

Stockholm School of Economics  
Department of Management and Organization  
Master Thesis, 20 credits

# **Stuck in the Middle**

## **- A Strategic Management Perspective on the Manufacturing Firms in the South African Clothing and Textile Industry**

### Abstract

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The South African Clothing and Textile industry is in a state of crisis, with substantial job losses as a result. This study focuses specifically on the manufacturing firms in the industry and aims to create a broad understanding of their internal and external environment, as well as developing a general strategy in order for them to improve their competitiveness. The research method used is a multiple case study, including interviews at six case companies, complemented with eight interviews with industry informants and secondary evidence. The empirical data has been analyzed using the two main theoretical perspectives within the Strategic Management field, i.e. the Industrial Organization perspectives and the Resource Based Views. The study concludes that the manufacturing firms' internal environment is highly uncompetitive. The thesis predicts that the future external environment will likely be characterized by poor profit potential in the export markets but with better opportunities for profits in the domestic market. On a general level, the profit potential is expected to be better in high-end segments than in low value added markets in the future. The study further forecasts that effective and flexible production, product development and innovation, quick and reliable distribution, skills in support services, access to local raw material, as well as strategic relationships are factors that will likely determine the future success of the manufacturing firms. In order for the firms to improve their competitiveness this study suggests a general Focused Differentiation strategy for them to pursue and presents specific segments for them to target.

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## Acronyms used

AGOA	:	African Growth and Opportunity Act
ATC	:	Agreement on Textiles and Clothing
CEO	:	Chief Executive Officer
CCS	:	Centre for Chinese Studies
CCTC	:	Cape Clothing and Textile Cluster
CMT	:	Cut, Make and Trim
C&T	:	Clothing and Textiles
DCCS	:	Duty Credit Certificate Scheme
DM	:	Development Manager
DTI	:	Department: Trade and Industry
EU	:	European Union
FTA	:	Free Trade Agreements
IO	:	Industrial Organization
KZN	:	KwaZulu-Natal
MD	:	Managing Director
NIE	:	Newly Industrialized Economies
PTA	:	Preferential Trade Agreements
RBV	:	Resource Based View
R&C	:	Resources and Capabilities
R&D	:	Research and Development
ROO	:	Rules of Origin
SA	:	South Africa
SACTWU	:	South African Clothing and Textile Workers' Union
SME	:	Small and Medium Enterprise
SMME	:	Small, Medium and Micro Enterprise
SSA	:	Sub Saharan African region
TM	:	Technical Manager
US	:	United States (of America)
VRIO	:	Valuable, Rare, costly to Imitate, efficiently Organized
WTO	:	World Trade Organization

## **1. Introduction**

*This chapter aims to introduce the subject and the purpose of this thesis. The study's delimitations, definitions and outline are also presented.*

### **1.1 Subject description**

The global Clothing and Textile (C&T) industry is one of the largest industries in the world and is in a constant state of transformation. During the 1990s the international C&T industry expanded and shifted its course dramatically. One of the major changes has been the move from the “old” manufacturing industry of the developed countries, to the “new” industry of the developing world. Today, the phenomenon of outsourcing dominates the industry, which in turn has changed the global value chain. The developed countries have shifted their focus from manufacturing of commodity items to producing high value added products and offering high-skilled services, such as design and branding capabilities. Globalization and the gradual liberalization of C&T trade have significantly increased the competition in the international C&T industry. Today China and South Asian countries have the most competitive manufacturing industries. They are gaining large market shares from less effective and more expensive production bases in their competing countries, namely in the regions of Africa, European Union (EU) and South America (Barnes et al. 2005, Technopak 2007).

#### **1.1.1 South Africa's clothing and textile industry**

South Africa's (SA) C&T industry has a long history, dating back more than a century. The industry comprises a complete value chain from the production of raw materials, to the manufacturing of products, and to retail clothing stores (Salm 2002). Presently the industry is facing a huge crisis (Vlok 2006, Barnes et al. 2005). The crisis began in 2002, when South Africa's C&T exports decreased significantly while imports increased substantially. This was mainly due to a significant appreciation of the local currency (the Rand). Other vital reasons were the trade liberalization and an uncompetitive domestic industry. The main characteristic of the crisis has been a large-scale loss of employment. The industry has witnessed a 37 percent decline in employment between 1996 and 2005. The loss of employment has had a devastating effect on low skilled workers in poor black communities who have lost stable and secure sources of income and where few other opportunities exist (Vlok 2006).

#### **1.1.2 The manufacturing sector**

Manufacturing is the industry sector which has suffered the greatest losses from the crisis. The situation that the SA C&T manufacturing firms are faced with today is highly complex and problematic. The competition in their markets has significantly increased due to the liberalization of the global C&T trade. China and South Asian countries are a major threat, who with their cheap labor and high productivity, are muscling South African manufacturing firms out of their export markets and also noticeably undercutting them in the domestic market. The poor competitiveness of the SA C&T manufacturers has to do with the firms' lack of productivity and managements skills. Furthermore, the labor market in South Africa is notoriously inflexible and the labor costs are high, which



further weakens the manufacturers' competitiveness (Barnes et al. 2005, the DTI 2005, Vlok 2006).

## **1.2 Purpose and research questions**

How the manufacturing firms can improve their competitiveness has not been fully investigated. A number of reports<sup>1</sup> have been written on the SA C&T industry. However, the research is generally on an industry-level, providing suggestions for how the industry as a whole can improve its competitiveness or how the government should act to support the industry. What would be valuable for the management of the individual manufacturing firms is firm-level research suggesting how they can improve the competitiveness of their businesses. To the best of my knowledge no such specific study has been conducted.

*The primary purpose of this thesis is to develop a general strategy for the manufacturing firms in order for them to improve their competitiveness. The secondary purpose, serving as a supportive function for the primary objective, is to create a broad understanding of the manufacturing firms' internal and external environment.*

To fulfill the thesis purpose I have developed four research questions. The first three questions are linked to the secondary purpose and the last question to the primary purpose.

- *What is the future profit potential in the industry?*
- *What factors determine success in the industry in the future?*
- *What are the firms' key strengths and weaknesses?*
- *How can the firms improve their competitiveness?*

## **1.3 Delimitations**

The scope of the thesis is delimited in a few areas to secure a meaningful study and due to research resource limitations. Firstly, the study only covers the SA C&T industry, even though it may be possible to apply some of the conclusions to other industries and in other countries. Secondly, the focus is on the manufacturing segment of the SA C&T industry. Thus, the suppliers of raw material and the buyers are not fully investigated. Thirdly, the geographical scope of the research is restricted to the Cape Town area in the Western Cape Province. However, the thesis's conclusions aim to be applicable for all provinces in SA. Fourthly, the thesis is delimited to only providing general suggestions for the manufacturing firms. Thus, specific solutions to individual firms are not presented in this thesis. Moreover, the thesis emphasizes those factors that the management of the manufacturing firms' possibly can influence. Hence, external factors that go beyond management control, which are difficult to predict, or needs significant amount of resources to investigate, will not fully be explored in this study. These factors mainly refer to currency fluctuation, governmental actions and the general economic

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<sup>1</sup> Barnes (2005), Barnes, Morris and Esselar (2004), Eeden, J & Sandrey, R. (2007), Gibbon (2002), Ralis (2004), Salm (2002), the DTI (2005), Van der Westhuizen (2006), Vlok (2006).

development in SA. Lastly, the analysis is delimited to the thesis's theoretical framework, which in turn is constrained to the two main perspectives in strategic management thinking, i.e. Industrial Organization (IO) perspectives and Resource Based Views (RBVs).

## 1.4 Definitions

Some of the thesis's most common language expressions are defined below.

- *Competitive advantage*: A competitive advantage provides a firms to earn (or the potential to earn) a persistently higher rate of profit than its competitors (Grant 2005).
- *Competitiveness*: The ability to offer products and services that meet the quality standards of the local and world markets at prices that are competitive and provide adequate returns on the resources employed or consumed in producing them (Business Dictionary).
- *External environment*: The firms' external environment refers to the industry conditions, including internal competition, buyers, suppliers, substitutes and potential entrants (Porter 1980).
- *Future*: I have defined the future as 6-8 years from now, approximately until year 2015.
- *Internal environment*: The internal environment refers to the firms' resources and capabilities (R&C) (Grant 2005).
- *Manufacturing firms*: All firms manufacturing C&T products and/or supplying related services.
- *The SA C&T industry*: All firms in SA supplying the local and world C&T markets.
- *Size of firms (employees)*: Micro (1-9), Small (10-49), Medium (50- 249) and Large (250+).

## 1.5 Thesis outline

This section briefly describes each chapter for a quick overview of the thesis.

1. *Introduction*: This chapter introduces the subject and the purpose of this thesis.
2. *Theoretical Framework*: In this chapter the theories used when conducting the analysis is presented. An overall analysis model is then developed based on the theories.
3. *Methodology*: In this chapter the method used for conducting my research is presented. The quality of the research method is also tested.
4. *Empirical presentation*: This chapter presents the empirical material that the thesis aims to analyze. The chapter provides a broad description of the SA C&T industry and the manufacturing firms' characteristics.
5. *Analysis*: This chapter which is structured according to the overall analysis model analyzes the empirical findings by applying them on the theoretical framework. In the first two parts the firms' external and internal environment is carefully analyzed. The final part examines the strategy implications from the previous analyses.
6. *Conclusions and discussion*: This final chapter summarizes and critically assesses the main findings from the analysis chapter. Suggestions for future research are also presented.

## 2. Theoretical framework

*In this chapter the theories that I will use when conducting the analysis is presented. I begin with explaining the underlying rationale for my choice of theory. Secondly, the theories are briefly examined with focus on the parts that are relevant for my analysis. Lastly, an overall analysis model is presented.*

### 2.1 The choice of theory

The theoretical framework is based on Strategic Management research. According to Regnér (1999) there are two main perspectives in strategic management thinking; the Industrial Organization (IO) perspectives and the Resource Based Views (RBVs). The two schools have different points of departure when performing strategy analysis. The IO perspectives approach attempts to analyze the firm's external environment while RBVs emphasize the firm's internal environment. The IO perspectives and RBVs will be the two theoretical perspectives used in this thesis. I believe that limiting the theoretical framework to two general perspectives is important in order for me to conduct a meaningful analysis. These two perspectives I believe will suffice to give the reader an understandable picture of the manufacturing firms' complex situation.

According to Grant (2005) a researcher must have a profound understanding of both the firm's industry environment and its internal environment to develop a successful strategy. Thus, to fulfill the primary purpose of this thesis, i.e. *to develop a general strategy for the manufacturing firms in order for them to improve their competitiveness*, I need to analyze how the firms' are affected by both external factors and the internal factors in their environment. The general analytic tool for understanding the external environment of the firms will be Porter's (1980) Five Forces of Competition model. I chose Porter's model because it is a helpful and widely used framework for classifying and analyzing the firm's external factors (Grant 2005). The internal environment of the firms will be analyzed by using the RBVs which provides tools for understanding the firm's R&C. This perspective is chosen as it is one of the most influential theories in the strategy management field and thus widely accepted (Slack and Lewis 2002). By combining the two perspectives I believe I can conduct a comprehensive and dynamic analysis of the industry and in turn create a broad understanding of the firm's external and internal environment as well as developing a general strategy in order for them to improve their competitiveness, which is the purpose of this study.

#### 2.1.1 Critique of the two perspectives

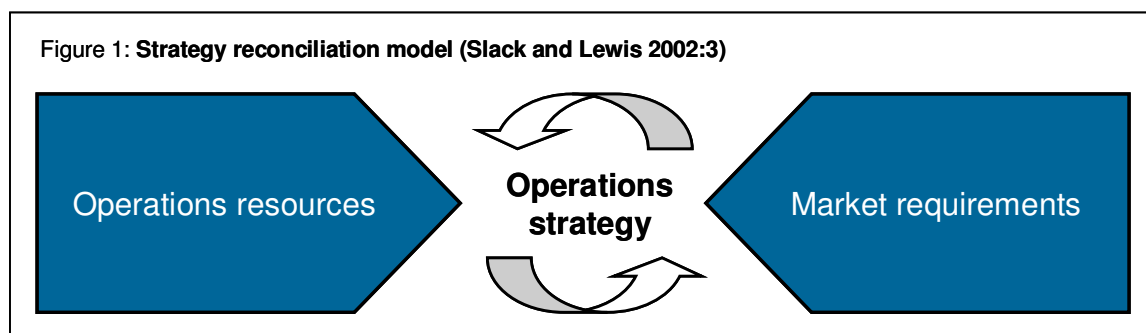
Porter's Five Forces of Competition model has been described by theorists as being an inadequate theory (e.g. Barney 1991, Foss 1996, and Rumelt 1991). As Foss (1996) metaphorically describes it: "Porter has only fully captured one of the blades of the scissor of competitive advantage in his theorizing: only industry determinants of competitive advantage are comprehensively identified and discussed, while a comprehensive analysis of firm determinants is lacking" (p. 18). Rumelt (1991) further argues that the external environment has a minor role in determining the firm's profitability.

The RBVs have been criticized as being of limited use because RBV theorists are not unified of what constitutes a resource or capability (Regnér 1999). Porter (1980) believes that RBVs can not be an alternative theory of strategy because his view is that R&C are not valuable in itself and is not useful to analyze outside the external context. Porter (1980) views resources as a requirement to perform activities but not as sources of competitive advantages.

Regnér (1999) criticizes the IO and classic RBV theory for only being useful for explaining the present and past industry factors. Regnér (ibid) thus believes that the IO and classic RBV theory are of limited use in developing future competitive advantages. However, Regnér believes that the *dynamic RBV approach* is promising for that purpose as it puts greater focus on the *development* of R&C.

### 2.1.2 Combining the two perspectives

The IO perspectives and RBVs are two different approaches to strategy formulation. However, several theorists believe that the two schools can effectively complement each other as both of the perspectives deal with the same issue, i.e. how to establish and sustain a competitive advantage (e.g. Foss 1996, Grant 2005, Quinn 1992, and Slack and Lewis 2002). According to Foss (1996), the IO perspective and the Porter's Five Forces of Competition model in particular are useful in understanding how a company in the *short run* can compete and position itself in the industry's temporary structure. The RBVs are a useful complement as they are more oriented toward the firm's possibility to compete in the *long run* using its internal R&C. This argument is supported by Quinn (1992) and Grant (2005) who believe that the RBVs can be a more durable basis for strategy formulation than the IO perspective when the external environment is rapidly changing. Furthermore, Foss and Knudsen (2003) argues that strategists would be better equipped to answer the question of how a competitive advantage can be sustained by combining the two views. Thus, as Foss (1996) puts it: "there are clearly thematic complementarities between the industry analysis framework of Porter and the resource-based approach" (p. 19). Slack and Lewis (2002) have provided a basic model (see Figure 1) for approaching strategy. In the model strategy reconciles the requirements of the market with the R&C of the firm.



The above researchers confirm that combining IO perspectives with RBVs is accordingly a more comprehensive and dynamic method of conducting strategy analysis. Furthermore the uncertainties and limitations of the two perspectives are eliminated when combining

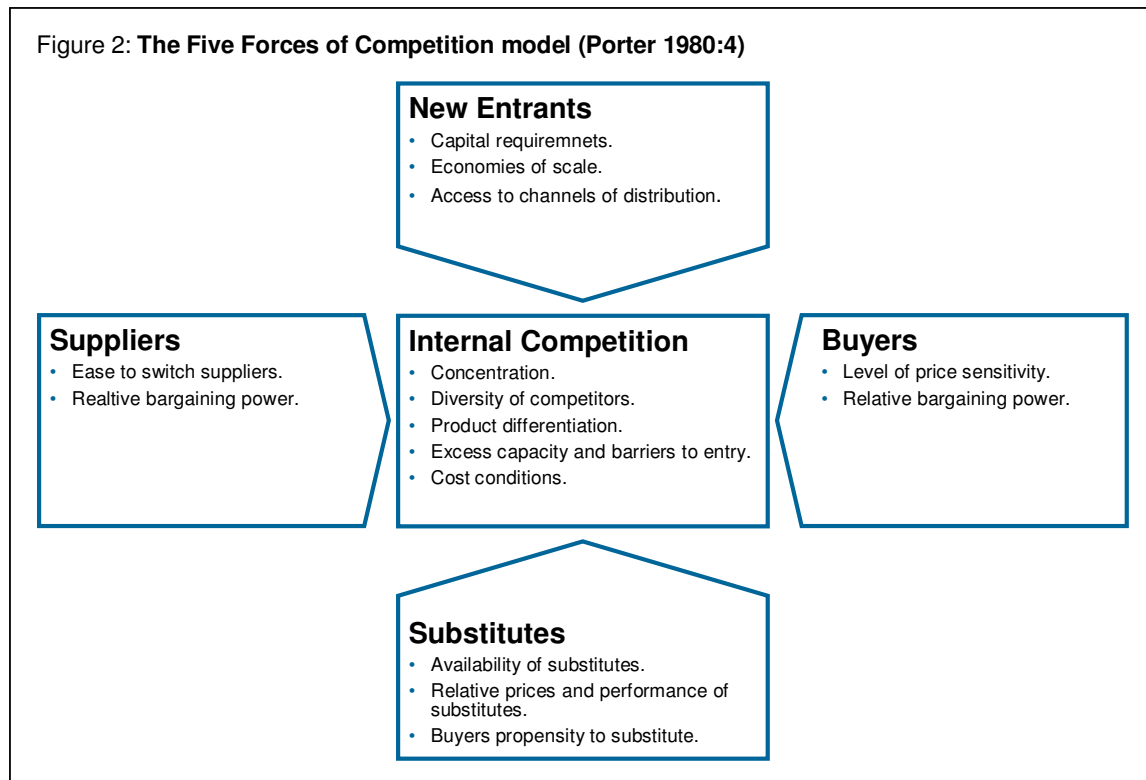
the two together (Foss and Knudsen 2003). Thus, as my theoretical framework includes both perspectives I believe the weaknesses of the two theoretical perspectives are reduced.

## **2.2 Industrial organization perspective**

The IO model was initially created by Edward Mason in 1939 and further developed by Joe Bain in 1956 to analyze a company's strategy (Regnér 1999). In IO theory the firm is treated as a "black box" since the firm's internal environment is ignored. Instead the belief is that the firm's performance is a result of adapting to the condition of the external environment. The IO perspective was truly recognized when Porter published his book *Competitive Strategy* in 1980 where he linked IO to strategic planning (ibid). In this book he presents the Five Forces of Competition framework (see Figure 2) which has been one of the most influential models in strategic management theory (Grant 2005). The model is briefly described below.

### **2.2.1 Porter's Five Forces of Competition framework**

According to Porter's (1980) Five Forces of Competition framework the profitability (rate on return on capital relative to its cost of capital) of an industry is determined by five forces of competitive pressure – *threat of entry*, *threat of substitutes*, *bargaining power of suppliers*, *bargaining power of buyers* and *internal competition*. In this model the main task for the firm is to create a competitive advantage by successfully positioning itself in relation the five forces (Regnér 1999). According to Porter (1980) a firm needs to adapt to industry circumstances, but can also influence the industry structure through its choice of strategies, for example by creating barriers of entry, increase product differentiation or reduce number of competitors and so on. Thus, the firm's performance is a function of two main factors, the profit potential of the industry and the firm's relative position in that industry.



