

How the Textile Companies in South-East Europe Create Value: The Case of the Republic of Macedonia

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Abstract: *One thing is in common for all the textile companies in the Republic of Macedonia: they engage a good part of the working population across the country and realize significant foreign exchange inflows from their export activities. However, there is a general opinion that the textile companies rarely practice strategic planning. Their function is basically reactive to changes in the environment. The share of the textile industry in the creation of gross value added in the national economy is low.*

This paper is devoted to the analysis of the current competition and offers ways to create sustainable competitive advantage for companies in the textile industry. The textile company's competitive advantage is a common denominator of all the activities it performs. Therefore, the competitive advantage comes from those individual activities such as designing, manufacturing, marketing, distribution and sale of products or services. Each of these activities has contributed to the formation of the relative cost-position and the basis for differentiating products; and at the same time each activity adds value to the final product.

The basic tool for the examination of all the companies' activities and their mutual interaction and influence in creating the companies' competitive advantage is the value chain. Its analysis is the research subject in this paper. The research results and findings suggest that textile companies should concentrate more on those activities that significantly contribute to strengthening its competitive advantage based on differentiation. The result would be higher added value, and the latter is the basis for higher profitability.

Keywords: *textile companies, competitive advantage, value chain, differentiation*

Introduction

The value chain breaks down the firm's relevant activities in order to learn the potential basis for product differentiation and cost behavior. It is stressed out - relevant activities, because all the activities that a company performs are not

equally important in the creation of the final product. Therefore, it is necessary to identify key activities that add value to the product and thus, stimulate them and to marginalize or eliminate others that cause unnecessary costs. The company gains a competitive advantage when it succeeds to carry out relevant activities in creating value for the customer more efficiently or better than its competitors (Barkey & Hesterley, 2009; Porter, 2008).

Identification of activities that add value

Any textile company performs a set of activities that include: designing, manufacturing, distribution, sales and certain additional services for their products. Each of these activities has a firmly established time and schedule. Therefore, the activities can be systematized in the so-called *value chain* (Porter, 1998 and Barney, 2006). Specifically, the value chain of the textile company can be defined as a sequence of activities that transforms a piece of cloth into a ready-to-wear garment, adding significant value to the final product. The value chain of a textile company and the way it performs individual activities are the result of the past experience of the company, its strategy, the approach to the strategy implementation and the economy of the activities (Keller & Colin, 2011). Despite the large number of competitors in the textile industry, each of them is characterized by its own value chain and from here arise the differences in the activities between individual competitors. Such specificity in individual value chains are potential sources of competitive advantage, and it is the foundation on which the strategy and way of its implementation is built.

In terms of competition, value represents the amount the customer is willing and able to pay for what the company provides for him/her (product or service), and the value is measured by the total revenues (the number of goods sold multiplied by the price per unit). The company is considered to be profitable if the value it obtains (ie the total revenues) is greater than the costs incurred in its creation (the final product). Creating value for buyers that exceeds the cost of its creation is the main goal and reason for strategies to be formulated and exercised.

The value chain displays the total value that the final product contains, which is generated during the execution of all the different activities in the company. Thus, the value chain consists of activities that add value and marginal profit (Figure 1). The *activities that add value* to the final product are all the physical

and technological activities that the textile company performs in the process of the final product creation. These are the "building blocks" that build the product and create value for customers. The *marginal profit* represents the difference between the total value and the cumulative costs that incurred during the performance of activities that add value to the product. For each activity that adds value to the product, it is necessary to provide appropriate inputs, human resources (labour and management) and certain technology. Also, any activity that adds value uses and generates information, for example: information about customers, tests for the quality of the final product, statistical evidence of errors, etc. (Jensen, 2000). The quality performance of any activity that adds value to the final product requires the engage of appropriate resources and creates certain liabilities.

