuring issues.

The business strategy to move to a different product portfolio originated gradually. At various trade fairs that Mr Havel visited in Southeast Asia (Shanghai, Canton, Djakarta, Singapore, New Delhi, Dhaka and Taipei), he established contacts with furniture manufacturers. Within the company itself, the restructuring did not require any major measures to be implemented. No special machines had to be bought as the production has been outsourced to China. The company only hired two furniture experts, specifically one designer and one cabinet maker. The other employees were retrained. This was easy because the main principles of their work remain the same and only the object of business has changed. The retraining was announced to employees just at the beginning of this restructuring process. The employees accepted the retraining as they saw that the competition in the clothing industry was getting more intensive, which threatened their jobs. The creative division changed its focus from fashion to furniture and home accessories. In the case of the internet shops, the company hired software specialists.

Approximately 135 employees have been made redundant since 1994 as a consequence of outsourcing the production to China. In the period of internal restructuring (2008–2012) the number of employees decreased by 30; however, it was mostly associated with the continuing outsourcing of production. Firstly the workers who were employed in other companies' activities were made redundant. The selection of employees who became unemployed was made according to the needs of company as the effectiveness of the production had to be maintained. However, Mr Havel maintained the jobs of hardworking lone parents whose redundancies would have exposed them to a very difficult situation. The dismissal was announced to all relevant workers in advance. All the dismissed workers got severance pay according to law.

The restructuring steps were financed from the company's own resources and with the use of the company's existing revolving credit account (the limit is CZK 10 million (approximately €400,000), but the average outstanding debt is approximately CZK 5 million (€200,000)).

## **Challenges and constraints of restructuring**

When evaluating restructuring activities from the perspective of small and medium-sized enterprises, Mr Havel believes that the restructuring of the product portfolio is more complex than the restructuring of other areas, mainly because it requires great support in the form of human resources, which small and medium-sized enterprises generally do not have. From the viewpoint of H&D, this was especially valid concerning the transformation of the company's product portfolio. This transformation required especially capable designers and it was hard to find them. If Mr Havel could turn back the clock and perform the restructuring process again, he would hire a personnel officer, as he was not successful in finding high-quality employees for the position of designer quickly enough. At the same time, a high-quality workforce plays a decisive role in the success of every company. In this respect, Mr Havel draws attention to the weak position of small and medium-sized enterprises, which cannot afford to pay for ads on the large job portals such as [www.jobs.cz](http://www.jobs.cz).

On the other hand, small and medium-sized enterprises are more flexible but, at the same time, also place greater demands on a flexible workforce. As an example, Mr Havel specified that during the restructuring period, he changed the job descriptions of two or three people every month.

## **Restructuring advice and support**

Mr Havel did not feel the need to receive any significant level of support during the restructuring process. He continues to feel this way even looking back in retrospect.

## **Outcomes of restructuring**

Mr Havel hopes that the restructuring is going smoothly – as the restructuring is not yet complete, he hopes that it will, in due course, speed up the rate of return for the furniture portfolio. Although the company does not have an official restructuring plan, it has an ISO certificate, and the annual recertification requirement provides the initiative to evaluate production processes and redefine them as required.

The impact of internal restructuring on employment is not clear as it is hard to distinguish it from the impact on employment associated with the offshoring of clothing production to China. This kind of restructuring, which started in 1994, has had a significant influence on the employment. The employee headcount in the clothing production division has decreased as a result (180 employees in 2004, 65 in 2010, 45 in 2012). Concerning the period of the internal restructuring (approximately 2008–2012), the number of employees decreased fell by 30. Some redundancies were made by stopping other activities of the company such as security guards and canteen staff, or by restructuring the operation of boiling room. However, most of the redundancies were made in the clothing and furniture warehouse. The company's employee headcount also reduced naturally to a large degree as employees retired. Mr Havel estimates that the share of those who left voluntarily was about 50% of the total number of employees who were made redundant. There were no redundancies in the business department, which is very important as a support for the import activities. The company did not hire any new production workers for six years. If any were hired, it was only for a limited period of time.

The dismissal preceded redeployment. Mr Havel specified that during the restructuring period, he changed the job descriptions of two or three people every month and by some of them even repeatedly (therefore it is hard to give a concrete number for employees redeployed). Such frequent changes naturally annoyed employees; they felt uncertainty and needed to struggle with new tasks. However they tried to adapt to such changes in order to maintain their jobs in a region where the unemployment rate was 9.8% at the end of 2012.

Taking into account the fact that the importance of the production operations is already minimal in Prostějov, this decrease in employment will probably stop and the number of employees will stabilise. Nevertheless, as Mr Havel noted, in the current turbulent period it is not easy to predict the business performance, especially with respect to unstable exchange rates of dollar and euro.

From the perspective of the company's employees, the restructuring events did not have any significant effect on the length of working hours or on the organisation of labour. Mr Havel believes that the internal restructuring and the change in the product portfolio increased their uncertainty. On the other hand, however, employees in a region with a high unemployment rate (where another important clothing manufacturer, OP Prostějov, has already shut down) place a higher value on their jobs.

As far as the company's turnover is concerned, thus far the restructuring measures have not yet brought the desired key effect with regard to increasing turnover. On the other hand, the reduction in turnover from the clothing line is gradually being replaced by increased turnover from the furniture and home accessory product lines. This is another key objective for the future – to expand trading with household textiles, home accessories and furniture (currently the share held by furniture is growing by approximately 30% annually).

Lenka Kolářová (female, aged 39), who has been employed at the company for four years, described the changes related to the restructuring processes from the employees' point of view. She is a good example of how important a flexible workforce is for small companies. She started out in the returned textiles department, moved on to the materials warehouse, and is now a warehouse employee in the Home Design Section.

Mrs Kolářová has experienced both the company's good year in 2008 as well as the subsequent decrease in production. For this reason she was able to evaluate the changes that were made at the company. She has been working in the Home Design Section since 2009. If she had remained in the textile division, she would be currently unemployed. The tasks she performs for the Home Design Section are, however, only one part of her job description. At this point in time, she not only sews clothing, but she also meets with suppliers and is responsible for the storage of materials.

According to her, the workload remains the same, just the nature of the work changes. She is still employed on a permanent basis. Her relationships with her co-workers are good and the same applies to her relationship with the company's director. However, as an employee, she was involved in the decision-making about the company's restructuring in only a passive manner.

As far as evaluating the changes associated with the restructuring is concerned, she says that the changes were beneficial, as she did not lose her job. However she views the decline of the company's textile division negatively and somewhat nostalgically. She says there were no drastic layoffs, and those that did occur were relatively calm and peaceful and no one left under dramatic circumstances, even though there were those who left dissatisfied. Those who remained must adjust to the frequent changes in their job descriptions and the associated increased level of stress. She says however that they have not yet exceeded the point of tolerance.

As far as the personal impact the restructuring has had on Mr Havel, he says he has more work and less profit – it was CZK 8 million (€320,000) in 2010 and in 2012 it will be a 'positive' zero.

## Commentary

In his recommendations for companies undergoing restructuring, Mr Havel mentioned the necessity of thoroughly considering each decision with full awareness of all of the factors that affect the process in question. Today's business environment requires the ongoing analysis of every situation and continuous decision-making.

## Authors

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## Information sources

## Interviews

Ivo Havel, Director, H&D

Lenka Kolářová, employee, H&D

- [European Monitoring Centre on Change - EMCC](#)
  - [About EMCC](#)
  - [European Restructuring Monitor](#)
    - [About the European Restructuring Monitor](#)
    - [Restructuring events database](#)
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