The model reflects the theory that the industry goes beyond the established firms in the industry. Instead, Porter's (ibid) view is that customers, suppliers, substitutes and potential entrants are all "competitors" to firms in the industry. Porter (ibid) further explains that the strength of each individual force can vary across industries and change over time as an industry grows, and not all of the forces are equally important for different industries. The Five Forces of Competition model is applicable when analyzing both domestic and global industries because the structural factors and market forces that operate in global industries are the same as those in more domestic markets (ibid). Each competitive force is briefly described below.

### Internal competition

This competitive force is the core of Porter's model. This is because it is often the major determining factor of the overall state and the general level of competition in the industry (Grant 2005). Internal competition can be based on cost or differentiation. In industries where firms mainly compete on cost are often unstable and leaves the industry worse off from the standpoint of profitability. On the other hand, rivalry based on differentiation through advertising, innovation and other non-price dimension, may well increase demand in the industry for the benefit of all firms. Porter (1980) further explains that international competitors should be treated as established competitors when analyzing the internal rivalry.

There are six main factors that play a significant role in determining the nature and intensity of rivalry between established competitors; *concentration, the diversity of competitors, product differentiation, excess capacity, exit barriers, and cost condition*

(Grant 2005). *Concentration* is the number and size of competitors in the industry. The higher the concentration in the industry the higher the intensity of competition tends to be. *Diversity* refers to the competitor's similarity, pertaining to origins, objectives, cost, and strategies. The internal competition is likely to be more intense when rivals are more diverse. The level of *product differentiation* determines the level of price competition in the industry. In low value added products price competition tends to be strong and in segments where products are highly differentiated price competition tends to be low. An industry is faced with *excess capacity* when the demand is lower than the firm's supply capacity. Excess capacity is partly a result of the industries *exit barriers*. If the exit barriers are high there is a risk of excess capacity, especially in declining industries where demand is decreasing. The more excess capacity the industry faces the more intense competition tends to be. The *cost condition* refers to the firm's structure of fixed and variable costs. When the industry is faced with high fixed and low variable costs the price is likely to be the sole basis for competition (ibid).

### **Threat of entry**

Threat of entry is the pressure from new firms entering the industry. The strength of this force depends on the attractiveness of the industry. The profit potential determines the industry's attractiveness, which is partly determined by the barriers to entry (ibid). One can view the barriers to entry as the advantages that established firms have over new entrants. According to Grant, some of the factors one must investigate to determine the height of the barriers to entry are *capital requirements*, *economies of scale* and *access to channels of distribution* (ibid).

*Capital requirements* refer to the capital needed to establish a firm in the industry, such as investing in production facilities, research and development (R&D) and staff. Capital requirements vary across industries. If a start-up requires extensive initial capital the threat of entry in the industry is reduced. *Economies of scale* also affect the threat of firms establishing as new firms often experience a higher unit cost than established firms. The affect of economies of scale is more significant in industries where firms have large scale operations as they often experience a higher grade of scale economies than small operations. *Access to channels of distribution* is a direct barrier that new firms face when entering a market. If distribution channels, such as retailers, have limited capacity to carry new products it is difficult for new firms to entry. On the other hand, if retailers have available shelf space there are opportunities for new entrants (ibid).

### **Bargaining power of buyers**

The buyers are the firm's customers, which is also often called the firm's output market. The customers put pressure on the firm's as they bargain for lower prices, better quality, and playing competitors against each other. The customers are a significant factor in a firm's attempt to succeed. Therefore, buyer selection is a crucial strategic question (Porter 1980). Porter (ibid) further explains that a firm can improve its strategic position by focusing on buyers with the least bargaining power. Even if a company sells to a single industry, there are often segments of buyers within that industry who exercise less power.

There are two main factors that play a significant role in determining the strengths of the bargaining power that firms face from their customers. The two factors are the buyer's *price sensitivity* and the buyer's *relative bargaining power*" (Grant 2005).

A buyer tends to be *price sensitive* if the firm's product makes up a large proportion of the buyer's total cost, if the product is not highly differentiated, if the buyer faces intense competition, and if the product is not of great importance for the buyer's product or service. If the opposite circumstances exist the buyer tends to be less sensitive to price (ibid).

The buyer's *relative bargaining power* tends to be strong if the buyer is large in size relative to the supplier, if the buyer is well informed about the market conditions, and if the buyer has the ability to vertically integrate what the suppliers provide. The buyer's relative bargaining power is likely to be weak if the opposite circumstances are in place (ibid).

### **Bargaining power of suppliers**

The suppliers are also referred to as the firm's input market. In the input market the firms purchase raw materials, components, financial services and labor (ibid). By threatening to raise prices, reduce the quality of the product or service, the supplier can exert bargaining power over the firms. Thus, in industries where the suppliers are powerful the profitability of the firm can be squeezed (Porter 1980). In this force, labor unions are viewed as suppliers and can be an important source of bargaining power. According to Grant (2005) a high percentage of unionized employees correlate directly with low profitability.

The factors determining the power of suppliers tend to mirror those factors making buyers powerful. The only difference is that the suppliers are the producers of products and services and the firms are the buyers. In this sense the key determinants of the suppliers' power is "the ease of which the firm can switch suppliers and the relative bargaining power of each party" (Grant 2005:83).

### **Pressure from substitute products**

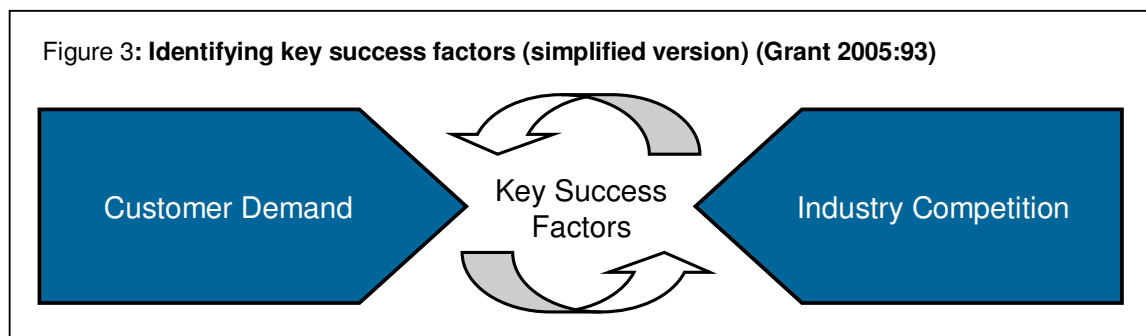
Firms in an industry are broadly also competing with other industries that supply substitute products. A substitute is a product that can perform the same function as the products of the industry (Porter 1980). The strength of this force is determined by the availability of substitutes and the substitute's price and performance relative to the industries product or service. If substitutes are widely available buyers tend to be more price sensitive and thus limiting the prices the firms in an industry can profitably charge. On the other hand, if substitutes are rare the customers are relatively insensitive to the price. The force is also affected by the buyers' willingness to substitute. If buyers have a high propensity to buy substitute products the profit potential of the industry decreases (Grant 2005).



### 2.2.2 Sources of competitive advantage

In the above section the external environment has been presented. I will now examine the sources of competitive advantage that can be identified in the external environment. According to Grant (ibid), creating a successful business is all about creating and sustaining a competitive advantage. The same author defines a competitive advantage as follows: “When two or more firms compete within the same market, one firm possesses a competitive advantage over its rivals when it earns (or has the potential to earn) a persistently higher rate of profit” (Grant 2005:225). A competitive advantage can thus allow a firm to either charge higher prices or enjoy lower costs than its rivals. It is important to note that a competitive advantage does not explicitly mean higher rate of profits since future investments may forgo profits (Grant 2005).

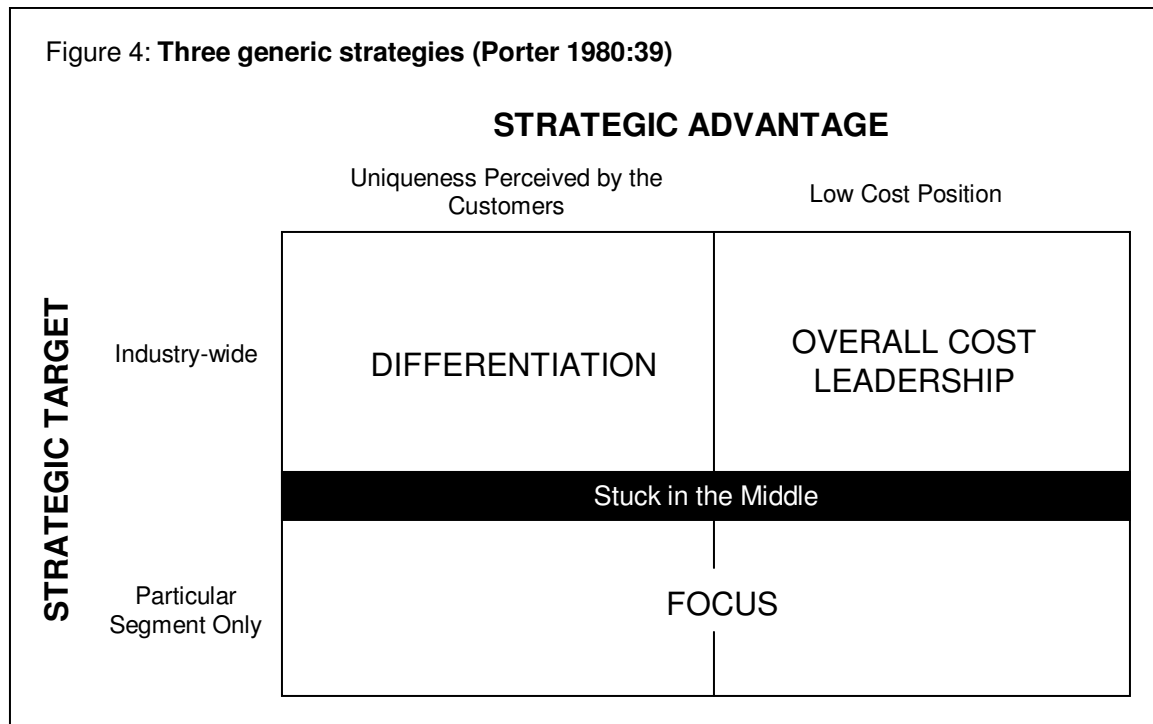
Grant refers to the sources of competitive advantage in the external environment as the *key success factors*. As Grant puts it, the key successes are those “factors within the firm’s market environment that determine its ability to survive and prosper” (Grant 2005:92). The key success factors are a function of two main factors; industry competition and customers demand. Thus, the sources of competitive advantage in an industry are identified by analyzing industry competition and consumer demand (see Figure 3) (Grant 2005).



When the key success factors are identified the firm needs to develop strategies to establish and sustain them (ibid). The next section presents three different types of general strategies for establishing and sustaining a competitive advantage in the external environment.

### 2.2.3 Strategies for successful positioning

According to Porter (1980) the main task for a firm is to create a competitive advantage by successfully positioning the firm in relation to the industry structure. A successful position is one that allows a firm to possess a competitive advantage and thus earn a persistently higher rate of profit than its rivals. To outperform its competitors in the long run a firm must sustain its competitive advantage. Porter (ibid) provides three generic strategies (see Figure 4) for establishing a sustainable competitive advantage, *Overall Cost Leadership*, *Differentiation*, and *Focus*.



When pursuing the *overall cost leadership* strategy the goal is to achieve a competitive advantage by supplying identical products or services but at a lower price. To become a cost leader requires a firm to develop and implement a cost minimization strategy that runs through the entire value chain. Initiating a low cost strategy often requires heavy up front investments, for example in state-of-the-art equipment. When pursuing the *differentiation* strategy the goal is to achieve a competitive advantage by supplying “a product that is differentiated in such a way that the customer is willing to pay a price premium that exceeds the additional cost of the differentiation” (Grant 2005:242). A firm can differentiate its products and services in many different ways, for instance in design and brand image, technology, features, and customer services. In general a differentiation strategy is a more secure basis for sustained profits than a low cost approach (Grant 2005). The final generic strategy is *focus*, which means focusing on a particular segment in the industry. Within the focus strategy the firms can either choose to compete on cost leadership or differentiation, or both (Porter 1980). A firm that fails to develop one of the above strategies is *stuck in the middle*, which is considered an extremely poor strategic situation and almost guaranteeing low profitability (ibid). A firm in this position faces difficulties supplying the low mass-market segments and the high-margin customers. Common characteristics of firms stuck in the middle are blurred corporate culture and a conflicting set of organizational arrangements and motivation system. A firm stuck in the middle must make a fundamental strategic alteration towards any of the three generic strategies (ibid).

Porter (ibid) notes that a firm can pursue more than one of these strategies; however the author believes that it is not often successful. However, Grant (2005) explains that in practice few firms develop only one of these single strategies. For example, being a cost leader does not necessary imply that a product or service is undifferentiated. Grant (ibid)

further explains that market leaders in most industries are held by those firms that successfully reconciled cost leadership with differentiation. Porter (1980) emphasizes the importance of total commitment when pursuing one of the competitive strategies. Furthermore, Grant (2005) stresses the importance of understanding both the firm's R&C as well as their industry environment before initiating one of the generic strategies. The strategies presented above are fundamentally different approaches to business strategy. Therefore, implementing them successfully requires different R&C (see Table 1) (Porter 1980).

Table 1: Requirements of the generic strategies (Porter 2004:41)

Differentiation	Overall Cost Leadership	Focus
Strong marketing abilities	Access to capital	A combination of both directed at a particular strategic target
Product engineering skills	Process engineering skills	
Cross-functional coordination	Specialization of jobs and functions	
Creativity	Tight cost control	
Research capability	Frequent reports	
Incentives linked to qualitative targets	Incentives linked to quantitative targets	

According to Porter (ibid) there are two main risks when pursuing the generic strategies. Firstly, there is a risk of failing to attain or sustain the strategy. Secondly, there is a risk of the value of the advantages provided by the strategy to erode as the industry structure changes. Firms pursuing a differentiated strategy run specific risks. The buyers' need for differentiation factor might erode and the price differential between low cost products and differentiated products may become too great (ibid). According to Grant (2005) firms pursuing a focused approach run a specific risk that the targeted segment change over time, or that the firms adopts an inappropriate segmentation in the first place.

#### 2.2.4 Applying external analysis

I have in the earlier section provided the theoretical framework for the external analysis. To apply them successfully on the SA C&T industry I have chosen Grant's (ibid) analysis framework, which I have extended by including identification of future key success factors, since it is a crucial part when analyzing the firms' internal environment (ibid). I believe that the framework suits my thesis well as it focuses on developing strategies for future industry condition. The framework follows in three steps described below.

##### 1. Describe industry present structure

The researcher is suggested to start with defining the industry to identify the different players and their relationships in the industry. The present strength of each competitive force is then analyzed to identify the current profit potential of the industry. Describing industry present structure serves as foundation for the next two steps in the analysis.

##### 2. Forecast industry profitability and key success factors

To predict future industry profitability the researcher is suggested to identify trends that will likely affect the industry structure in the future. When these trends have been

recognized their affect on the five forces of competition should be explored. From the findings the researcher should be able to forecast the industry profitability. Future key success factors in the industry are identified by analyzing the future industry competition and future customer demand (see Figure 3).

### **3. Develop strategies to alter industry structure.**

After the future profit potential and key success factors are established possible strategies for a *successful position* can be identified.

## **2.3 Resource based view**

So far I have discussed theories on how to identify profit opportunities in the firm's external environment. I will now shift focus from the interface between strategy and the external environment towards the interface between strategy and the internal environment. The natural step will therefore be to draw a parallel to the research field that focuses on the firm's internal environment, namely the RBVs. The RBV became a known theory during the 1990s and today it is one of the most influential theories in the strategy management field (Slack and Lewis 2002). According to the RBVs of strategy a firm is essentially a pool of R&C, and these R&C are the primary determinants of the firm's strategy and performance (Grant 2005). Thus, the RBVs strive to explain what is in the "black box" which is neglected in IO theory (Regnér 1999). The RBVs derives from the underlying assumption that R&C "are not uniformly distributed across firms and thus provides the potential of being a source of competitive advantage" (Hallgren 2007:9). Furthermore, R&C may not be transferable between firms which results in potential sustainable competitive advantages (Barney 1991).

The RBVs has two subgroups, the "classic" and the "dynamic" (Regnér 1999). The classical view, also referred to as the traditional view, assumes that the environment is stable and the focus is thus on explaining existing R&C. The other view assumes a more dynamic environment which is unstable and under a constant state of transformation. The focus in the dynamic approach is on explaining the development of R&C (ibid). I believe the latter is more applicable in this thesis as the C&T industry is notably unstable and continuously changing.

### **2.3.1 Resources**

In the RBV research literature there are different definitions of what constitutes a resource. Some are broad including all assets tied and controlled by the firm while some are narrower mostly involving specific technologies (ibid). I will define a resource broadly as "all assets [...] controlled by a firm that enable the firm to conceive of all implement strategies that improve its efficiency and effectiveness" (Barney 1991:101).

Identifying a firm's R&C in practice is not obvious as some are hidden deep within the organizational processes and composed of tacit components such as skills and experience (Slack and Lewis 2002). Grant's (2005) classification of resources into, *tangible*, *intangible* and *human*, is helpful to identify a firm's resources. Tangible resources are the financial and physical assets which are relatively easy to identify and evaluate in a firm, such as buildings, machinery, equipment. The firm's intangible resources are to a large

extent invisible in the balance sheet but contribute more to the total asset value than the tangible resources. Examples of intangible resources are technology, reputation and organizational culture. According to Grant (ibid) the organizational culture is a key intangible resource. Culture relates to organizations values, traditions and social norms which together partly determine the motivation of the employees. Grant (ibid) defines human resources as "the productive service that human beings offer to the firm in terms of their skills, knowledge and reasoning and decision-making abilities" (p. 144). A resource is however not very useful on its own. It is the way in which these resources work together that define what a firm can do, i.e. the firm's organizational capability (Grant 2005).

### 2.3.2 Capabilities

In the RBV research literature *capabilities* is used as a term to describe "a firm's capacity to undertake a particular productive activity" (Grant 2005:144). Some researchers use the term competence while some use capability, but they essentially refer to the same thing. According to Hallgren (2007) there are two dominant approaches in manufacturing strategy literature to explain the heterogeneity of firms. These are the *routine based approach* and the *performance based approach*. The routine based approach explains capabilities as routines, i.e. regular and predicted patterns of activity made up of a sequence of coordinated actions by individuals (Grant 2005). The performance based approach view capabilities as a business unit's intended or realized competitive performance (Hallgren 2007).

To categorize the SA C&T manufacturing firm's capabilities I will apply the *performance based approach* because the approach clearer directs the proper use of manufacturing resources (Swink and Hegarty 1998). In the performance based approach the firm's capabilities are classified using measures of operational performance. The common sets of manufacturing performances are: *Quality*, *Delivery*, *Flexibility* and *Cost* (Hallgren 2007). These will briefly be described below.

*Quality*: The quality performance is a multidimensional issue. A key dimension is *specification quality* which concerns the product's characteristics and how well the product's features, performance and aesthetics fit the customers' requirements (Slack and Lewis 2002). In manufacturing strategy however the primary quality dimension is *conformance quality* (Hallgren 2007). The conformance quality is a result of the firm's operation's ability to manufacture products to their predefined specification reliably and consistently (Slack and Lewis 2002).