According to the above, it is easy to see that the individual actions that make up the value chain of the textile companies and their mutual combination are potential sources of competitive advantage of the company. The way each operation will be executed and combined with others determines the economy of each activity and the overall economy of the company as a whole. This method determines the relative cost-position of the company against its competitors (Porter, 1998). The question whether the textile company creates its value chain with smaller or greater costs than its competitors is the basis for the company's orientation towards the strategy of cost *leadership*. This strategic choice realizes its great potential when combined with a full vertical integration of the company. The idea is to 'save by performing the activities in house' (Porter, 2001). This is the main advantage rising from the cost leadership strategy. The efficiency is the root for successful cost leadership implementation. So in the terms of the textile industry, only highly vertically integrated companies (especially backwards: growing their own cotton, producing their own strands and knitting their own fabrics instead of buying them) could implement a successful cost leadership strategy. Thus, this is a strategic alternative which is practiced predominantly by the large textile companies in Turkey, China and India because it requires a great engagement of resources and impacts the equity and liquidity structure of the textile company. This is basically the biggest disadvantage for most of the textile companies in South East Europe, especially in Macedonia. Thus, they (should) focus towards the other alternative in which the activities of the value chain would be executed and their combination could also affect the extent to which the needs and expectations of customers would be met. This leads the textile companies to a potential selection of the *differentiation* strategy. This particular strategic choice is the key to the success of the textile companies in Macedonia

and the region. Performing the activities with higher quality, faster, flexible, better, using improved workers' competences and know-how, the textile company discovers its competitive advantage based on differentiation. This strategic choice overcomes the disadvantages it implies to the textile companies in Macedonia – the increasing costs with the higher price that could be achieved due to the higher level of added value to the final product.

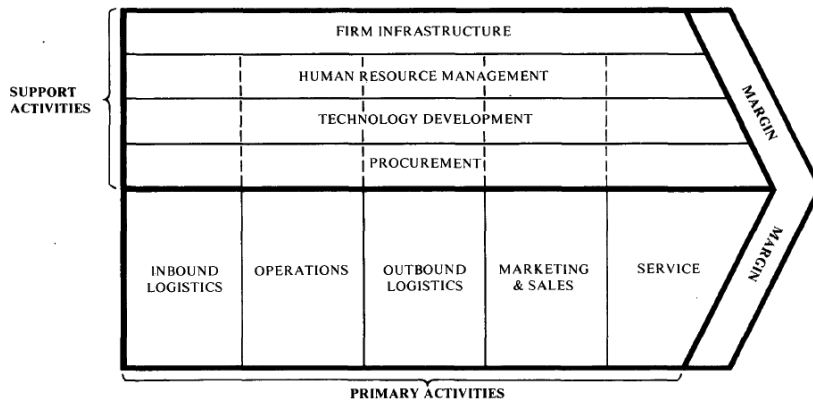


Figure 1. The Value Chain

Source: Porter, 1998, p.37

The comparison of the value chain of the company with those of competitors provides important informational basis for the determination of the differences from which the competitive advantage derives. The recognition of each activity that creates additional value to the final product is the foundation of creating a quality value chain. Additional effort should be invested for the proper grouping of activities and obtaining the final value chain. For this purpose, any textile company should prepare a detailed description of all the different activities that are part of the primary and supporting activities in the value chain.

Primary activities in the value chain

The five groups of primary activities (Porter, 1998) in the value chain can be found in all companies, and different activities are included within each group, depending on the specific activity. The following are characteristic for the textile companies:

1. *Inbound logistics*. This group includes activities related to receiving, storing and issuing inputs to start the production process, such as: storage and warehousing of materials, auxiliary materials handling, inventory control, size and frequency of orders from suppliers, time deployment of orders and alike.
2. *Production*. It covers the activities of the transformation of inputs into the final product as: machinery, splicing, packaging, maintenance of equipment, quality testing and other manufacturing activities.
3. *Outbound logistics*. This group constitutes of activities as: storing, handling and distribution of finished products to customers, including: storing stocks of finished products, engagement of distribution vehicles, processing of purchase orders, time distribution of supplies and alike.
4. *Marketing and sales*. The group includes a set of activities related to: the sale of the final product, finding ways to stimulate the demand for the product or service, promotion, economic propaganda, training the sales force, determining the price level, choosing and combining distributive channels and numerous similar activities.
5. *Services*. This group combines activities associated with additional services to maintain and enhance the value of the final product, such as: repairs, maintenance advices and a whole range of activities for after sales support.