*Delivery*: The firm's delivery performance is a function of two factors, *speed* and *reliability* (Ward et al. 1996). Slack and Lewis (2002) defines delivery speed as the elapsed time from when a customer becomes aware of that they need a product or service until they possess it and are satisfied with it. Delivery reliability is the ability to deliver on-time. Reliability performance is closely linked to the firm's speed performance. For sustainable success promises of speedy deliveries need to be kept with a high degree of reliability (Ward et al. 1996). The organizational structure has a significant effect on how

the production flows and directly affects the speed and reliability of delivery (Slack and Lewis 2002).

*Flexibility:* Flexibility is also a multifaceted term. According to Olhager (1993) the most influential dimensions of flexibility in manufacturing strategy is the ability to change between products and the ability to adjust manufacturing volume. Slack and Lewis (2002) refers to the above-mentioned dimensions as *mix flexibility* and *volume flexibility*. Volume flexibility is “the absolute level of aggregated output which the company can achieve for a given product mix and the time taken to change the aggregated level of output” (Slack and Lewis 2002:47). Mix flexibility is “the range of products and services which the company produces within a given time period and the time necessary to adjust the mix of products and services being produced” (Ibid).

*Cost:* Slack and Lewis (2002) define cost broadly as “any financial input to the operation that enables it to produce its products and services” (p. 48). The same authors believe that cost is the most important among the performance measurements. For firms competing on the sole basis of price, low costs will be their primary performance target. Firms with other sources of competitiveness will also be interested in keeping their cost low as every dollar removed from the operations cost base is a dollar added to the firm’s profits (Slack and Lewis 2002).

### 2.3.3 Dynamic capabilities

The *dynamitic capability approach* of Teece, Pisano and Shuen (2000) complements the classic RBVs because it does not only focus on the firm’s existing resources but on the mechanisms by which a firm adapts its capabilities to the changing environment. Teece et al. (ibid) have defined dynamic capabilities as the firm’s ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments.

The firm’s dynamic capability is affected by the firm’s *path dependency*, *core rigidities* and *processes*. Path dependency refers to the specific history of a firm. Current capabilities are a result of the past and restrain what capabilities the company can perform in the future (Grant 2005). Core rigidities are highly developed capabilities which may inhibit the firm’s dynamic capability because “the more highly developed a firm’s organizational capabilities are, the narrower their repertoire and the more difficult it is for the firm to adapt them to new circumstances” (Grant 2005:166). The processes concern the firms’ organizational routines which refer to “regular and predicted patterns of activity made up of a sequence of coordinated actions by individuals” (Grant 2005:148). Highly developed routines can limit the firm’s dynamic capability as it is less adaptable to new conditions (Grant 2005). “Dynamic capabilities thus reflect an organization's ability to achieve new and innovative forms of competitive advantage despite path dependencies and core rigidities in the firm's organizational and technological processes” (Teece et al. 2000:337).

### 2.3.4 Criteria for competitive advantage

In the IO framework the sources of competitive advantage are found in the firm’s external environment. However, in the RBV the sources of competitive advantage can

also be identified, but here in the firm's internal environment. Grant (2005) provides a framework for identifying those R&C that are potential sources of competitive advantage. The model is an extended version of the VRIO framework introduced by Barney (1994). VRIO stands for Valuable, Rare, costly to Imitate, efficiently Organized R&C. Grant's (2005) framework has identified five criteria that must be fulfilled for a resource or capability to be a source of sustainable competitive advantage: *Scarcity*, *Relevance*, *Durability*, *Transferability* and *Replicability*. Scarcity and relevance are needed to *establish* a competitive advantage while durability, transferability and replicability are required for *sustaining* a competitive advantage. Grant (ibid) has complemented the VRIO framework with a dynamic dimension, including durability. Thus, I believe Grant's model is more applicable for my analysis because my primary interest is to identify future sources of competitive advantage. The five criteria are shortly described below.

*Scarcity*: A resource or capability may be essential to compete but it is only a sufficient basis for establishing a competitive advantage if it is scarce, i.e. not widely available in the industry.

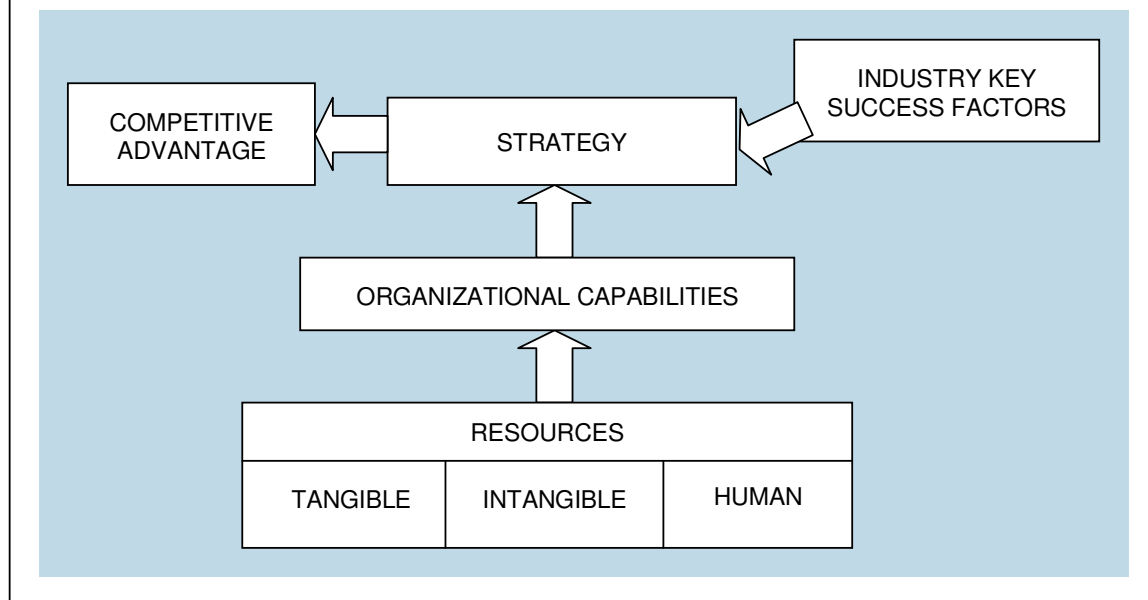
*Relevance*: For a resource or capability to attain a competitive advantage it needs to be linked to the *key success factors* in the industry.

*Durability*: For sustaining a competitive advantage a resource needs to be durable, i.e. a long lived source of competitive advantage.

*Transferability* and *Replicability*: These two conditions both concern the ability to imitate a resource or capability. The less mobile and the more difficult it is to copy a resource or capability, the more secure basis they provide for sustaining a competitive advantage.

In general, capabilities are a more sufficient basis for sustaining a competitive advantage than individual resources since they are based on teams of resources and complex organizational routines and thus are less mobile and replicable than individual resources (ibid). The link between resources, capabilities, industry success factors, and competitive advantage is presented in Grant's (ibid) model below (see Figure 5).

Figure 5: The links among resources, capabilities, and competitive advantage (Grant 2005:139)



### 2.3.5 Applying internal analysis

In the above sections the theoretical framework for the internal analysis has been described. Now a framework for applying the theories on the SA C&T industry will be presented. I have chosen Grant's (ibid) three stage analysis as I believe it is a straightforward and well structured guide. A brief description of every stage will follow.

#### Stage 1: Identifying the key resources and capabilities

To identify the key R&C a researcher can look at both the demand and supply sides. On the demand side, the researcher should focus on identifying those R&C that are of importance in achieving the key success factors. On the supply side the researcher can focus on identifying those R&C that has been used in the company's value chain activities.

#### Stage 2: Assessing resources and capabilities

In the next stage the researcher is suggested to assess the identified R&C against their *importance* for sustaining a competitive advantage and *strength* relative to their rivals. The resource and capabilities importance is estimated by assessing them against the Grant's (ibid) *criteria for competitive advantage*.<sup>2</sup> The relative strength is set by benchmarking against competitors. In the end, by reconciling their importance and relative strength the firm's key strengths and weaknesses can be identified.

<sup>2</sup> See page 15 for section on Grant's (2005) criteria for competitive advantage.



### Stage 3: Developing strategy implications

From the identified key strengths and weaknesses the researcher can at this stage develop strategies for the firm with focus on *exploiting* its key strengths and *managing* its weaknesses.

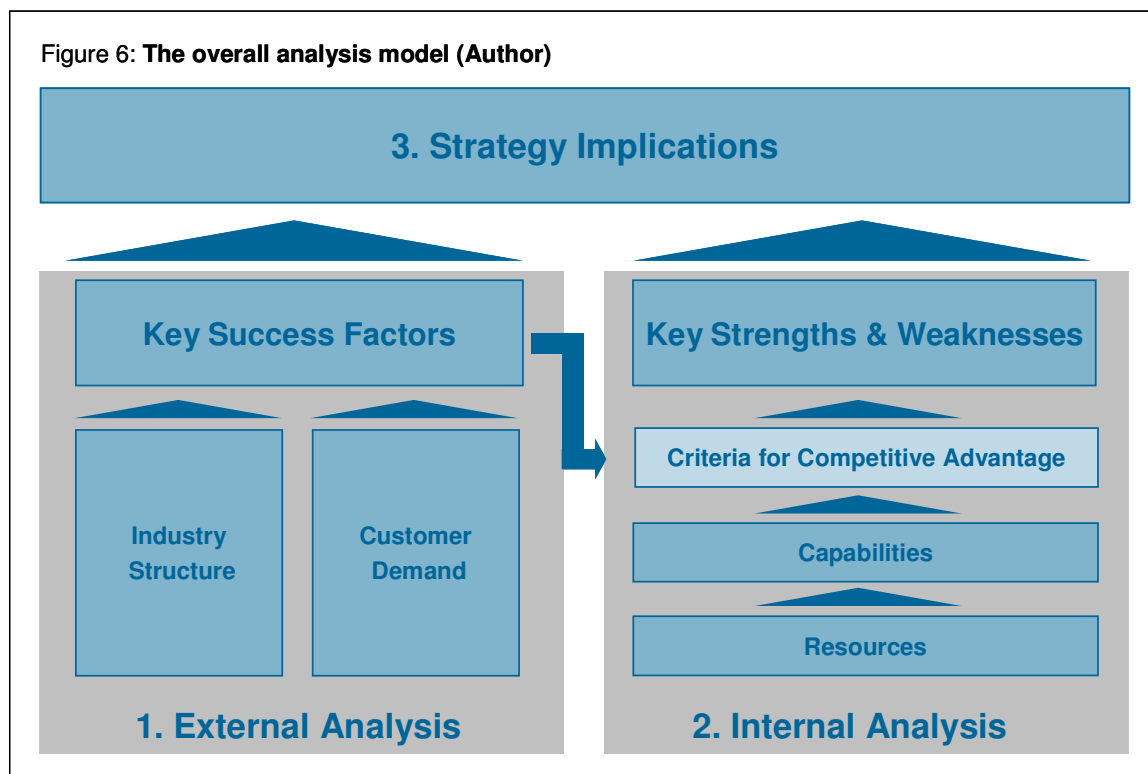
## 2.4 The overall analysis model

Based on Grant's model (see Figure 5) and the two frameworks presented earlier for applying the theories on the SA C&T industry, I have developed a model (see Figure 6) which will be used as the structural framework for my analysis.

*1. External Analysis:* In the first part the firms' external environment is investigated. The primary objective will be to identify the industry's profit potential and the key success factors by analyzing the industry structure and customer demand.

*2. Internal Analysis:* In the second part the firms' internal environment is studied. Firstly, the key R&C are identified. Secondly, they are assessed against their relative strength and importance using Grant's (2005) criteria for competitive advantage. At this stage of the analysis the key success factors, identified in the external analysis, will serve the purpose of partly determining the importance of the firms' R&C. Thirdly, from assessing the key R&C the firms' key strengths and weaknesses are recognized.

*3. Strategy Implications:* The third and final part combines the resulting conclusions of the external and internal analyses in order to develop a general strategy for the firms.



### 3. Methodology

*In this chapter the method used for conducting my thesis is presented. I start with describing the background of the research and the approach and strategy used for conducting the research. Thereafter, in chronological order, the practical process for data gathering and data reduction and analysis is explained. Lastly, I test the quality of the method used.*

#### 3.1 Research background

This thesis is a Minor Field Study (MFS) funded by the Swedish International Development Cooperation Agency (Sida). The reason for applying for a MFS scholarship is my growing interest in developing countries, especially in the African region. Over the last few years I have been in several developing countries in Africa, such as Zambia, Tanzania, Kenya, and South Africa. The latter was the country that I thought would provide the most conducive conditions for my thesis. I had been there for three months on vacation in 2007 and when I arrived back in Sweden I had decided that I wanted to write my thesis in South Africa. When choosing a topic for my MFS study I had two main requirements; I wanted to write about a subject that concerned the disenfranchised groups in the SA society and I also aimed to relate my economic studies in Management and Organization. In the South African embassy in Stockholm I stumbled upon an article<sup>3</sup> about the South African C&T industry which caught my attention. The article explained that the country's C&T industry was in a state of crisis with significant job losses as a consequence and that it partly had to do with poor management and organization skills. The article also emphasized the importance of the survival of the industry due to its socio-economic affects, especially in poor black communities. Thus, the SA C&T industry matched my general pre-set requirements and was therefore chosen as the subject of my thesis. Of the C&T industry's different actors I decided to specifically study the manufacturing firms, because manufacturing is the most labor intensive sector and suffers tremendous losses from the crisis. Therefore, the manufacturing firms also have the greatest impact on the less fortunate groups of the SA society (Vlok 2006).

#### 3.2 Research approach

*In this part I present the general approach used when conducting the research as well as the reasons for the choice of this approach.*

##### 3.2.1 Abductive approach

Due to the purpose of this thesis, which is to create a broad understanding of the manufacturing firms' internal and external environment and develop a general strategy for them to pursue, I have chosen an abductive approach. An abductive approach is an interaction between deduction and induction (Jacobsen 2002). My research questions have their starting points in reality (inductive) but the empirical findings have been analyzed and structured with the help of theories (deductive). Relating the empirical

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<sup>3</sup> Oxford Business Group. (2006). Emerging South Africa 2006, Oxford Business Group.

findings to theories have facilitated a deeper understanding of the firms' environment and also provided me with tools for developing a general strategy for the firms. During the working process I have been open for new information but at the same time been aware of my own preconceptions and limitations.

### **3.2.2 Exploratory and problem solving approach**

There are different research approaches depending on what type of knowledge is supposed to be produced (Andersen 1998). To fulfill my thesis' primary and secondary purpose I have chosen two different knowledge approaches; an exploratory and a problem solving approach. According to Andersen (1998) an exploratory study is helpful when identifying general problems in organizations and is useful as preparatory work to other categories of studies. The problem solving approach takes one step further and provides solutions to the identified problems (ibid). My study starts with an exploratory approach, to create a broad understanding of the firms' external and internal environment, and which also served as preparatory work for the primary purpose of this thesis. To fulfill the primary purpose, to develop a general strategy, my research approach changed more into a problem solving nature.

### **3.2.3 Qualitative study**

When conducting academic research there are two main methods; a qualitative and a quantitative (Andersen 1998). I have chosen a qualitative approach as I believe that the thesis subject is difficult to fully understand with number and statistics which characterize the quantitative study (ibid). A qualitative study is more useful when the researcher requires deep knowledge of the problem and aims to put the problem into a holistic perspective in order to facilitate understanding of linkages (ibid). I believe the qualitative method was more suitable for my thesis which requires a holistic perspective and a deep understanding of linkages in order to develop a general strategy for the manufacturing firms to pursue.

## **3.3 Research strategy – A multiple case study**

*In this section the research strategy is described and the underlying rationale for choosing it. I continue with describing how I have designed the research strategy to best suit the thesis's requirements.*

### **3.3.1 The choice of strategy**

When choosing a research strategy it should be done in respect of the research questions, the researchers control over actual behavior events, and if the research is historical or contemporary (Yin 2003). According to Yin (ibid) the case study has a distinct advantage "when "how" and "why" questions are being posed, when the investigator has little control over events, when the focus is on contemporary phenomenon within some real-life context" (p. 1). Moreover, the case study allows the researcher to get a holistic and meaningful view of real life events (ibid).

With the above statements in hindsight I believe the case study was suitable for my study. Firstly, I am trying to understand a complex contemporary phenomenon which I obviously have little control over, i.e. the manufacturing firms' external and internal

environment. Secondly, the forth research question is a “how” question (the three first research question are of an exploratory nature which are suitable for any research strategy (ibid.)). Lastly, due to the nature of my purpose it is important for me to obtain a meaningful overview of the manufacturing firms in the C&T industry.

### 3.3.2 Designing the case study

After deciding research strategy the next step was to design the case study. Considering my research resources in hand I have designed the case study with the aim to maximize the quality of the study (see page 28 for section on research quality).

#### General design - Multiple cases with holistic perspective

Yin (ibid) presents four different basic case study designs, see Table 2. A researcher must make two decisions. Firstly, a researcher needs to choose between conducting a single case study or multiple case studies. A single case study is useful when studying new exploratory investigation. Using a single case also brings more in-depth knowledge. On the other hand, a multiple case study is useful when producing generalized knowledge (Andersen 1998). According to Yin (2003) a multiple case designs also give more validity and reliability to the study. Since the purpose of this thesis is to create a *broad* understanding and develop a *general* strategy for the SA C&T manufacturing firms the multiple case study design was chosen.

Table 2: **Basic design of case study** (Yin 2003:40)

	Single-case designs	Multiple-case designs
Holistic	Type 1	Type 3
Embedded	Type 2	Type 4

Secondly, a researcher needs to choose between an embedded or holistic case study. I have chosen a holistic perspective because my aim is to apply the information from each single case on a more general level to be able to fulfill the purpose of the thesis. Thus, I have designed the case study according to type 3 in Table 2.

#### The choice of case companies

Following is an explanation of my logic and process when choosing the case companies. Firstly, I needed to choose a geographical location from where I would conduct my research. I decided to locate myself close to the Cape Town area, situated in the center of the Western Cape Province. The reason for this is threefold; for one Cape Town is the C&T centre of South Africa, secondly the city has the largest number of manufacturing firms, and lastly it enjoys the highest employment level (Vlok 2006).

Once the location was set I needed to decide which firms to target in the Cape Town area. According to Yin (2003) a screening process is especially important when there are several qualified case candidates. The aim with a screening procedure is to insure that the cases represent what the researcher intends to study (ibid). Thus, to be sure that the cases chosen are of value for my research I developed a few broad requirements prior to the data gathering process in SA. I choose not to make too specific requirements because the risk of failing to meet predetermined requirements is higher when conducting an MFS. When performing research in a developing country the researcher needs to be flexible due to the difficulty of predicting the prevailing conditions on field. Furthermore, the time frame on field is limited (MFS Course Uppsala).

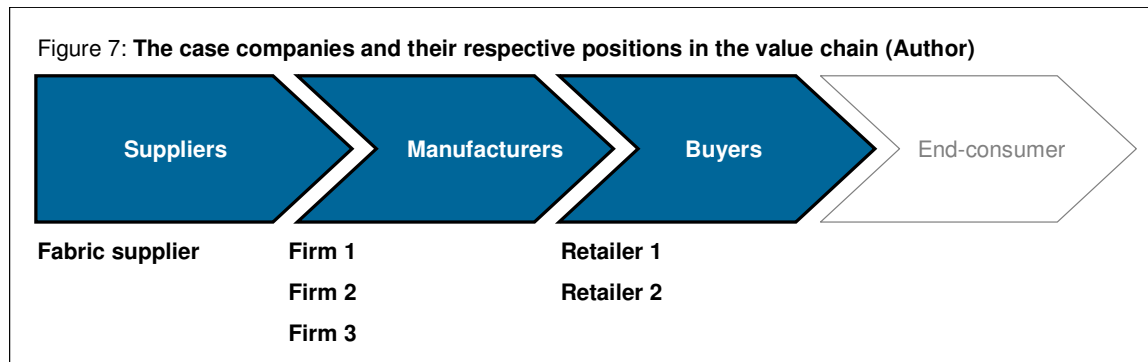
After discussion with my tutor at the Stockholm School of Economics I found that six to eight cases would be within the frame of my research resources and would be enough for me to fulfill the purpose of my thesis. To get a general and meaningful picture of the manufacturers' situation I decided to select cases from all of the main sectors of the C&T value chain, i.e. suppliers of raw material, manufacturers and buyers. Even though this thesis focuses on the manufacturing firms in the area, I believe it is important to get the suppliers' and the customers' point of view to fully understand the manufacturers' environment. Further, to gain a deep understanding of the manufacturing firms' situation I specified to do at least three cases with manufacturing firms. To improve the generalizability of the research I also decided to conduct case studies with different sizes of manufacturers (Micro, Small, Medium or Large) from different segments in the industry. The different requirements are summarized below:

- Six to eight case companies.
- Case companies from different parts of the supply chain.
- Minimum of three manufacturers.
- Different size of the manufacturers.
- Manufacturers from different segments.

The majority of the cases were chosen on site with assistance from my supervisor Linda de Vries at the University of the Western Cape and Chris Burke at Centre for Chinese Studies. They provided me with the first set of contacts which led me to other contacts and networks and thus, via a *snowball sampling method*<sup>4</sup>, the case companies were found. When contacting the potential case firms I followed a two step procedure. I started with sending out a *Letter of Introduction* (see Appendix B) to the contacts that I had acquired. If I did not get a response after a few days I called back. It was not always easy to get in contact with the potential case companies as the Internet is not widely used. However, after some effort I finally managed to find six companies that were willing to cooperate and that together fulfilled the pre-set requirements. The case companies are all presented in Figure 7. A short description of each case study is found in the Appendix A.

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<sup>4</sup> The snowball sampling method simply means to locate study objects through contacts and networks (Bryman 2004).

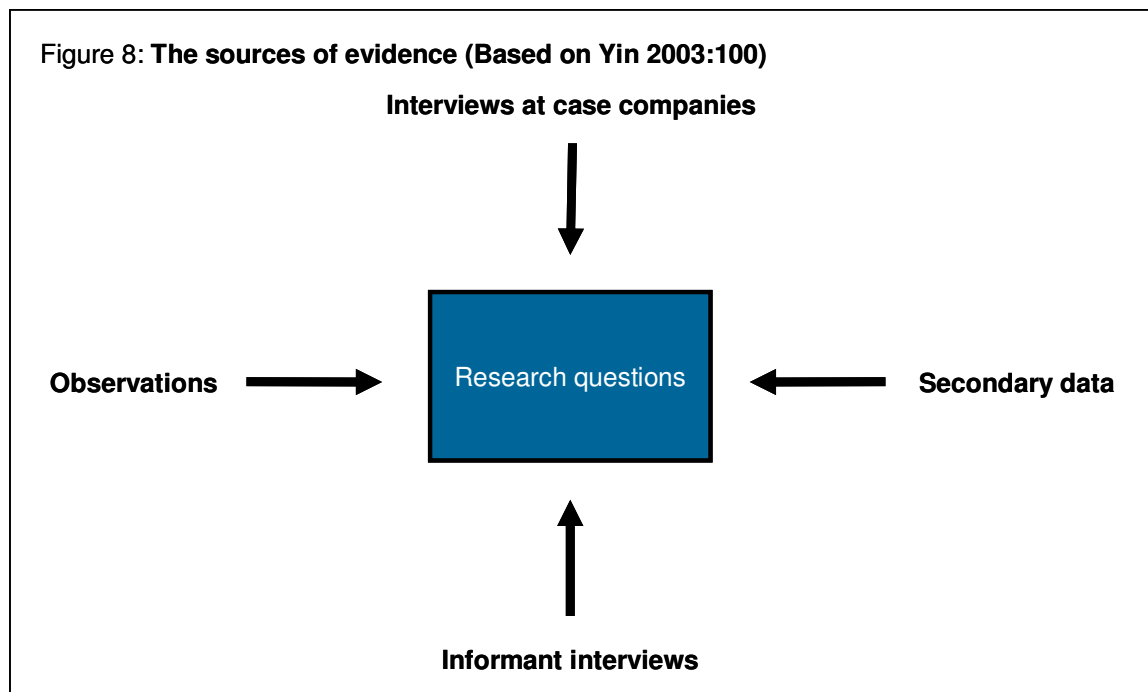


### 3.4 Data gathering

*In this section the data gathering process is described. First, the different sources of data and the process for collecting the data are presented. Then, the process of collecting the primary sources and the secondary sources of evidence is described more specifically.*

#### 3.4.1 Multiple sources of evidence

I have chosen to use multiple sources of evidence; case study interviews, informant interviews, observations, and secondary data, all *triangulating*<sup>5</sup> on the same set of research questions (see Figure 8). According to Yin (ibid) multiple sources of evidence enhances the quality of the research. To create a correct and general understanding of the SA C&T industry I believe that the use of multiple data sources was needed.



<sup>5</sup> Triangulating of data simply means using multiple sources of evidence aimed to corroborating the same fact or phenomenon (Yin 2003).

### **3.4.2 Data gathering process**

I will here briefly describe the general process for gathering the above-mentioned evidence. I began my study with writing an application for the MFS scholarship in a form of a draft synopsis of my thesis. During this process I also began an extensive search through reports on the SA C&T industry on the Internet. Moreover, through theories within the Strategic Management field I developed the thesis's purpose and the research questions.

Before traveling to SA I formed four different interview guides (see Appendix C); one for interviews with industry informants, one for manufacturing firms, one for suppliers of raw material, and one for the buyers, i.e. the manufacturing firms customers. The guide used for interviewing the industry informants was structured in accordance with the research questions. The interview guides for the case companies mainly contained company specific questions. As I required different data from the different case companies, I made three different interview guides which were used depending on where in the value chain the company was positioned.

Once in South Africa I began the primary data collection. I started with an informant interview with Chris Burke. He provided me with a general picture of the industry. According to Andersen (1998) informant interviews are a useful tool in the beginning of the data gathering process when one is not completely certain of what questions to ask. With the information gathered from the first interview I modified the interview guides and removed and added a few more questions. The rest of the interviews with the case companies and industry informants were conducted in parallel during a two month period. There were also observations done at the case companies. I also received some secondary material from my interviewees, such as annual reports, etc.

### **3.4.3 Primary data**

I will now in more detail describe the process of gathering the primary data. The primary data consist of three sources of evidence; interviews with case companies, interviews with industry informants and observations. They are separately described below.

#### **Interviews with case companies**

With the purpose of my thesis in mind, the interviews were conducted with people at management level because that is where the strategic decisions are taken. I decided to conduct interviews with one to four individuals in each company. My wish was to conduct as many interviews as possible at each company with the maximum of four interviews due to research resource limitations. Conducting more than four interviews would have created too large amount of data for me to be able to carefully analyze. However, as the case companies were different in terms of size and because the availability of management staff differed between the companies, the number of interviews consequently differed between the companies. The interviewees are outlined in Table 3.

Table 3: The interviewees at each case company

Case company	Position of interviewee
Firm 1. Large CMT – Retailer focus	Managing Director (MD)
Firm 2. Small CMT – Hospitality industry focus	Manager
Firm 3. Micro C&T manufacturer	Manager
Fabric Supplier	Chief Executive Officer (CEO)
Retailer 1	Development Manager (DM) Head of Sourcing Technical Manager (TM) Lingerie Technical Manager Women's Wear
Retailer 2	Head of Sourcing

### The interview process

All of the case companies and the interviewees at each case were anonymized to allow an open dialog during the interview and to get access to sensitive information. A few days before the interview I had sent out a *Letter of introduction* (see Appendix B) and an *Interview guide* (see Appendix C) to the interviewees, for them to get a good understanding of the study and to get a chance to prepare their answers. My hope was to enable more correct and well thought-through answers from the interviewees.

The interviews were conducted according to a semi-structured interview method. This method is useful when a few objects are interviewed and when specific issues are supposed to be emphasized (ibid). The semi-structured interview allowed me to ask counter questions and thus dig deeper into some specific issues that was of special interest for my study. During the conversation, the interview guide served as a reference, and I allowed myself and the interviewee to freely change the order of the questions in the guide. However, I made sure that each question had been answered before ending the conversation. It was especially important for me to have a clear guide to fall back unto, for the purpose of minimizing the risk of the interviewee changing the conversation to only focusing on his or her stronger areas, which is a common problem when interviewing persons at high-level positions (ibid). The interviews were conducted personally by me and were approximately one hour long and carried out at the interviewee's workplace. During the interview, notes were taken and to minimize loss of data the conversations were recorded after permission from the interviewee.

### Interviews with industry informants

To fully understand the firms' environment I complemented the cases with interviews with eight persons working in industry support organizations (see Appendix C) and other institutions closely connected to the industry. The interviewees were found via networking comparable to the previously mentioned *snow ball sampling method* (Bryman 2004). The interviewees were recommended because of their reputation as having



excellent insight in the industry. The first interview was conducted using an open interview method, which is recommended when the researcher has little knowledge of the subject (Andersen 1998). The rest of the interviews were of a semi-structured nature similar to the case company interview process described above, albeit with a few differences. The main difference was that the industry informants were not anonymized and the interview questions differed by being on a more general level. The industry informants are outlined in Table 4 below.

Table 4: **Industry informants and their respective positions**

<b>Interviewee</b>	<b>Position</b>
Averil Appolis	Manager of CLOTEX
Chris Burke	Research Fellow at Centre for Chinese Studies
Graham Choice	Chairman of the Cape Clothing and Textile Cluster
Vanessa Eckles	Deputy Director of CLOTEX
Trudi Hartzenberg	Executive Director of Tralac
Reuben Kadalie	Contract Research and Development Manager at CSIR
Mike Morris	Professor at the School of Economics, University of Cape Town
Etienne Vlok	Researcher at SACTWU

### **Observations**

Observations were conducted at all three manufacturing case companies. As mentioned before, my study started with an exploratory purpose to understand the manufacturing firms' environment. According to Andersen (ibid) observations is a particularly useful method for exploration. When interviewing the manufacturing managers on site I had the opportunity to walk around with them and observe the plants' facilities and production processes. Observing with my own eyes how the manufacturers operated enhanced my understanding of the manufacturing firms and also gave me closeness to the subject, which is difficult to access in other ways (ibid). My observation method was unstructured, which means that I did not have any predetermined observation activities prior to the company visit (ibid). I tried to observe as many things as possible during the site seeing, which usually lasted between 10 - 20 minutes at each manufacturing plant.

#### **3.4.4 Secondary data**

The information collected by other researchers, persons, and institutions are categorized as secondary data (ibid). I have used three main sources of secondary data; industry reports, company internal documents and academic literature. The majority of the industry reports were gathered in the beginning of the work process to get a broad understanding of the subject. A few reports were also provided later in the process by the interviewees. The industry reports have mainly complemented the contemporary data from the interviews with historical evidence (apart from Technopak (2007) which

describes future trends in the industry), which was valuable for me to better understand the industry's context. The case interviewees also provided me with internal material, such as annual reports and confidential strategy documents (benchmarking reports, sourcing strategy documents) etc. These sources have been used implicitly and have served the purpose of providing me with an insight to the firms. I have also done an extensive search through academic literature in the Stockholm School of Economics' library and its data bases. Two books have been the main source of theories, *Competitive Strategy* by Michael E. Porter (1980) and *Contemporary Strategy Analysis* by Robert M. Grant (2005).

### **3.5 Data reduction and analysis**

I have in the previous sections discussed the main elements in the data gathering process. I will now continue with explaining the process for reducing and analyzing the data, which is a major challenge when using qualitative methods (Jacobsen 2002). Qualitative methods often result in a lot of data that needs to be reduced and structured to make analysis possible. Furthermore, when using a qualitative method it is not possible to systemize the information before the data gathering process. Instead the data needs to be structured and organized after collection (ibid). To reduce the risk of the process becoming too complex it is important to have a predetermined strategy for reducing and analyzing the data before starting the case study (Yin 2003). Before collecting the data I had chosen a general process recommended by Jacobsen (2002) that is made up of three main stages; *describing*, *structuring and categorizing*, and *combining*.

#### **Describing the data**

This stage aims to *describe* the data in as much detail as possible (ibid). I did this by carefully documenting the data. After each interview I listened to the recorded material and documented all of the answers and summarized the main impression in a case study protocol for each company. This was then saved in a company specific folder on my computer. The same process was conducted with the industry informant interviews but the answers were documented in the interview guide and saved in another folder. During this process I also critically reflected over the interview situation and the trustworthiness of the data gathered. In the case study protocols I also included interesting observations and valuable information from the internal material. If the internal material was in digital format it was saved in the company specific folder. This documentation process was very time consuming but was essential for the next stages in the data reduction process. Furthermore, having all the answers in full text provided me with the possibility to do accurate word by word quotations.

#### **Structuring and categorizing the data**

The second phase *structures and categorizes* the data (ibid). I started with setting up the different themes to structure the case company protocols. This was done inductively, because I based my themes on the data gathered. Next, I carefully read through each case study protocol and systematically categorized the findings according to the different themes. The answers from the industry informants were structured according to the interview guide, which categorized them into the thesis research questions.

### **Combining the data**

In the last stage of the process the data is *combined* (Ibid). After categorizing the answers for each individual case and interview I combined the six case protocols, with the eight informant interviews and with the secondary data. Combining the data made it possible to overview the findings and thus also to identify cross case patterns and other similarities and dissimilarities in the interviewees' opinions. To structure and analyze the combined findings I applied them on theoretical concepts within the Strategic Management field and finally arrived at the conclusions concerning the manufacturing firms.

## **3.6 Quality of research**

In this section the quality of my research is tested. To evaluate the quality of the case study Yin (2003) presents four different tests; *construct validity*, *internal validity*, *external validity* and *reliability*. The internal validity test is however not applicable to my case study as it is only a concern for explanatory case studies (ibid). My research is of an exploratory and problem solving nature and thus, I will evaluate the quality of my research using the remaining three tests.

### **3.6.1 Construct validity**

The term *construct validity* concerns how well the research measures what is supposed to be measured (ibid). Case studies in general have been criticized for poor construct validity due to the lack of "hard" data (ibid). Holistic case studies in particular have problems of being at an abstract level (ibid). Yin (2003) presents two steps to increase the construct validity:

- Specify what to study.
- Make sure that the evidence used indeed reflects what is supposed to be studied.

I have clearly specified in my purpose and in the research questions what I intend to study. I have tried my utmost to make sure that the data I have gathered is relevant for answering my research questions and thus fulfill the purpose. However, due to resource limitations and uncontrollable field conditions the research has construct validity weaknesses.

Firstly, the requirements used for screening the case companies are on a general level. The requirements could have been more specific and I could also have used other screening criteria. One could argue that the case studies should have been represented by a higher degree of manufacturers because it is their situation that I am specifically studying. However, I believe it also was important to study their environment, i.e. their suppliers and customers to get a broad picture of the manufacturing firms' situation. I prioritized those sources of evidence in favor of more data from several other manufacturing firms.

My thesis aims to develop a general strategy for the manufactures in order for them to improve their competitiveness. However, the manufacturers that I interviewed all had viable competitive positions. One could make the case that the research would have been more valid if I conducted case studies with clearly uncompetitive firms. It is worth noting

that I did try to get in contact with firms experiencing significant losses and lay-offs, but without any success. However, the case studies with the manufacturers served a valuable purpose of exemplifying best practices. Furthermore, this weakness is managed by using multiple sources of evidence.

When conducting the case studies I have only interviewed people in management positions. One could argue that interviews at all levels would have increased the validity of the research. For example, gathering data from the workers may have provided me with a better understanding of staff problems, such as the lack of motivation and the high absenteeism rates. However, I believe that it was more valuable for me to get the managers opinion which I expected to be on a broader and more strategic level.

To increase the construct validity I focused on making the interview guides as useful as possible for providing me with the information needed to answer the research questions. For example, I conducted an open informant interview before carrying out the case studies. This enabled me to specify the answers to better serve their purpose. To further improve the construct validity of the case studies Yin (2003) recommends conducting a pilot case. I reviewed the option but quickly realized when arriving in SA that a pilot case was not viable in order to fulfill the above-mentioned requirements on number of cases.

Lastly, I could also have complemented my research with a quantitative study, covering a bigger area and gathering data from numerous people to further broaden my knowledge. However, due to mobility and time limitations I believe it would not have been possible.

### 3.6.2 External validity

External validity concerns how generalizable the research is (ibid). To increase the generalizability of the case study it is important to describe the data in as much detail as possible and to inductively separate general and specific knowledge (ibid). The more cases investigated the more generalizable the knowledge is (Andersen 1998). Due to the nature of the thesis purpose, which is to create a *broad* understanding and develop a *general* strategy, the generalizability of my research have been highly prioritized when designing the case study. To increase the external validity of the research I have used multiple case studies and multiple sources of evidence. The case studies represent different parts of the industry value chain. The manufacturing case studies also represent different sizes and types of manufacturers and they supply different segments in the industry. Furthermore, the case studies have been complemented by extensive interviews with industry informants as well as several industry reports. Moreover, I have carefully documented each case study describing the data in as much detail as possible. Due to these measures I believe I have had a good platform to cross check the data and identify general patterns and evaluate what data that is company specific.

### 3.6.3 Reliability

The reliability of the research concerns the possibility for other investigators to conduct the *same* case study all over again (Yin 2003). To allow a researcher to repeat the case study the emphasis should be on documenting the procedures and findings (ibid). To increase the reliability of my research I have carefully documented the interview answers

in interview guides and case study protocols. I have also tried to document the chain of events by explaining the data gathering and reduction process in as much detail as possible in this chapter. Furthermore, the interview guides are displayed in the appendix for other readers to partake.

There are some factors that make it difficult for other investigators to re-do my case study. Yin (ibid) emphasizes the importance of developing a case study data base and to make the case study protocols and other information accessible to other researcher. All of the findings have been stored in my personal computer but I have not created an easy accessible data base due to resource limitation. Furthermore, some information was given to me in confidence and can not be distributed to other researchers.

Another reliability weakness of my method is the process of choosing study objects. The case companies and informant interviews were chosen using a *snow ball sampling method*. The research population is thus a biased result of social relations and gives no basis for statistical inference (Bryman 2004). To increase the reliability I have set up a few criteria for choosing the case companies. I also determined how many interviews and at which level in the organization they should be carried out.

To further secure a high degree of reliability the errors and biases in a study need to be minimized (Yin 2003). Bias information is especially a problem in qualitative research methods when social interaction is common (Jacobsen 2002). Firstly, there is the risk of information being biased due to the author interpretation of the data. For example, my Swedish background and preconceptions constantly affects my interpretations. Furthermore, cultural factors may increase the risk of misinterpretation. However, since I stayed in South Africa three months before conducting the research I was quite familiar with their culture, thus reducing the risk of the information being misinterpreted due to cultural factors.