Each of the above groups of activities plays a vital role in the process of creating a competitive advantage for the textile companies, taking into account the impact of the textile industry as a whole and the competitive scope of the company. Of course, it must be understood that all groups of primary activities are important for any company. It is not a choice of more or less devotion to different activities; on the contrary, an appropriate care for each individual group of activities is necessary. Indeed, each of the activity does not contribute equally to the value formation in the textile company. I.e. the production activities are 'the bases' but their contribution to the value of the final product is considered to be the lowest. These activities are usually subjected to the popular CMT (cut, make, trim) arrangements among the popular European brands and the textile companies in Macedonia and in the region. The production activities from the value chain account for less than 5% of the total value added

to the final textile product (Ministry of Economy, 2007). The following are the inbound and outbound logistics with additional 10-12% from the added value and the marketing, sales and services activities account for around 30%. Once again, this does not mean that the textile company should focus only to those activities that contribute more to the process of value creation, on the contrary. It is suggested that a textile company should develop by improving its performance, starting from the bases, towards the other groups of activities in the value chain. We stress that improving the performances is vital for the Macedonian economy, since the textile industry is a very significant part of the GDP (Sivevska, 2012).

Supporting activities in the value chain

The four groups of additional activities in the value chain, as well as the primary, are met along the company, independent of its core business (Walters & Rainbird, 2007). Specific for the textile companies are the following:

1. *Procurement.* The procurement function includes all activities associated with the purchase of the necessary inputs for quality manufacturing process or for any other activity within the value chain. Inputs include: materials, raw materials, auxiliary materials, other consumables, as well as adequate assets, equipment, machinery and tools, office equipment and of course, facilities.

The activities included in this group are often treated as primary activities; however, procurement is among the group of additional activities, because it is the strongest support of all other primary and additional activities. Normally, this does not mean that such categorization reduces its role and importance in the value chain, on the contrary.

The activities which are part of this group represent a significant part of the overall cost-structure of the company, and thus have a significant influence on the companies' strategic choice. Therefore, an adequate system of control and quality improvement in implementation is necessary, in order to avoid any potential negative effects on the value chain as a whole.

2. *Technology development.* A specific technology is needed for each activity that adds value to the product, whether it comes to know-

how, procedures, knowledge and experience, technological process or advanced equipment. Diversity of technologies can be found in various companies, ranging from information technologies for information processing, until detailed manufacturing processes and procedures. The development of technology consists of a range of activities that can generally be classified in a group of activities for product improvement and activities for process improvement.

This set of additional activities includes: product design, design of processes and manufacturing, installation of machinery and equipment, maintenance and alike. The activities from the technology development group are supporting activities of many other primary and additional activities and emerge as one of the key sources of competitive advantage for the company.

3. *Human resource management.* This group consists of activities related to: recruitment, hiring, training, development and payment of employees at every level in the company. The activities from this group support both the primary and additional activities and take place throughout the company and across the value chain.

Because of the labour intensity in the textile industry it is necessary to pay attention to this group of activities, for it creates a good part of the total costs in the value chain. At the same time, these are activities that are directly related to human-like factor, and therefore insert a dose of uncertainty and difficulty in predicting their future behavior.

The human resource management affects the creation of competitive advantage for any company by determining the role, skills, knowledge and motivation of employees at every level in the company. These activities could be a key source of competitive advantage in the textile company.

4. *Company infrastructure.* This group includes a number of various supportive activities, among which the management activities at all levels: top, middle and low, as well as: planning, finance, accounting, law, public relations and alike.

The infrastructure activities, unlike the other supporting activities, often provide support for the value chain as a whole, rather than for in-

dividual activities. Even though the infrastructure of the company is commonly seen as the necessary "glue" for the cohesion of the other activities that create value, it must be noted that infrastructure activities are just as important in creating and maintaining the competitive advantage of the company as the other activities in the value chain. In the textile industry the negotiating power of the management team is crucial for the successes of the business.

Each of these activities in the textile company is further characterized as *direct*, *indirect* or *activity that provides quality* in the value chain. This additional classification is practiced not only for primary activities, but also among supporting activities. The role of indirect activities and activities that provide quality sometimes is not well understood, however, to establish the competitive advantage more easily, it is important to clearly distinguish between each of the three types of activities. Indirect activities and activities that provide quality carry out a significant part of the costs generated while creating value for the customer, while the support they provide to other activities affects the potential basis for differentiation. Many managers-owners do not pay proper attention to the grouping and analysis of these activities economy, often considering the direct and indirect activities as one indivisible whole. However, it should be born in mind that between the costs caused by these groups of activities relations of compromise exist – this is the so-called *trade-off*. For instance, more spending related to maintenance of equipment would increase its life and reduce the depreciation rate.

Also, there are frequent cases of classifying indirect activities and those who provide quality as activities that increase costs, not taking into account the potential basis for differentiation arising from these additional activities. Activities that ensure quality in the process of creating value for the customer are present throughout the value chain, for a valid reason that superior performances could not be achieved if each activity is not impeccably well performed. Because of this, it is easy to assume that the costs associated with the activities that provide quality are high, but they are in any case smaller than those created by poor quality. The question that deserves to be analysed is not whether these activities should be part of the value chain, but how to determine the optimal sequence of control actions that provide the desired level of quality. Undoubtedly, the desire of each company would be the accomplishment of such primary and supporting activities in the value chain, which would not require any additional corrective action. In that case, we could certainly say that the quality is "free".

Establishing the value chain

To recognize the competitive advantage of the textile company, it is required to establish the value chain in order to successfully perform in this area. To achieve this, it is necessary to analyse all individual activities that the company performs, and then group them into the already established groups of primary and supporting activities that form the value chain. Particular activities are systematized in one of the two main groups according to the underlying background of the activity.

It is particularly important to emphasize that not all activities are truly part of the value chain. The aim of their individual analysis is to determine how this activity contributes to the creation of added value for the end customer. Only those activities that add value to the final product of the value chain should be emphasized, all others should be eliminated or marginalized.

The definition of the relevant activities that add value requires determination and analysis of their economy. Broad groups of activities like: production, marketing and sales need to be detailed to the level of individual activities. The extent to which it is necessary to carry out the decomposition of certain group activities depends primarily on the individual economy of each operation and the reasons and purposes behind the analysis of the value chain. The basic principle to be observed is the following: To isolate and analyse activities that:

- Have its own economy;
- Have a strong influence on the basis of differentiation;
- Cause significant amount of costs.

The selection and systematization of the appropriate group for the particular activity that adds value requires exceptional combination of knowledge and experience, analytical skills, readiness for adjudication and prevention of the occurrence of errors (Clayton, 2001). The establishment of the value chain is not an easy task. Many individual activities show border properties, belonging to two or more groups. For example, processing of orders could be part of external logistics or marketing and sales, and sales force activities often perform features from the additional services category. The misunderstanding of the proper group is the most common mistake, followed by the ignorance over some particular activities which lead to the creation of a suboptimal value

chain with a corresponding lack of the expected positive results. The activities that add value should be grouped in the group through which they best contribute to the creation of value for the customer, and thus in the creation and maintenance of the competitive advantage (Afuah, 2009). The right combination is achieved by investing great efforts and long-term persistence.

Linkages between the activities in the value chain

Although the activities that add value are the "building blocks" in the creation of the company's competitive advantage, the value chain is not only a simple sum of individual activities, but a system of interdependent operations. The activities in the value chain are interconnected and interdependent (Porter, 1998). For example, the inbound and outbound activities are connected between each other and the both groups are connected with the marketing and sales activities at the same time. Or, the production activities are depended over the inbound logistics, the company's infrastructure and HR management; and they all affect the technology development in the company. The linkages between the different activities within the value chain represent such relationships that the execution of an activity affects the cost or performance of another.

The competitive advantage of a textile company can come right from the individual connections between the activities in the value chain, as it also can occur by the performance of a single activity. The linkages in the value chain lead to the creation of competitive advantage in two ways, through (Porter, 2008):

- Optimization and
- Coordination.