Secondly, there is a risk that the answers given from the interviewees are biased. One weakness of my research method is that many case studies only included one interview, which increases the risk of the information being biased. To reduce this risk I cross checked the answers with the other interviewees' opinions and with my secondary sources. Furthermore, the case company interviews were anonymized and the interviews were conducted in the respondents' natural environment, which reduces the *context affect*<sup>6</sup>. I have also tried to formulate the questions in a way to minimize the risk of influencing the interviewees' answers. Even though the above measures were taken there is always a risk of biased answers. However, being aware of the risks might minimize their affect on the results.

I have so far focused on the reliability of the primary sources. However, there is also a risk of biased secondary information. The reliability of the industry reports has been tested by evaluating the authors and the reports' purposes and contexts. For example, I established which organization the paper was written for and the organization's main function. When reading through the reports I have had that information in mind.

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<sup>6</sup> The context affect simply means that the content of the data is affected by the environment (Jacobsen 2002).

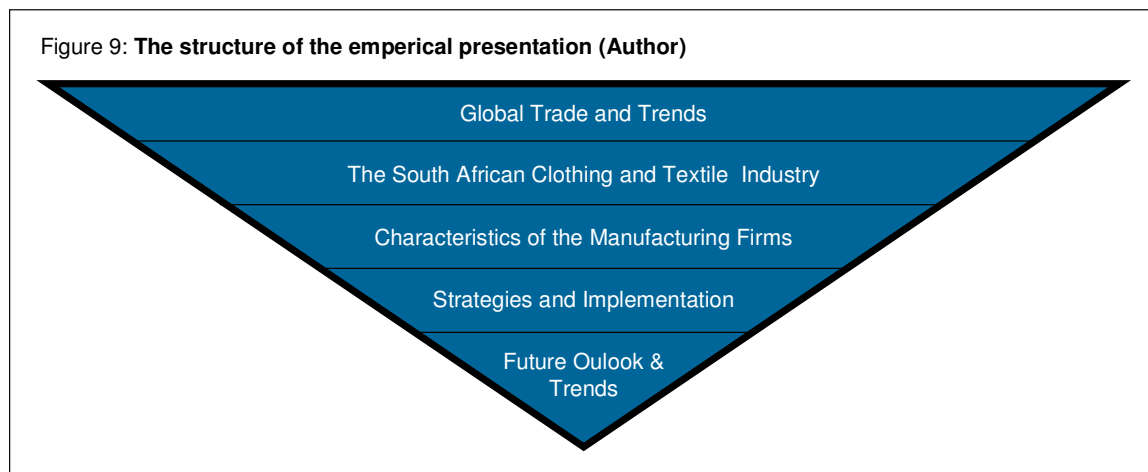
### **3.7 Presentation of data**

This section provides a short explanation of how the data in the thesis is presented. The reader should notice the following:

- Quotations are used to contribute to greater understanding of a specific issue.
- The industry informant interviewees are presented with their surname.
- The anonymous case company interviewees are presented with their firm position.
- The case companies have been given fake names.
- Central terms are written in *italics*.
- The term “firms” refers to the SA C&T manufacturers if nothing else stated.

## 4. Empirical Presentation

*The empirical presentation is structured according to a cone-shaped model (see Figure 9) starting broadly with giving a brief overview of the global C&T trade and a description of global present and future trends affecting it. The focus is then narrowed down presenting the SA C&T industry and the C&T manufacturers' characteristics. Different strategies proposed by the interviewees and their suggestions for implementation is then presented. In the end of the chapter the future outlook of the industry is discussed and the regional trends that may affect it. A short description of each case company is found in the Appendix A.*



### 4.1 Global trade

C&T are one of the world's most traded manufactured products (CSP 2005). In 2005 global C&T exports were valued at USD 480 billion. Over the last 13 years exports have increased at an annual compounded rate of 6.6 percent. By 2015 global C&T trade is predicted to reach USD 805 billion (Technopak<sup>7</sup> 2007). There are three major phases in the modern history of global C&T trade which will briefly be described below (ibid).

#### 4.1.1 The Multi Fiber Arrangement regime 1974-1994

Until 1974 C&T production was mainly concentrated in the main consumption centers of the USA, Europe and Japan. In the early 1970's production started to move from the developed economies to developing countries. This shift in production was a result of original production centers increasingly becoming uncompetitive mainly due to the economic development facing these countries. The first countries to take advantage of the decreasing competitiveness of the traditional production basis were the Newly Industrialized Economies (NIE) of Hong Kong, Taiwan and Korea which benefited from much lower labor wages. These countries began setting up a C&T production basis with

<sup>7</sup> Technopak Advisors Pvt. Ltd. was founded in 1991. The organization focus entirely on providing knowledge based services and solutions to leading companies in the Consumer Products industry. The organization comprises more than 200 skilled professionals in four offices in India. For more info about Technopak visit [www.technopak.com](http://www.technopak.com).

improved quality and flexibility which resulted in a significant decline in production in the United States (US), Europe and Japan (Technopak 2007).

To protect its domestic industries developed countries launched a comprehensive trade restriction named the Multi Fiber Arrangement (MFA) in 1974. The MFA involved trade restraints, such as quota restrictions and bilateral agreements, with the aim of providing time for the original industries to become competitive. As a result of the MFA trade patterns started to shift from the NIE towards less developed and less quota restrained Asian countries (China, Indonesia, Thailand, Pakistan, Sri Lanka, and Vietnam) with China being one of the most competitive players. The emergence of a new low cost production basis aggravated the situation for the developed countries' industries. The various shifts in trade finally resulted in production and consumption being separated into different regions or clusters (ibid). During the MFA period buyers in the developed countries started co-coordinating the global supply chain networks. Due to mergers and acquisitions the buyers became larger and more concentrated thus increasing their buying power (the DTI 2005).

Due to protests from developing countries the MFA ended in 1995 and the World Trade Organization (WTO) was founded. The WTO replaced the MFA with Agreement on Textiles and Clothing (ATC) for a quota phase out and consequently a new era in global C&T begun (Technopak 2007).

#### **4.1.2 The Agreement on Textiles and Clothing period 1995-2004**

The aim with the ATC was to eliminate the quotas during a transitional phase of ten years. Thus, by the end of 2005 the goal was for all the C&T products should to stand quota free. The formation of the WTO and ATC was the beginning of the global liberalization of C&T trade and resulted in increased global trade from US\$ 310 Billion in 1995 to US\$ 450 Billion in 2004. The main development in the ATC period was the emergence of China as a major exporter and importer of C&T, increasing its share in global C&T trade from 12 percent in 1995 to 24 percent in 2005. China's increasing market share was a result of government incentives, increasing government investments in C&T as well as low cost labor. The ATC period also witnessed new producing centers emerging in the Sub Saharan African<sup>8</sup> (SSA) region, the South East Asian nations<sup>9</sup>, the Andean<sup>10</sup> countries and the Caribbean<sup>11</sup> region. This development was partly due to the Free Trade Agreements (FTA) and the Preferential Trade Agreements (PTA) signed with the US and also due to production movement of the NIE and developed countries to these areas. During the ATC period the buyers of C&T based their sourcing decision mainly on availability of quotas and access to raw material (ibid).

In order for manufacturers in the developed economies of the US, Europe and Japan to compete with their low cost competitors, outsourcing production offshore became an essential strategy during the ATC period. Some production was outsourced to Asian low

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<sup>8</sup> Kenya, Lesotho, Madagascar, Mauritius, South Africa etc. (The list constitutes the major countries only)

<sup>9</sup> Indonesia, Philippines, Malaysia, Thailand, Cambodia, Vietnam etc. (The list constitutes the major countries only)

<sup>10</sup> Costa Rica, Peru, Bolivia, Ecuador etc. (The list constitutes the major countries only)

<sup>11</sup> Dominic Republic, Honduras, Guatemala, El Salvador etc. (The list constitutes the major countries only)



cost countries but the majority of manufacturers established close production networks where they supplied intermediate inputs (cut fabric, thread, buttons and trim) to low cost firms in neighboring countries. These firms assembled the inputs supplied using relatively low cost labor and then delivered them back to the supplying manufacturer (the DTI 2005).

To compete with cheaper developing countries the developed economies have moved towards higher value added production which has resulted in investments to integrate new technologies in the production process. However, investments in developing countries have been much greater. Over the last decade the investments has been declining in the EU and US whilst for example China, India and Turkey have increased their investments massively (ibid).

Between 1995 and 2004 there has been a significant decline in the in the number of C&T firms and employees in developed economies. The US has suffered the most, followed by UK, Germany and France. But in developing economies clothing employment has been growing steadily (ibid).

#### **4.1.3 The post quota era 2005-2006**

On January 1, 2005 quota restrictions were removed from all C&T products imported by the developed economies. The elimination of quotas had, as expected, a major impact on the sourcing patterns of importers. During the quota era buyers had been forced to source from unfavorable locations. But after 2005 buyers could shift sourcing to a more optimal production bases in lower cost Asian nations which resulted in increased imports from the major consumption bases of the US, EU and Japan. The first non-quota year witnessed an increase of imports of 7 percent in the US, 1 percent in the EU and 4 percent in Japan. During the second year, 2006, imports increased further. The major winners from increased imports were China and South Asian countries who significantly gained market share due to lower cost compared to their competing countries in the regions of Africa, EU and South America (Technopak 2007). By 2005 the two largest industries in the world were China and India (the DTI 2005).

Buyers have become larger in size and thus further increasing their control of the global supply chain networks. Today large retailers control where products are made around the world, at what price and how quickly they need to be moved. They also have control of many aspects of the production process itself, such as design, fabric sourcing, lead times, price and quality (ibid).

### **4.2 Global trends**

Technopak (2007) has analyzed the state of current trade and emerging consumer and retail trends and has determined what some of the key changes are that would impact the global C&T industry in the next six to eight years. While some of the changes will impact the manufacturers directly a large number of changes would also impact the manufacturers in an indirect manner. Based on Technopak's (ibid) report I have identified the following trends.

### 4.2.1 Present trends

*Growing imports but falling prices:* After the end of the quota era, the consumer bases of the US and EU have increased their imports while the prices have fallen. This trend is expected to continue.

*New sourcing rules:* After the abolishment of quotas, retailers and brand owners have made significant changes to their buying strategies and their relationship with suppliers. There have been three major changes.

Firstly, the end of quotas provided an opportunity for the buyers to rationalize their supplier base thus segmenting them in to one of the following three categories to optimize sourcing benefits:

- *Strategic partner* involved in close working relationships selected not only based on price but also on capabilities such as lead time and quality.
- *Niche supplier* offering unique product, capabilities or location.
- *Opportunistic supplier* used per need basis.

Secondly, there has been a shift from purely transactional relationships to strategic long-term relationships. This has resulted in suppliers benefiting from a constant flow of orders while buyers can reduce lead times.

Thirdly, there has been a shift from fragmented sourcing to the use of full-package suppliers. The last sourcing trend means outsourcing operations such as product development and inventory management to suppliers, and consequently enabling retailers to focus on their core business.

*Suppliers building capabilities:* In response to the new demands of buyers and new opportunities provided through the end of quotas, suppliers are building special capabilities like design and product development, logistics, productivity improvements, quality control systems, inventory management and IT support. Furthermore, large suppliers that were spread in different countries due to quotas are now consolidating. Lastly, textile suppliers overall have significantly increased their investments in textile machineries.

*Free trade agreements and safeguards:* Trade agreements, tariffs and safeguards are expected to play an increasingly important role in the C&T trade. A large number of countries faced with declining exports and increasing unemployment have begun to sign FTAs and PTAs with the major consuming countries. Such measures influence buyers to source from countries with duty free access and also encourage suppliers to relocate facilities to these countries in order to gain competitive advantages.

### 4.2.2 Future trends

*Trade growth, stabilization and emergence of new supplying countries:* Due to decreased domestic production in the US and EU, global trade is expected to reach USD 805 billion by 2015, up from USD 480 billion in 2005. The clothing trade is expected to increase

more than the textile industry. Although the trade map is not expected to change dramatically, Technopak (ibid) believes the C&T industries in China and India will see a stabilization of exports due to a growing domestic market, forcing retailers in developed markets to look for new sourcing bases. As this happens, Vietnam and Cambodia are likely to emerge as major C&T suppliers. The biggest losers will include African countries, Mexico and the Intra EU region. Since industries in low cost countries will increase significantly, industries in high cost countries will most likely be replaced by services and high tech industries.

*Consolidation, collaboration and relocation:* Consolidation and collaboration between large suppliers, especially those in vulnerable countries (African countries, Mexico and the Intra EU region) will increase, as will joint ventures between high cost suppliers wanting low-cost manufacturing facilities and low-cost suppliers that wish to gain ready access to markets and product development skills. Furthermore, consolidation in the sector will see multibillion dollar textile conglomerates emerge. These large companies will come from China, Hong Kong and the Mediterranean region as operations are expanded in South Asia. Medium and small sized companies will remain relevant, offering fashion products that require smaller orders but more complexity, niche products and as an outsourcing option for larger companies. Relocation of high cost suppliers to low cost countries will also increase. Joint manufacturing will emerge as the importance on dual sourcing increases. In dual sourcing buyers prefer to source fashion sensitive products from production centers close to the point of sale, while basic products are sourced from low cost countries.

*Redefinition of the traditional roles:* Retailers and buyers looking for more efficient operations will retain control of merchandise planning and retail sales, while other functions – consumer trends forecasting, designing, product, warehouse and logistics – will be outsourced to suppliers.

*Speed and reliability:* Buyers will focus on speed, on-time delivery and reliability when selecting suppliers. This is because buyers are looking for leaner operations and lower inventory and also due to the continuing growth of fast fashion.

*Scarcity of resources would lead to the development of new technologies:* As the scarcity of natural resources used in the textile industry increases, the industry will look for new technologies and fibers that use resources more efficiently.

*Migration of skilled manpower from buying to supplying countries:* In the developing textile bases of India, Pakistan, Bangladesh, Vietnam and China, the demand for knowledge and skills in product development and design and manufacturing best practices is increasing. This will result in migration of skilled manpower from established textile nations such as Italy, Germany, the UK and the US to the developing countries. Despite this shift, most of the cutting-edge development in the industry will still come from the developed countries like US, UK and Germany in the next six to eight years.

### **4.3 The South African Clothing and Textile Industry**

#### **4.3.1 The history of the industry**

To understand the dynamics within the SA C&T industry one needs to have some knowledge of its historical and economical background. There are three key phases in the history of the C&T industry in SA, linked to the level of protection and competition from global trade (Vlok 2006).

The first phase of the SA C&T industry is characterized by protectionist and domestically-focused national economic policies (ibid). The industry began with the manufacturing of blankets in the 1920s and 1930s. After the Second World War the domestic industry started to develop, expanding into furnishing, industrial textiles and clothing, before moving into the production of synthetic fiber in the 1960s (Salm 2002). In 1960s the real development of the industry began, and during this decade it almost doubled its size (Gibbon 2002). Before South Africa became a democracy and a member of the WTO, the C&T industry was highly protected from international competition through an import substitution strategy and thus focused exclusively on the domestic market. Over time this isolation strategy, with relatively high tariff barriers, caused inefficiencies in the industry and resulted in a failure to become internationally competitive and therefore incapable of developing significant export capacity and economies of scale. Production was at this stage concentrated in low value added products (Vlok 2006).

The second phase took place after the end of apartheid rule, when South Africa in 1994 joined the WTO and saw the opening of its market to international trade. This time was characterized by strong trade liberalization. During the late 1990's and early 2000s the SA manufacturers increased their exports steadily while SA imports were stagnant. This was possible because of two main factors; the Duty Credit Certificate Scheme (DCCS)<sup>12</sup> and significant depreciation of the local currency, the Rand, which was undervalued during this period of time. Exports were at this time concentrated to low value added products (ibid).

The third phase began around 2002, when exports decreased significantly while imports increased substantially, particularly from China. This was mainly due to a significant appreciation of the local currency and an uncompetitive domestic industry. This was the starting point of the crisis facing the domestic manufacturing firms. The main characteristic of the crisis is large-scale loss of employment. The South African Clothing and Textile Workers' Union (SACTWU) have documented more than 55,500 job losses since 2003, and according to official statistics there has been a 37 percent decline in employment since 1996 (ibid).

#### **4.3.2 The industry's role in global trade**

The SA C&T industry is a very small actor in global trade (the DTI 2005). According to Gibbon (2002) the SA C&T industry does participate in the global value chain but in a

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<sup>12</sup> For more info on the DCCS see Appendix E – Policy Framework.

limited and non dynamic way, and mainly supplying the US and EU market with low value added products. The goods are often basic items manufactured with long production runs, low labor content and low differentiation (the DTI 2005).

In the SSA region the SA C&T industry is one of the mayor industries. The SSA accounted for less than one percent of global exports and their share of global production was just above one percent of C&T in the beginning of 2001. Within the SSA countries the production and exports are concentrated in only a few countries, primarily Kenya, Lesotho, Mauritius, Madagascar, Swaziland and SA. To support the industries in the less developed countries within the SSA they have been provided with two major opportunities. Firstly, African Growth and Opportunity Act (AGOA)<sup>13</sup> which grants SSA countries duty free access into the US market. Secondly, the MFA, which has provided SSA countries with the opportunity to expand where world suppliers are subject to quotas and/or tariffs, but where SSA is accepted because of PTAs (ibid).

The MFA has now ended and there is a gradual decline in tariffs which is expected to have a significant negative impact on the SSA countries. A great disadvantage of the SAA countries is that they are not low cost countries. This is due to their low productivity, long lead times, and high labor costs. Additional disadvantages are logistics, IT and poor infrastructure. Thus, the opportunities provided by AGOA are critical for SSA manufacturers in order to be globally competitive (ibid).

### **4.3.3 The industry markets**

The SA C&T industry generally supplies three markets; the export markets of the EU and the US, and the domestic market (Salm 2002). The SA C&T industry's position in these markets will briefly be described below.

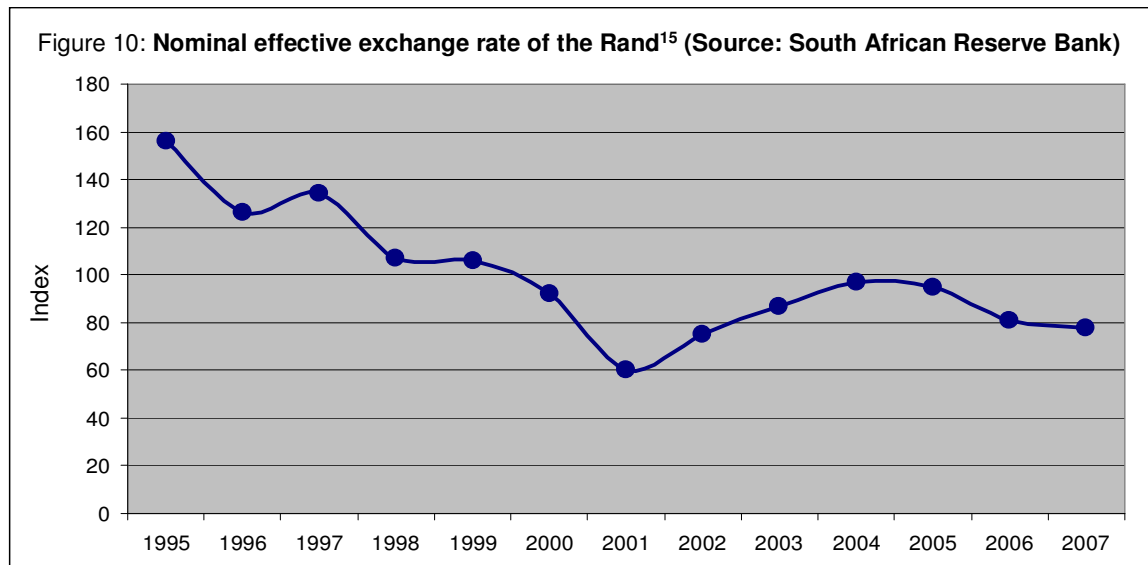
#### **The export markets**

Exports have for many years mainly been focused towards the EU market, in particular the UK, with the support of the SA – EU FTA<sup>14</sup>. In the end of 1999 the US market was opened up with the help of the opportunities provided by the AGOA. In general the industry's export performance has been modest with the bulk of exports being directed into low end-, mass market segments, such as t-shirts and other basic commodity items. The combination of DCCS, trade agreements and a depreciating currency (see Figure 10) resulted in significant improvements of the SA C&T industry's export performance during the late 1990s and early 2000 (the DTI 2005).