Each company must choose the optimum combination of activities in the value chain, taking into account that the connections between individual actions often reflect a compromise between the relations among the activities in achieving the same end result. For example, detailed product design, strict control of incoming materials and enhanced control of the whole creation of the product quality leads to lower costs for after sales service and increase in the level of customer satisfaction.

A proper coordination of the individual activities in the value chain is also necessary. For example, the timely delivery of finished goods requires good coordination between production and outbound logistics, also including (to a

certain degree) the activities from the additional services category. The ability for good coordination of activities and their inter-connections often leads to a cost reduction and / or reinforcement of the basics of differentiation. Improved coordination, for example, can reduce or eliminate the need to store inventory in any form (just-in-time system).

The cost reduction or improved differentiation as a result of the existence of linkages within the value chain are far more successful than trying to reduce the costs of a specific group of activities or an individual activity inserted in the value chain, in the belief that they will contribute to better differentiation of end products against the competitors (Porter, 2008).

The linkages between the activities in the value chain are numerous and many of them are common and inevitable for any company. The most obvious are those between the primary and supporting activities (indicated by the dotted graph in the value chain represented above in Figure 1). For example, purchases of inputs directly affect the production process.

The linkages among the primary activities are more subtle. For example, enhanced quality control of incoming inputs (internal logistics) in the manufacturing process affects the reduction of the likelihood of errors, and hence reduces the total manufacturing costs, improves the system maintenance, increases the life of the production equipment and alike.

Generally, we can speak of two basic types of linkages between the activities in the value chain:

- Internal linkages and
- External or vertical linkages.

Internal linkages are those connections among certain groups (e.g. between the primary and supporting activities) within the value chain of the company. External or vertical linkages connect the specific activities of the value chain of the company with other activities from the value chain of suppliers and / or distributors.

Internal linkages in the value chain

Internal linkages between the activities of the same or different groups within the value chain of the textile company occur for the following reasons:

- The same function can be performed in different ways. For example, the provision of an appropriate level of quality according to established standards can be achieved by supplying quality inputs, constant control during the manufacturing process or 100% control of the finished products.
- The cost or performance of direct activities can be improved by indirect activities. For example, a good time allocation reduces costs and saves time and resources (e.g. sales force).
- The activities that would be carried out in advance within the company could reduce / eliminate the need for additional services later. For example, 100% control of finished products eliminates the need for replacement of defective products that have reached the hands of the buyer.
- The function of quality assurance can be made in different ways. For example, proactive control and parallel control of inputs during the production process replaces the post production control of finished products.

Although the linkages within the value chain of the company are crucial in creating a competitive advantage, they are usually more difficult to be identified. The importance of procurement in reducing the production costs and improvement of quality sometimes may not be so obvious, but that does not mean it does not exist.

Identifying the links between activities in the value chain means finding ways in which each activity that adds value affects or is affected by other activities. This assures that the linkages are a good basis for the beginning of the necessary analyses of the sources of competitive advantage. The breakdown of each group of primary and supporting activities helps in the recognition of the relevant activities that create value for the customer, but also detects all existing and meaningful linkages among the activities.

The identification and management of linkages necessarily disposes a good informational basis. The information flows allow better optimization and coordination within the value chain. Thus, the company's information system is especially important in the detection of the competitive advantage and its long-term maintenance.

The management of the linkages between the individual activities in the value chain is a quite complex organizational task, even more difficult than the managing of the activities that add value. The successful execution of this task

is the key to maintaining competitive advantage and the realization of the company's strategy.

External or vertical linkages in the value chain

Linkages do not occur only among the activities within the value chain of the company, but also among the activities of the company's value chain and the value chains of suppliers and / or distributors. Such linkages are called external or vertical linkages. The vertical linkages work the same way as the internal. The manner in which the supplier or distributor performs certain activities in its value chain affects the cost and performance of some of the company's activities and vice versa.

Suppliers manufacture the product or service that contributes to the creation of value for the final product of the company. At the same time, the company and suppliers establish relationships and contacts in several common areas in the value chain. The company's procurement and internal logistics interacts with the supplier's external logistics. Further, the supplier's employees provide services and training for the employees of the company, maintenance of equipment and other additional services that have direct or indirect impact on the creation of value for the buyer. In this and similar way, any linkage between the value chains can significantly affect the cost structure of the company and the basis for differentiation. For example, frequent deliveries by suppliers can reduce or eliminate the need and cost of storing inventory, proper packaging inputs can reduce or remove the disadvantage of the input materials, total quality control undertaken by the supplier eliminates the need for control of the company's inputs and many other similar activities.

The linkages between the value chains of suppliers and the company provides a number of features for creating, maintaining and even strengthening the competitive advantage of the company. There is a possibility to achieve mutual benefit and simultaneously improve the performance of both companies, through joint optimization and coordination of activities in the value system. Developing cooperation between suppliers and the company suggests that it is not about "game score zero" where one side gets the expense of the other, on the contrary, it is a common long-term benefit and success for both companies.

Dividing the use of joint optimization and coordination of activities between the company and its suppliers is a function of the bargaining power of sup-

pliers and is accomplished through additional profits in the value chain of suppliers. On the other hand, the same distribution of benefits depends on the bargaining power of the company and its practices and experiences as a buyer. So, both: good coordination with suppliers and negotiating favourable power are required to achieve competitive advantage. It is therefore necessary for the company to invest in long-term development and improvement of the activities in the value chain, otherwise it could miss numerous occasions.

The linkages with the distributors are as important as those with the suppliers. Distributors have their own value chains through which the company's product passes before it reaches the hands of the buyer, the ultimate destination. The additional value gained by distributors as income - the difference between the producer's price and the price paid by the ultimate buyer is often around 50% of the final sales price. For this account, distributors perform activities like selling, advertising, sales promotions, sales force training, etc., to the extent that can fully carry out these activities for producers in the form of outsourcing.

Just as in the case with the suppliers, between the distributors and the company arise contacts and links among various activities in the value chain, such as the inner-outer logistics, marketing and sales, services and the like. Joint optimization and coordination of such activities lead to the strengthening of the competitive advantage of the company, through appropriate impact on the cost structure and the basis for differentiation. The relations which were found in the distribution of the benefits between the company and suppliers occur again between the company and its distributors. Vertical mergers are often far from the focus of the textile companies' management. Even when recognized, achieving proper coordination between the two companies requires additional efforts. However, it is not impossible. Notable is the fact that many companies solve this issue with vertical integration (forward or backward), believing that in this way they could provide the required level of coordination and optimization. The vertical linkages, as well as the internal, require a good information system.

Conclusion

The competitive advantage of the textile companies in Macedonia and the region lies in the various sources of differentiation. In order to identify and exploit the differentiation strategy, the textile companies ought to establish the

value chain of the company (as recommended above) so to provide the basis for successful performance in this business. Thus, it is necessary to analyse all the individual activities that the company performs, and then to group them into the already established groups of primary and supporting activities that form the value chain. Each of these activities does not contribute equally to the value formation in the textile company. This does not mean that the textile company should focus only to those activities that contribute more to the process of value creation, on the contrary. It is suggested that the textile company should develop by improving its performance, starting from the bases (the production activities, inbound and outbound logistics) towards the other groups of activities in the value chain (such as firms infrastructure, technology development and HR management).

The definition of the relevant activities that add value requires determination and analysis of their economy. The broad groups of activities like production, marketing and sales need to be detailed to individual activities. The extent to which it is necessary to carry out a decomposition of certain group of activities depends primarily on the individual economy of each operation. The basic principle that should be observed is the following: to isolate and analyse activities that:

- Have their economy;
- Have a strong influence on the basis of differentiation;
- Cause a significant amount of costs.

Following this principle the textile companies could manage to cope with the individual activities that behave eclectically, showing characteristics for belonging into two or more groups. The activities that add value should be grouped in that group through which they best contribute to the creation of value for the customer, and thus in creating and maintaining the competitive advantage of the company. The right combination is achieved in the long run.

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