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<sup>13</sup> For more information on AGOA see Appendix E – Policy Framework.

<sup>14</sup> For more information about the SA-EU FTA see Appendix E – Policy Framework.



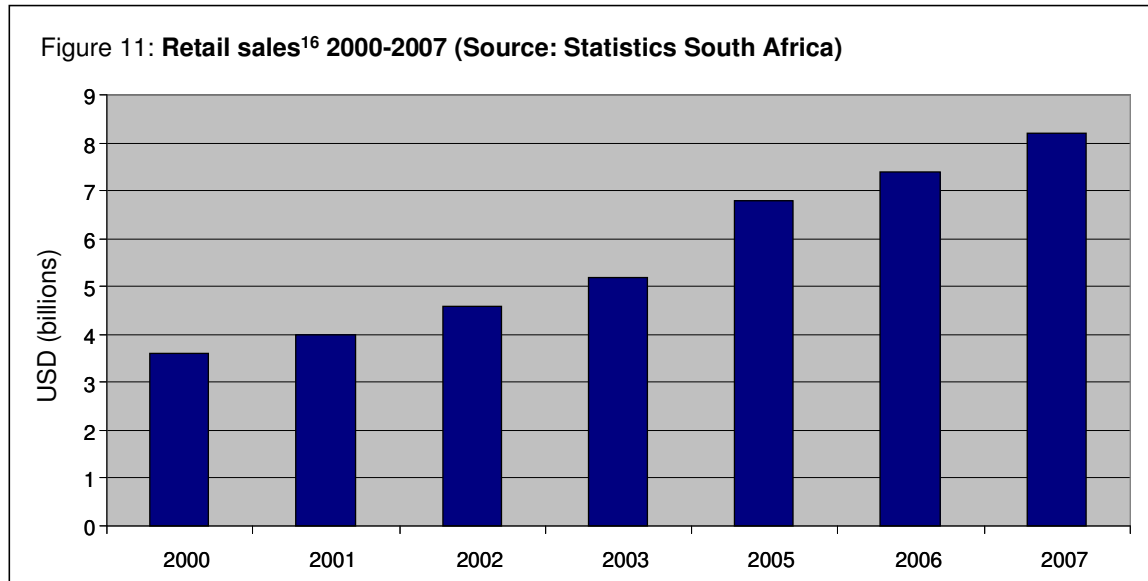
Since 2002 however, export performance has decreased drastically due to substantial appreciation of the Rand, which has made domestically produced goods less price competitive internationally. South African firms have therefore found it difficult to compete with low cost countries, such as China, India, Indonesia, Turkey and Pakistan (ibid). Price competition in lower, mass market segments is intense, since cost is the sole basis for competition. However, price competition in higher-end segments tends to be weaker, for example industrial textiles and design clothing. Nonetheless, there is still a high concentration of firms in these higher-end markets (Kadalie).

The SA firms' general export performance is dependent on preferences offered by AGOA and the EU-SA FTA, as well as the value of the Rand. According to the DTI (2005) firms have well-established connections with buyers in both the EU and US markets. There is on the other hand a lack of strategic partnerships between the governments in export markets and SA C&T firms in the pursuit of exports. Furthermore, the SA firms' position in export markets is relatively weak and there is low activity in exploiting new distribution channels in export markets. The SA manufacturers have an advantage over their Asian competitors in terms of proximity to the EU, SSA and Eastern seaboard US markets. On the other hand, Mexico and the Caribbean Basin have a geographical advantage over SA as they are closer to the US, Eastern Europe and North Africa. Furthermore, Asian competitors also have a distance advantage when exporting to Australia, Japan and the Middle East. The manufacturing basis in the EU supplying the EU market clearly has a distance advantage over SA. The dominant western culture and English language proficiency in South Africa are export strengths of the manufacturing firms. Furthermore, the firms comply with international social and labor standards and have a good quality reputation overseas (ibid).

<sup>15</sup> The figure is based on the last available data from each year. The weighted average exchange rate of the rand is based on trade in and consumption of manufactured goods between South Africa and its most important trading partners. The weighted average exchange rate of the rand, published from 29 July 2003, is calculated against thirteen currencies and consistently excludes Zimbabwe. The weights of the four major currencies are in brackets: Euro (36.38), US Dollar (15.47), British Pound (15.37), Japanese Yen (10.43). Index : 2000 = 100.

### The domestic market

The domestic market for C&T has expanded significantly in recent years. SA has experienced a retail boom due to a fast growing middle class (se Figure 11) (ibid). The SA Government has over the last year tried to put a brake on this with the help of high interest rates. As a consequence the retail boom is currently slightly slowing down (Head of Sourcing Retailer 1).



Notably however, the increase in retail sales has not been accompanied by significant expansion in the local C&T manufacturing industry. Employment has declined dramatically and manufacturing sales have been stagnant over the last few years (se Figure 13). SA buyers have thus increased their imports to manage the expansion of the domestic market. Between 2002 and 2005 imports increased significantly, especially from China which made up 74 percent of total imports in 2004 (Vlok 2006).

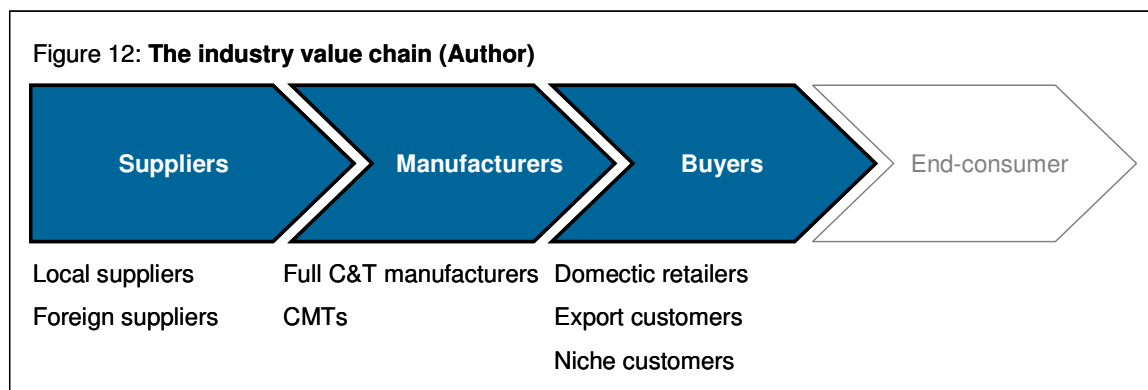
To provide time for the local manufacturers to become competitive the SA Government imposed quotas on Chinese imports. The outcome was however not what the SA Government wished for. Imports from China did drop but instead of buyers sourcing from local manufacturers they shifted their sourcing towards other foreign low cost countries (Eeden and Sandrey 2007). As interviewee at Retailer 1 puts it, “We dealt with the quotas by looking at our earlier partners if they had other plants in other countries, for example Thailand.” The quotas have thus aggravated the situation for the domestic manufacturers since buyers have found new production bases to source from. The SA manufacturing firms thus have a serious problem with distributing their products to domestic customers despite being protected from Chinese imports and with an obvious distance advantage over foreign firms (Burke). The manufacturing firms also have an advantage of cultural similarity with local customers (Head of Sourcing Retailer 1). A common opinion of my interviewees was that the reason for the lack of local demand in

<sup>16</sup> Sales are in actual values, converted from ZAR to USD, conversion rate: 1 ZAR  $\approx$  0.1 USD (Source: Oanda)

the domestic market is the SA manufacturers' reputation of being ineffective, inflexible and unreliable.

#### 4.3.4 The industry value chain

The SA C&T industry comprises a complete value chain from the production of raw materials to products to retail clothing stores (see Figure 12). During the era of isolation the value chain was generally driven by the manufacturers as the buyers did not have any other sourcing options. With the liberalization of trade buyers could start sourcing globally and the supply chain became buyer driven (Appolis). The manufacturing firms exist as an integrated element in the value chain being supplied by local and foreign raw material producers and their products being bought by domestic retailers, export and niche customers (Salm 2002).



It is important to note that Figure 12 illustrates a simplified version of reality since there are several other players in the industry, such as informal manufacturers, intermediaries, casual workers etc. (Van der Westhuizen 2006). Furthermore, in reality the value chain is driven the other way around because it is the buyers who dictates the terms (Appolis). I have nonetheless chosen to illustrate the value chain according to how the production flows and to only include the industry's major players in order to provide the reader with an understandable picture. This section will describe the suppliers' and the customers' characteristics. The manufacturing firms are described more in-depth in the next section.

#### Suppliers

The manufacturing firms' yarn and fabric suppliers are found both domestically and internationally (Salm 2002). Of the total C&T raw material market of 34 000 tons approximately 14 000 tons is imported and circa 20 000 tons are bought from domestic suppliers (CEO Fabric supplier).

What clearly ties the domestic C&T sectors together is the fact that the most significant input into the clothing sector is fabric, which accounts for approximately half of the cost to produce a garment. The textile suppliers produce 48 percent of its fabric for the clothing sector, the rest consisting of upholstery, furnishing, household textiles and industrial textiles (Barnes 2005). Local fabric suppliers are struggling with access to yarn because local yarn producers can not produce enough yarn to fill the domestic demand.



Thus, the yarn used in the local fabric is often from foreign suppliers, (CEO Fabric supplier).

Despite the vertical linkages, a healthy customer/supplier relationship is not common. Clothing firms often complain of the lack of customer service, bad quality and poor deliveries (Salm 2002). Manager at Firm 3 describes their situation as follows: “We had one main local supplier of fabrics last year that could not deliver. It nearly lost us two customers, now I got various suppliers.”

The two sectors are dependent on each other because the clothing sector is dependent on the fabric suppliers and the textile sector on the fabric buyer. Trade agreements stipulating rules of origins (ROO) of fabric (AGOA and EU-SA FTA) for exports strengthen this dependency. This dependency, however, creates problems, especially for the manufacturers. This is because there is a lack of domestically produced fabrics and limited access to a great variation of fabrics in South Africa (Salm 2002). As Manager at Firm 2 puts it: “The local mills cannot supply us with what we need. There is no raw material for linen because we need 100 percent cotton. I would buy locally if it was possible.”

Thus, firms often need to look outside the local market and import fabric from foreign suppliers (Manager Firm 2). There are a vast number of foreign suppliers which tend to be large in size and offer similar products. Therefore it is relatively easy to find new suppliers but more difficult to find reliable and speedy suppliers (Manager Firm 3). However, the present quota restriction on China have made it even more difficult finding suppliers and also made it more expensive to import. Before the quota restriction firms mainly imported fabric from China but now they have to look elsewhere in the world (Burke).

### **Buyers**

The majority of the C&T industry’s products have historically been sold to the domestic retailers (Salm 2002), 70 percent of sales being generated from the top five retailers (Vlok 2006). A minority of customers can be located in the US and EU markets and in niche domestic segments (Barnes 2005).

The domestic retailers have always commanded a strong position in the supply chain in South Africa. The retailers are the main outlet for products and are therefore able to dictate terms to their suppliers and often forcing the manufacturers to lower their price (Salm 2002). They are large in size and have great knowledge about the C&T market (Choice). In many cases they control the entire value chain. For example, Retailer 1 controls the whole value chain when procuring organic clothing, from farm level through to the finished product (TM Women’s Wear Retailer 1). However, the Retailers are in general not keen to vertically integrate clothing production in their businesses (TM Lingerie Retailer 1). As TM Lingerie at Retailer 1 says; “We will never own any manufacturers. We see our suppliers as an extended part of our organization but we do not want to deal with their problems, employees etc.”

Today competition among the domestic retailers is intense and reducing costs is important in order to compete on the domestic market. As C&T products are one of the retailers' major inputs, the prices of the goods largely determine the retailers overall costs (ibid). Due to the retail boom retailers are currently expanding and broadening their product bases. Finding differentiated products in SA is difficult, therefore the retailers often need to import higher-end products to keep up with the increasing demand. However, the availability of low value added C&T products in the local market is satisfying (Head of Sourcing Retailer 1).

The relationship between the local manufacturing firms and the domestic retailers is tense because the retailers have a high propensity to import. The manufacturing firms often blame the crisis on the retailers as they have significantly decreased their sourcing from local manufacturers. The retailers have a different view; they believe that the responsibility lies with the manufacturers as they are not capable of fulfilling their demands (Hartzenberg). An Interviewee at Retailer 2 describes the situation as follows: "There has been a lack of trust the last few years. The manufacturers think that the retailers are trying to mess with them all the time and it does happen. The relationships are not good and what we are trying to do is to improve that." The relationship is slowly improving, largely with the help of the Cape Clothing and Textile Cluster (CCTC)<sup>17</sup>. The CCTC have provided a platform for retailers and manufacturers to start collaborating. Furthermore, the retailers have started to realize the advantage of sourcing locally as speed to market is becoming more important, putting the manufacturing firms in a better bargaining position (Choice).

### **Customers' future demand**

The customer demand is somewhat diversified because the firms' customer base is spread over various countries and segments. It is primarily the domestic retailers that stipulate the demand in the industry (the DTI 2005). Therefore the customers' demand, presented below, is equivalent to what the retailers request from their suppliers. Based on data from Technopak and interview responses I will in this section try to give a general picture of what the customers will likely demand in the coming years.

*Speed and reliability:* In the past, price has been the most important parameter of the customers sourcing decision (Technopak 2007). Interviewees at Retailer 1 and 2 all mentioned cost as an important factor for competing, however, the common thought was that other factors will become increasingly important the next few years. According to Technopak (ibid) speed and reliability will play an increasingly important role in sourcing of textile and apparel. This view is also supported by the majority of the interviewees at Retailer 1 and 2. The increased importance of these parameters is an effect of buyers looking for leaner operations and lower inventory in the future. Furthermore, the fashion trends are becoming shorter in the EU and the US, and forcing customers to turn stock more often and quicker. Thus, shorter lead-times and on-time delivery will be crucial for the success of retailers in the years ahead (ibid).

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<sup>17</sup> For more info on CCTC, see Appendix D – Industry support organizations.

*Flexibility:* According to Technopak (ibid) and the respondents at Retailer 1 and 2 C&T buyers in general will demand smaller product runs due to the continuing growth of fast fashion in coming years. Therefore flexibility will be an important factor for buyers when choosing supplier in the future.

*Support services:* According to Technopak (ibid) and my respondents at Retailer 1 and 2, buyers will outsource more of their current operations to their suppliers. Buyers will therefore look for full-package suppliers and strategic long-term relationships. This is an effect of buyers wanting to reduce their overall cycle time and become leaner. The customers will demand operations of design and product development capabilities as well as inventory management from their suppliers (Head of Sourcing Retailer 1).

*Differentiated products:* The respondents at Retailer 1 and 2 all emphasized the importance of differentiated products in the coming years. As TM Women's Wear at Retailer 1 said; "We demand differentiated high value added products with great raw materials, new fabric innovation, and high fashion. Firms have to be innovative. How can I differentiate myself is the question to ask".

## **4.4 Characteristics of the clothing and textile manufacturers**

### **4.4.1 Types of manufacturers**

The SA C&T industry consists of a wide range of manufacturers with differentiation in terms of size, vertical integration, resources etc. In 2006 there were approximately 1600<sup>18</sup> C&T firms. Most of the firms are small to medium sized enterprises (SME) employing 10 to 250 people (Vlok 2006). Two main types of manufacturing channels can be identified in the C&T industry, namely *Full C&T manufacturers* and *Cut-Make-and-Trim (CMT) manufacturers* (Salm 2002).

#### **Full clothing and textile manufacturers**

This manufacturing type is characterized by offering design and merchandising services and tends to produce their own branded garments. The size of the manufacturers varies from one machine room employing one operator to large machine floors with hundreds of operators. When demand exceeds the manufacturers' production capacity some of the production is outsourced to CMTs (ibid). Full C&T manufacturers constitute about 60 percent of the domestic manufacturing firms in the Western Cape (Gibbon 2002).

#### **Cut-Make-and-Trim manufacturers**

What separates the CMTs from the above-mentioned manufacturers is the fact that they do not own the work in progress. The common process is that they receive fabric from their customer with a pre specified design. The CMT then cut, sew, finish and package the finished product. Hence, the CMTs do not have to invest in design and merchandising capabilities (Salm 2002). The CMTs vary in size and focus exclusively on serving the

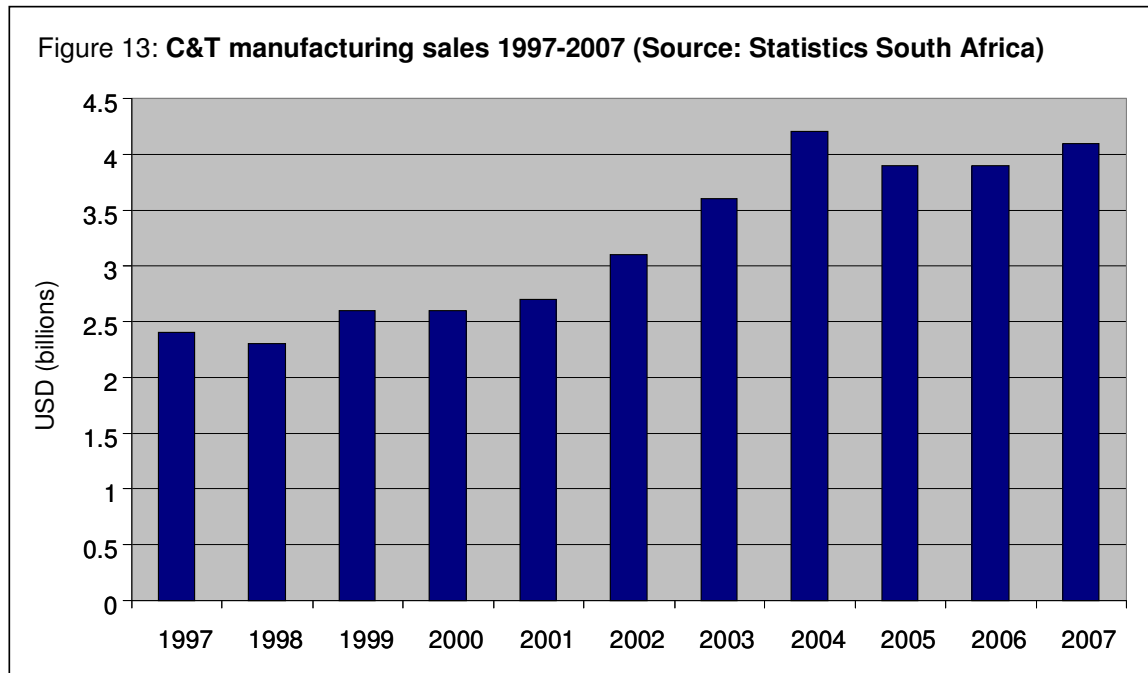
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<sup>18</sup> Statistics on the number of clothing and textile firms are unreliable because of the large number of informal firms. Informal/unregistered firms are, however, important for the industry as they are so many and therefore account for a significant portion of the overall capacity in the industry (Barnes et al. 2005).

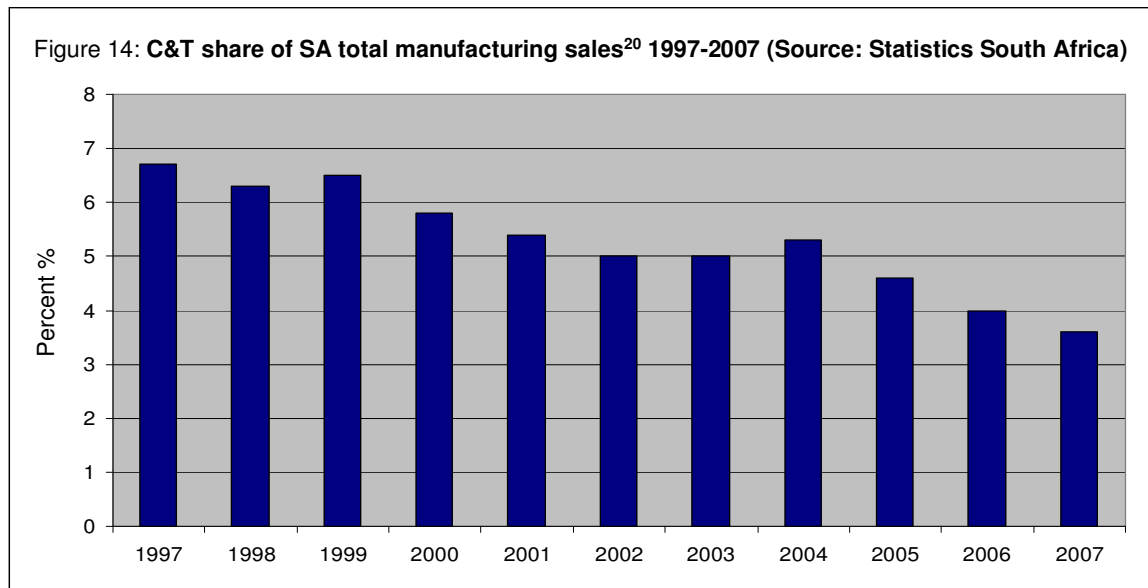
domestic market. CMTs constitute about 40 percent of the domestic manufacturing firms in the Western Cape (Gibbon 2002).

#### 4.4.2 Sales

The C&T manufacturing sales have been stagnant the last few years 2004-2007 (se Figure 13). In contrast the SA manufacturing industry as a whole has expanded significantly (Statistics South Africa). In 2007 the SA C&T manufacturing industry (including footwear and leather) generated sales of USD 4.1 billion<sup>19</sup> which contributes to 3.6 percent of total manufacturing output of USD 112.5 billion, which is a decline from 6.7 percent in 1997 (se Figure 14) (Statistics South Africa). Thus, the C&T industry has become a less important manufacturing sector to the SA economy. The 2007 sales were split almost equally between C&T, with textiles contributing USD 1.73 billion and clothing USD 1.65 billion (leather and footwear USD 0.76 billion) (Statistics South Africa). The majority of the sales is generated from the domestic market since only 22.6 percent of textiles output and 6.4 percent of clothing sales were exported in 2007 (the DTI).



<sup>19</sup> Sales are in actual values, converted from ZAR to USD, conversion rate: 1 ZAR  $\approx$  0.1 USD (Source: Oanda)



#### 4.4.3 Production

This section aims to give the reader an understanding of what types of products are being produced and how they are produced in the SA C&T industry. Thereafter, the manufacturers' production performance will be described.

##### Products

The C&T manufacturers make products across the spectrum<sup>21</sup>, although the majority of production is focused on low value added products. There does however exist some manufacturers who focus on high value added products, for example in men's tailored garments (Vlok 2006).

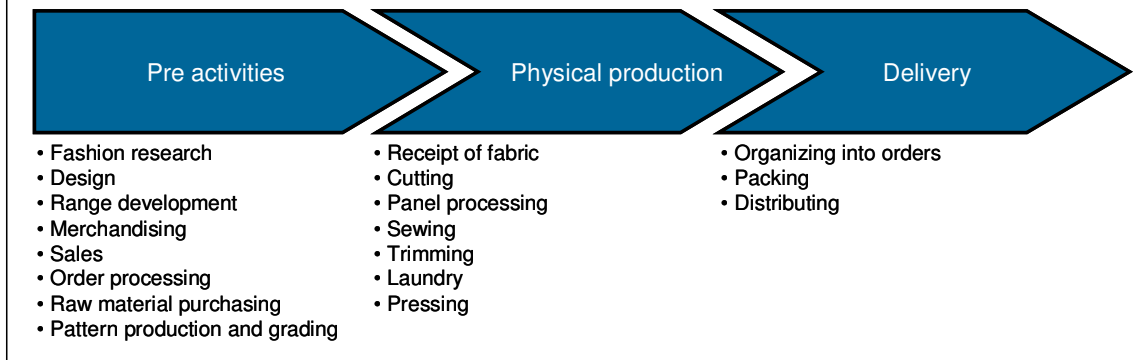
##### The production process

The production process is similar for all manufacturers with some minor differences. The main activities for C&T manufacturing firms are described in the Figure 15 below. It is important to distinct the CMTs from the other manufacturers because they basically only perform the "physical production" in the production process (Salm 2002).

<sup>20</sup> The figure is based on statistics including footwear and leather to make a ten year comparison possible.

<sup>21</sup> Raincoats, overcoats, windbreakers, suits, jackets, blazers, trousers, formal shirts, casual shirts, fashion shirts, pants, shorts, jackets, sportswear, swimwear, jeans wear, work wear, jerseys, pullovers, waistcoats, t-shirts, linen, industrial textiles, etc. (Salm 2002, Kadalie).

Figure 15: The production process (Author)



Once the pre activities have been performed the firms receive the raw material which have either been shipped by sea from foreign suppliers or transported by road from domestic sellers. If the raw material is imported it is subject to customs inspections and then transported by road within SA. After that the goods are uploaded and placed in the manufacturing rebate store. The fabric is then organized on cutting tables against specific orders to be cut into pieces. At this stage panel processing (embroidery and printing) is often performed. This activity is either done in-house or outsourced to CMTs. The physical production process ends on the sewing floor where the cut pieces are assembled into finished C&T products. The delivery process starts with the final products being organized into their orders and packed in cardboard cartons or on hangers or rails. Once the products are packed they are distributed to domestic customers by truck or in containers to export customers. The containers are transported by road or rail to the ports for shipment by sea (ibid).

### Production performance

The quality of the products the manufacturing firms produce is in general reliable and consistent (the DTI 2005). This view was supported by the majority of the interviewees who emphasize that the quality of low value added products is often satisfying while the quality of higher value added products is less consistent. It is quite clear that manufacturing firms struggle with fulfilling the customers demand regarding the product's characteristics. According to Head of Sourcing at Retailer 2 many of the firms are not capable of manufacturing the products demanded by the retailers. The same interviewee describes the situation as follows: "There are certain garments that can not be made in this country, certain knitwear and products that have add on. There is no machinery in this country to make value added garments." Opinions at Retailer 1 and 2 were unanimous in their view that the products features do not always fulfill their demand of differentiation.

The production facilities of the SA manufacturing firms are in general not world class. In the last few years the firms have not invested enough capital in upgrading the production facilities. The poor facilities significantly reduce the effectiveness of production. There are a however a few cases of high class production facilities in SA (the DTI 2005), which one of my case studies, Firm 1, exemplifies. These firms run effectively with low unit costs (Choice).

Since most of the firms are in the SME segment they are well suited for producing small runs and can quickly switch between product runs. In contrast they can not handle large runs and thus face problems with supplying the large export volume orders required by US buyers (the DTI 2005).

Another common weakness in the production is long lead times and late deliveries. According to Morris, the local manufacturers' delivery time is in some cases worse than shipping goods from China. As Head of Sourcing at Retailer 2 notes: "Local manufacturers can not deliver on time, absolutely not. At least 60 percent of everything we bought locally has been delivered later than agreed." When distributing the products the firms face expensive shipping cost, ineffective ports and poor transport communication (Hartzenberg).

Another weakness of the C&T production is excess capacity. The demand for locally produced C&T goods have declined but much of the capacity is still left. Due to excess capacity manufacturers do not always run production consistently (Head of Sourcing Retailer 2). The situation is aggravated by production gaps caused by seasonal demand fluctuations (Kadalié). This is a problem especially in the textile industry where machine start up costs are high (the DTI 2005). The lack of effectiveness and demand has also resulted in high inventory levels further reducing the firms' profitability (ibid).

The organizational structure of the manufacturers further reduces their productivity. A general opinion held reflected in my interviews was that the organizational structure of the manufacturing firms is ineffective because of its hierarchical and bureaucratic structure. CEO of Firm 1 describes a commonly used organizational structure as follows: "The production line has one production manager, the production manager reports to another production manager which have three or four supervisors. The supervisors then report to a factory manager and finally the factory manager reports to production director." The same interviewee describes Firm 1's organizational structure as follows: "the production managers are team leaders and they all report to a production director, there is nothing in between."

#### **4.4.4 Geographical distribution and ownership**

The C&T manufacturers are mainly concentrated in two geographical areas; the Western Cape and KwaZulu-Natal (KZN) (Vlok 2006). In the Western Cape clothing firms are concentrated in the metropolitan area of Cape Town which is recognized as the design centre of South Africa due to its fashion orientation (Barnes 2005). The geographical location of firms is rooted in the country's history. Prior to the 1960s, before the real development of the industry began, firms were mainly based in Johannesburg, with a small concentration of firms in Cape Town. With the new apartheid statutes limits were imposed on the use of African labor in urban areas. Bantustans, "homelands", were designed to keep rural Africans away from cities which lead to high concentrations of the poor and disenfranchised in the urban areas. Decentralization incentives were established, where industries were pushed by the government to relocate to these Bantustans, which many firms took advantage of. As a result, the industry moved from rural areas to the urban areas of the Transvaal, and expanded in Durban and Cape Town where there was

access to Indian and Colored labor. The leading retailers were located in Cape Town and soon the city became the industry's main centre, with firms focusing primarily on the large retail chains (Salm 2002).

In general, most of the firms in the industry are South African owned. More established, larger businesses, particularly in the textile industry, are owned by white people, while small and medium sized businesses in the clothing industry are owned by black people (Vlok 2006).

#### 4.4.5 Labor

The C&T industry is the most labor intensive sector of manufacturing in South Africa.<sup>22</sup> Officially the C&T industry employed almost 143,000<sup>23</sup> people (98,000 in clothing, 45,000 in textiles) in 2005 and contributed to 12 percent to total manufacturing employment and 1.8 percent of overall employment in South Africa. Of the workers, 94 percent are black (i.e. African, Indian or Colored) and almost 70 percent are women (ibid).

There has been as significant decline of jobs in the industry; in 1996 the industry employed 228 000 workers, which means that about 37 percent of the jobs were lost between the years 1996-2005 (ibid). If these declining trends continue the industry will disappear by 2012 (Ralis 2004). Even though this is clearly an overstatement, the general principal that the C&T industry is diminishing is correct (Barnes 2005). The loss of employment has had a devastating effect on workers who have lost stable and secure sources of income and where few other opportunities exist. Due to the labor demographics job losses have had a most significant impact on women as well as low skilled workers in poor black communities (Vlok 2006).

The C&T industry is one of government's prioritized sectors due to its employment significance (Hartzenberg). The importance of the industry for employers has in turn resulted in excess capacity in the domestic industry, since layoffs has been the least desired option (DM Retailer 1).

#### Wages

The wages in the C&T industry are governed by national collective agreements negotiated between employers and employees. A high percentage of the firms' employees are unionized (Vlok). Thus, the South African Clothing and Textile Workers' Union (SACTWU) has a strong position in the industry and pushes for higher wages and in turn reducing the firms' profitability (Morris). In terms of the national collective agreements a wage differential exists between firms located in metropolitan areas and firms located in non metropolitan areas (Barnes 2005). The legally prescribed minimum wage at 1 May 2005 in non metropolitan areas was about 22 USD<sup>24</sup> per week. The rate for a qualified machinist in non metropolitan areas was about 30 USD while in the metropolitan area of

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<sup>22</sup> Measured by number of jobs per unit of capital invested.

<sup>23</sup> If one includes informal workers in the statistics, employment could be estimated at about 200,000 (Vlok 2006).

<sup>24</sup> Wages are converted from ZAR to USD, conversion rate: 1 ZAR  $\approx$  0.1 USD (Source: Oanda)



Cape Town it was around 54 USD (Vlok 2006). Wages<sup>25</sup> in the industry has decreased since 1998. Parallel to the declining wages, the industry's output per employee levels has also decreased. Thus, in relation to output per employee the C&T firms face higher labor costs today than in 1998 (the DTI 2005).

The SA C&T industry's labor rates are high compared to its competitors. The SA labor market is in relation to competitors also inflexible and incurs additional labor costs in terms of overtime pay, shift pay, sick leave and pension contributions. These factors weaken the firms' flexibility and effectiveness while increasing costs. Consequently this reduces the firms' ability to compete, especially in the low value added segments (Barnes 2005).

### **Skills**

The industry requires a relatively unskilled labor force. Most of the employees are semi and low skilled workers (82 percent), while the rest of employees have mid-level occupations (13 percent) or positions demanding high -level skills (5 percent) (Barnes 2005).

The SA industry has existed for a long time and built up experience and cumulative knowledge (the DTI 2005). On the firm level however, it is clear that management skills at all levels are low. The industry top managers lack knowledge about how to become internationally competitive and knowledge about potential export markets is low (the DTI 2005). Furthermore, many firms lack a long-term vision/strategy (MD Firm 1). As MD at Firm 1 explains: "If you ask many of the managers, what their vision statement is, if they have a manufacturing strategy, product strategy, HR strategy, they will not have these laid down. They do not understand these basic concepts." The same MD continues with saying; "Managers that have been in the industry for 20- 30 years have not heard about the term measurement." Thus, there is a serious need to develop skills in the industry, especially middle and upper management skills. The institutions<sup>26</sup> in SA that educate the workforce have problems to secure sufficient support from the industry to fulfill their purpose. Furthermore, in-house high-level skills development is rare (Barnes 2005). The situation is exacerbated by the general view that the C&T industry is a so-called sunset industry making it unattractive for graduates. Hence, access to skilled operators, technical staff and management people is poor which reduces the competitiveness of the firms. On the other hand, access to low skilled workers is good (the DTI 2005).

#### **4.4.6 Organizational culture**

The organizational culture is highly affected by its history of isolation. The manufacturers' organizational culture is developed in a protected environment where it has not been necessary for firms to adjust its business to a dynamic environment. The firms that have been closed down have not reacted or reacted too slowly to the changes in the environment because they have a tradition of being protected by governmental policies (Burke). Thus, change is not a natural part in the culture of the firms

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<sup>25</sup> Inflation adjusted wages.

<sup>26</sup> Peninsular Technikon, Durban Technikon and Johannesburg University (Barnes 2005).

(Hartzenberg). The interviewees were unified in that the manufacturing firms are not proactive and have poor ability to respond to the shifts in consumer habits.

According to several of the interviewees there is a general lack of motivation in management as well as in workers. According to MD at Firm 1, it is partly due to the mindset of the CEOs. The same interviewee explains: “The CEOs of this industry are old now but they are still sitting there and they think they know everything. They are soon going to retire and do not want to spend millions on investments. They have lost their motivation to become internationally competitive.” The CEO’s mindset has in turn a negative affect on the overall motivation among workers (Choice). In the opinion of Choice, the weak motivation among staff is also linked to the reward systems used in the industry. The firms have a tradition to reward the workers in relation to the firms’ total profits not separating the different functions of the firm, such as design, merchandising and selling. Because the firms in general have experienced low profit or losses over the last few years, there has been no capital to reward the worker, even though some functions in the firm may have excelled. Therefore, workers in the areas where they have excelled are not rewarded due to other functions impeding all the profits. The low motivation of workers is probably also affected by the general view that C&T are sunset industries (ibid).

#### **4.4.7 Capital expenditure**

The general opinion of the interviewees was that the firms had not spent enough capital on new technology and R&D. According to the DTI (2005) the C&T firms have over the last decade spent only a small proportion their turnover on new technology and innovations. The majority of the investments (70 percent) have been concentrated on the textile sector. The result of low capital expenditure on new technology is aging equipment of the firms, which consequently reduces the firms’ production effectiveness. Furthermore, low capital expenditure on R&D reduces the level of product development and innovation in the industry (ibid).

The reason for low capital expenditure is the high cost of capital. This is due to souring interest rates, poor access of capital and flight of capital to other industries. Banks are reluctant to lend money to the industry which is largely due to the general view that C&T is a high risk industry (Manager Firm 3). The manager of Firm 3 describes the firm’s financing difficulties as follows; “The biggest problem when we started the business was to get seed capital. I had to sell my house. We went to two different banks but they said no.” The same Manager continues with saying: “You have all these great ideas, but you can not implement them because you can not get the funding. You do not have money to shoot through the roof.”

The borrowing situation of the small and micro sized CMTs is even worse as they find it difficult to meet the criteria of the banks. The banks require the lender to produce reports, projection and formal books. CMTs basically do not have the resources to fulfill these demands (Salm 2002). Furthermore, insufficient government support for C&T firms compared to the levels of support provided by competitor economy governments (e.g. China, India and Turkey) is a detriment to the financial situation of the firms (the DTI

2005). Another reason for low capital expenditure is a general flight of capital from the C&T industry to more lucrative industries, such as the booming property market. Many owners of clothing manufacturers use any excesses, profits for property investments instead of upgrading the manufacturing plant (Kadalie).

## **4.5 Strategies and implementation**

The previous sections have described the restructuring of the industry that has taken place the last decade with trade liberalization as the most prominent driving factor, resulting in increasing imports, significant employment losses, and lack of firm level competitiveness. The aim with this section is to describe the most common firm-level strategies proposed by the interviewees for future success and their suggestions for implementing them.

### **4.5.1 Recommended strategies for success**

The strategies presented below represents the most common thoughts of the interviewees about what strategies should be implemented at firm level for success. Some firms have already started implementing these strategies.

#### **Produce high value added products**

A general opinion of the respondents was that the SA C&T manufacturing industry tries to do everything, consequently not excelling in any specific segment. The C&T manufacturing firms are “neither high value added, fashion oriented first-world players, nor low-cost, mass-based third world players” (the DTI 2005:22). The majority of the interviews believed that the firms must move towards producing higher value added products. The interviewees were unanimous in their belief that the firms cannot compete with low cost production basis in the developing countries. Hartzenberg explains; “It is impossible to compete with China or other low cost producers in basic garments. The SA C&T industry is too small and we do not have the economies of scale to compete with them.” Thus, the firms should move to more complex and technical fabrics and produce differentiated products such as smart textiles, high fashion garments, sports wear equipment, military equipment etc (Kadalie).

#### **Exploit niche segments or new markets**

A frequently mentioned view of the interviewee participants was that the firms should focus on niche segments or new markets. As DM at Retailer 1 puts it, “Niche is the future for the local industry”. There are several segments/markets discussed by the respondents, the most frequent will be described below.

*Domestic retailers:* The most frequent suggestion from interviewees was to focus on supplying the domestic retailers. They gave three reasons for this. Firstly, the retailers are most likely to expand in the future. The retailers are serving the middle class in SA which is predicted to grow significantly. Secondly, the manufacturers firms have an obvious distance advantage. One retailer employee highlights this; “The local manufacturers have the big advantage to be on our door step” (DM Retailer 1). Lastly, local supply is important for the retailers. The interviewees at Retailer 1 and 2 all emphasized the importance of local supply. The Head of Sourcing at Retailer 2 explains: “The best

selling garments are the ones produced locally [...] we see the domestic market as an advantage” Firm 1 is pursuing this retail focused strategy and is one of the most successful manufacturers in SA. As MD at Firm 1 puts it; “To be an important part of a retailers supply chain there is nothing nicer”.

*Medium to high end niche segments in the domestic market:* Many interviewees also recommended firms to focus on high value added niche segments in the domestic market. Firms should focus on finding new markets or to develop their market niche (CEO Fabric supplier). Firm 3 is pursuing this strategy by successfully providing customized C&T products to corporate customers. Firm 2 has also adopted this strategy by serving the hospitality industry with high quality customized bed and table linens.

*Medium to high end niche segments in export markets:* To be successful in exports the interviewees agreed that the firms should focus on supplying medium to high-end niche segments. According to Hartzenberg there are a few cases of export orientated firms that have done exceptionally well focusing on this strategy. Kadalie believes that industrial and technical textiles are niche segments worth exploiting in export markets.

*New export markets:* The SSA region is an untapped market worth exploring; especially as many of the SA retailers are represented and expanding in these countries (Hartzenberg). Many countries in the SSA region have for a long time been too undeveloped for SA firms to target. However, with a growing development in SSA industries and infrastructure, this will make them a potential export market for the SA firms in the future (the DTI 2005).

#### **4.5.2 Suggestions for implementation**

The most frequent suggestion from the interviewees for implementing the above strategies will be described below:

##### **Change is necessary**

The interviewees were entirely unanimous that business as usual is no longer possible. The manufacturing firms will need to undergo a number of changes to thrive in the next decade. As one interviewee points out: “you can not do what you have been doing to go forward, you have to rethink” (TM Lingerie Retailer 1). There are many pockets of examples of firms that have managed to refocus and change fundamentally. For example a factory in Durban, that has moved from producing basic garments to serve a niche segment by specializing in Kevlar fabrics (DM Retailer 1).

The respondents believe that the manufacturers that are left in the industry have started to understand the importance of change. During the restructuring of the industry the manufacturers’ comfort zone has been challenged and many firms have woken up and realized that they are operating in global market (ibid). This is evident when looking at the growing membership in the CCTC since the cluster’s main purpose is to help firms to change in becoming internationally competitive (Choice). As Choice puts it: “The companies that want to change are in the cluster, they do not all know what to change but they all have the willingness to change”. The general opinion of my interviewees was that many of the firms left in the industry have a willingness to change. Hartzenberg

comments: “The firms that have survived until now are those who have changed or want to change, the other firms have already exited the market.”

The interviewees also expressed the importance to have the right mindset to initiate change. TM Lingerie at Retailer 1 explains that “you have to have the appetite and energy to fight this massive battle”. The interviewees all emphasized that the value added route will be a challenge for the manufacturing firms and which will require significant changes in their businesses. The most common changes proposed by the interview participants will be described below.

### **Increase customer focus**

During the era of isolation the supply chain was generally driven by the manufacturers because the buyers did not have any other sourcing options. Hence, many firms in the industry today lack customer focus (Appolis). A common belief of the respondents was therefore that the firms need to become more customer focused and actively target new customers. As Manager at Firm 2 puts it; “The firms need to become more proactive and show what they got instead of waiting for the market to come to them.” Furthermore, the manufacturers need to develop knowledge about the local industry and create an understanding of the local customer (Head of Sourcing Retailer 1). The CCTC is a good forum for attaining knowledge about the domestic customers’ requirements (Choice). MD at Firm 1 describes how his company changed towards a more customer focused strategy; “For years we worked as a traditional CMT only added the manufacturing value. That did not give us an understanding of our customers. I have worked in the military so I know that you have to understand both your enemy and your friends. So I got to know my customer, how he worked, what he demanded etc, and today we are the Retailer’s number one supplier.”

The interviewees also emphasized that firms need to improve their marketing. Firm 3, which recently entered the C&T market, has worked hard with marketing to establish a customer base. Manager at Firm 3 describes their marketing as follows; “We needed to do a lot of marketing because it is a really competitive market and we are a very young company. When we first started we went around trying to get customers, now it is mostly word of mouth. To improve our customer satisfaction we do not just leave our customers after delivery, we conduct surveys.”

### **Develop skills & knowledge**

The interviewees emphasized the importance of improving the skills and knowledge of the workers. Kadalie highlighted the need to develop a pool of skills in the organization to become more flexible, especially as the firms have high rate of absenteeism. Today many workers perform the same activity for years, such as shoulder seams. The workers need to be taught how to sew a whole garment and get an understanding of the whole garment. To have a pool of workers that can perform several tasks will increase labor flexibility. The workers will become an integrated part of the production process and the core of the manufacturing plant. This will in turn most likely increase the workers motivation (ibid). Firm 3 exemplifies the above-mentioned skill development method. The Manager of Firm 3 describes how they improve the workers skills; “What we are

trying to do is to teach our employees all the skills so that they can make one garment all by themselves. We also do management courses and quality courses with the help of CLOTEX.”

There is also a need for firms to bring in expertise management skills (Head of Sourcing Retailer 1). Firm 1 is a good example; the MD brought in experts from top German engineering schools that looked at lead time and restructured the plant. Suddenly Firm 1 became far more effective (MD Firm 1). Lastly, becoming a member of the CCTC is a good way to attain knowledge about what is happening in the C&T market and best practices (CEO Fabric supplier). The cluster also educates members on world class manufacturing standards and helps members adopt modern management techniques (Choice).

### **Collaboration**

Today the players in the industry operate individually; the manufacturers of garments operate in their world, the fabric mills operate by themselves and the retailers work in silence. But the players have common problems (DM Retailer 1) and several interviewees expressed the importance of collaboration between the industry players. Collaboration has started to some degree with the help of the CCTC, providing a platform for the industry players to improve their relationships (Choice). For the manufacturing firms the interviewees suggested that they should share and combine resources. Through collaboration firms can attain economies of scale and widen the production capacity and thus also manage larger orders. Collaboration is also important for the development of skills as firms can learn from each other and consequently increasing their overall skill level (TM Lingerie Retailer 1). Many of the interviewees suggested that manufacturers should become a member of the CCTC as it is a good forum that allows collaboration and integration (DM Retailer 1). DM at Retailer 1 comments; “The CCTC is an ideal forum to share innovative ways to overcome challenges.” The CCTC is however not ideal for small and micro enterprises as the financial requirements to become a member is not financially viable (Manager Firm 2). Instead these firms can turn to CLOTEX which is a good forum for collaboration as it is one of the organizations purposes. As Manager of CLOTEX says: “CLOTEX is vital in the sense of providing closeness between small, medium and micro sized manufacturers” (Appolis).

### **Increase productivity**

The interviewees were in agreement that the firms need to improve their productivity. To be able to compete in the new climate firms need to be quicker and more flexible than they presently are (DM Retailer 1). To improve productivity the respondents believed that many of the production plants need to be re-engineered in order to become world class manufacturing facilities. To increase productivity some interviewees emphasized the need to invest in new technology while some interviews underlined the importance of minimizing time under the needle. The respondents also expressed the importance of reducing costs. To initiate these changes several interviewees mentioned the CCTC as a good platform. The CCTC benchmark its members against the best manufacturers domestically and internationally, and also identifies the best practice (Choice).

**Drive innovation**

To move towards supplying higher value added products the interviewees suggest that firms should focus on product development and production innovation. Some interviewees expressed the need to develop more innovative products while some emphasized the importance of developing innovative ways of production. To develop more innovative products firms should focus on sourcing innovative fabric (Kadalie) and investing in R&D capabilities (DM Retailer 1). The firms also need to develop their design capability (Vlok). Manufacturing innovative products will also require innovative production (Burke). In order to find inventive ways of production the firms need to invest in technology. For example, high end products often need detailed and fine sewing which require high-tech equipment (TM Women's Wear Retailer 1). Manager at Firm 3 explains how they drive innovation: "We try to think out of the box and not wait for orders, we try to be innovative, and we try to do different things."

**4.6 Future outlook**

The above recommendations and suggestions imply fundamentally changing the way the manufacturers of the SA C&T industry are used to work. The opinions in the interviews were unanimous in that the firms are facing a huge challenge which will need significant capital investments and total commitment from management and workers. The interviewees' opinions differed regarding the firms' possibility to pursue the above strategies but they were all convinced that the industry will consolidate in the future. According to Morris there will be an increase of cluster membership but a decrease in number actual firms in the industry. This view is supported by Choice who holds that the C&T industry will not disappear but a new smaller and more competitive version will develop. Choice metaphorically describes the future of the industry in this fashion: "The industry is like a 150 year old tree, on the outside it is like crumbling bark that gets smaller in changing environment, but on the inside is a brand new healthy tree that is getting bigger, and eventually the inside will meet the outside and that will be the new industry."

**4.6.1 Regional trends**

Based on the interview responses and industry reports I have identified the following present and future trends in the SA and its SSA region that are likely to affect the future of the C&T industry.

*Emergence of new export markets:* Many countries in the Sub-Saharan Africa (SSA) region have for a long time been too undeveloped for SA firms to target. However, with a growing development in SSA industries and infrastructure, this will make them a potential export market for the SA firms in the future (the DTI 2005).

*Growing demand in SA:* The interviewees were unanimous that the demand for C&T will continue to increase due to a growing middle class.

*Changes in retailers sourcing pattern:* Over the last few years the willingness for retailers to source internationally has been high. However, the recent end of quotas on textiles and apparel trade might have a significant affect on the sourcing patterns of

retailers - the retailers major suppliers in previously quota restrained economies target the larger US and EU markets (Hartzenberg). Additionally, speed to market will become increasingly important due to the continuing growth of fast fashion (Technopak 2007). Thus, retailers will likely increase its sourcing from local suppliers in the future. The interviewees at Retailer 1 and 2 emphasized the importance of local supply in the future. Furthermore, the sourcing of differentiated products and support services will increase in coming years (Head of Sourcing Retailer 2).

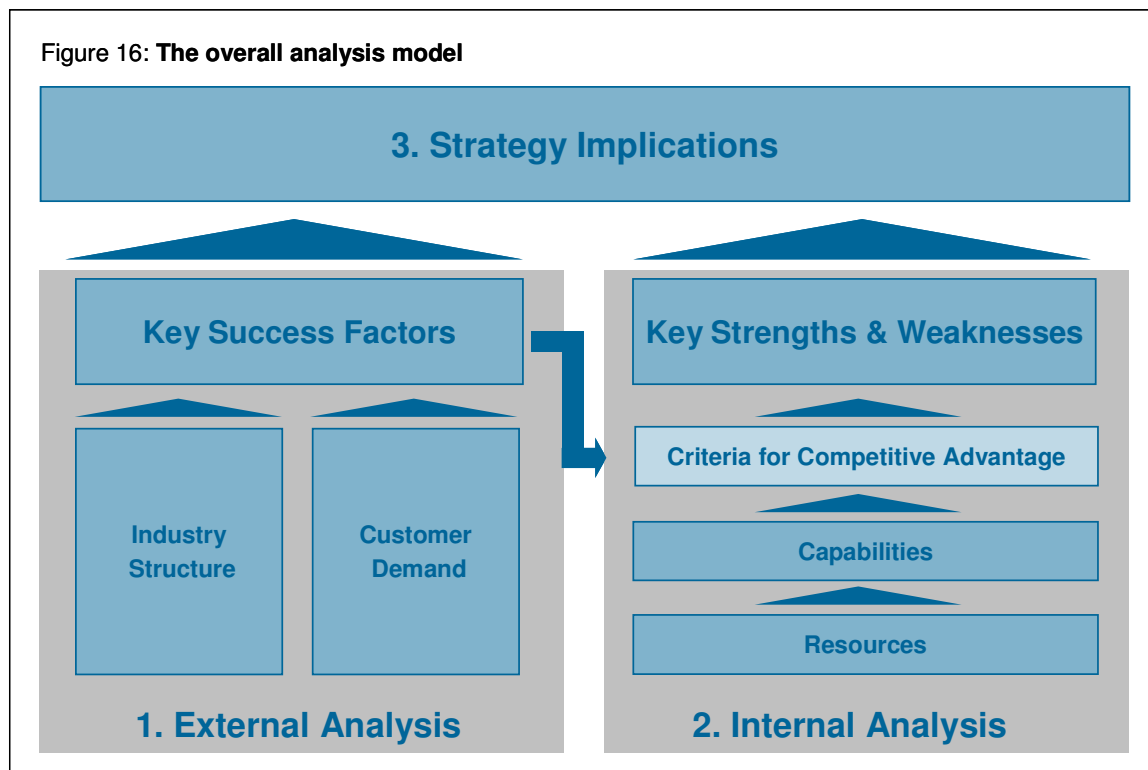
*Consolidation and collaboration:* C&T firms have shown an increasing willingness to cooperate with one another. The establishment of the CCTC highlights this (Choice). The trend is that the amount of firms becoming members of the clusters is increasing but the total amount of firms in the industry will continue to decrease (Morris). The industry is predicted to lose between 50,000 and 75,000 jobs in the formal and informal sector by 2014 (Barnes 2005).

*HIV/AIDS:* The HIV/AIDS epidemic will have a significant impact on the firms in the future as the C&T manufacturing industry is one of the most labor intensive industries in SA and as the workers is one of the most “high risk” groups within the population. HIV/AIDS will affect the firms in several ways, one being high absenteeism rates and another poor work morale (Salm 2002).



## 5. Analysis

*This chapter analyzes the empirical findings with the help of the thesis's theoretical framework. The chapter is divided into three parts according to the overall analysis model (see Figure 16). The first part analyzes the firms' external environment and the second part examines the firms' internal environment. The third and final part studies the strategy implications from the internal and external analysis. To make it clearer for the reader which sections that are being analyzed, a miniature model is provided in the footer of each page of the chapter. The section/sections of the overall model that are engaged in the analysis are highlighted in the miniature model.*



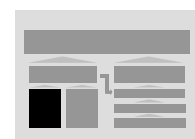
### 5.1 External analysis

*The external analysis proceeds in three stages. I begin with examining the industry's present structure using the Five Forces of Competition framework. Secondly, I analyze the future structure of the industry by studying the affect of key trends on the five forces. Finally, I forecast the future key success factors in the industry.*

#### 5.1.1 Present industry structure

##### Internal competition

According to Grant (2005), there are six main factors that play a significant role in determining the nature and intensity of the internal competition – *concentration, the diversity of competitors, product differentiation, excess capacity, exit barriers, and cost condition*. Before SA joined the WTO the SA C&T manufacturing firms were hardly



exposed to any international competition at all, they exclusively focused on the domestic market. Today, the situation has changed significantly since SA has gradually opened up its markets to foreign manufacturers. The firms are now competing with manufacturers both domestically and globally. Globally there is a high *concentration* of different manufacturers making the SA manufacturing firms subject to intense competition, mainly from low cost countries such as China, India, Indonesia, Turkey and Pakistan. Because of this vast geographical spread, the competitors are diverse in terms of origin, costs and strategies. The high level *diversity of competitors* probably enhances the rivalry between competitors as the internal competition is likely to intensify when competitors are more diverse (ibid).

Regarding *product differentiation*, firms are subject to different levels of competition depending on what type of products they are manufacturing. Low value added products, commodity items such as t-shirts, are subject to intense competition, since cost is the sole basis for competition. In sectors where the products are more differentiated, such as industrial textiles and design clothing, price competition tends to be weaker, although there are still many firms competing.

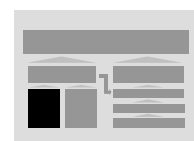
Today the SA industry is facing a problem with *excess capacity*. While the demand for SA C&T products has declined over the last decade, the industry has tried to uphold the same capacity level, probably due to high *barriers to exit*. One reason for barriers to exit is labor. Because the industry is an important employer for low skilled labor the SA Government has worked hard to sustain these jobs. The result is excess capacity as lay-offs are the least desired option. In turn, this may enhance price competition since firms are most likely encouraged to offer price reductions to attract new business in order to spread fixed costs over a greater sales volume. Furthermore, the industries' *cost conditions* probably add to the price competition. According to Grant (ibid) the cost structure is determined by the industry's scale economics. Generally, the variable cost to manufacture a product is low relative to the fixed cost (ibid). This will possibly encourage firms to take on marginal business at any price that covers the variable cost. Thus, excess capacity, high barriers to exit and the industry's cost structure implies intense competition and reduced profit potential in the industry.

### **Threat of entry**

The threat of new firms entering is an affect of the attractiveness of the industry which is partly determined by the barriers to entry. The height of the barriers to entry is in turn determined by three factors (ibid):

- *Capital requirements.*
- *Economies of scale.*
- *Access to distribution channels.*

The *capital requirements* in the SA C&T industry vary depending on what type of manufacturing facility is being established. If an entrepreneur wants to establish a large sized full clothing or textiles manufacturer he or she will most likely need to invest a significant amount of financial resources in manufacturing facilities, human resources



and R&D. In contrast, capital requirements are relatively low for starting up a small or micro sized CMT business where design and merchandising capabilities are not required.

*Economies of scale* is not likely to have a significant impact on the decision of entering the SA industry as the SA C&T industry mainly consists of small scale businesses.

In SA the retail market is booming and the demand for clothing is high. The retailers I interviewed expressed their willingness to broaden their product base. Hence, possible *distribution channels* exist for new firms. In reality however, there are few firms establishing themselves in SA. Most likely because the industry is viewed as a declining industry and there are more profitable industries in SA to invest in, such as the property industry. Therefore I believe that established SA firms do not have to worry about a significant amount of new firms establishing in SA. On the contrary, the global industry is growing significantly and there is a real threat created by firms overseas. Low cost countries are gaining market shares all over the world.

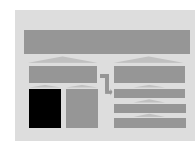
To sum up, barriers for entering the SA domestic market are in general low but vary to some extent depending on what type of manufacturing firm is being established. While the firms compete globally there is a need to beware of new foreign producers that could potentially overtake market share in both the domestic and export markets.

### **Bargaining power of buyers**

According to Grant (ibid), one must investigate two main factors to determine the strength of buyers' bargaining power:

- *Buyers' price sensitivity.*
- *Buyers' relative bargaining power.*

I will begin with analyzing the *buyers' price sensitivity* which is determined by four main factors; *the proportion of cost, differentiation, competition among buyers* and *importance of the product* (ibid). Looking at the SA industry in general, the C&T products produced by the manufacturing firm are arguably one of the biggest costs for their customers. Naturally the *proportion of cost* differs as the customers are diversified. For retailers C&T products are one of their greater costs, on the other hand, compared to car producers buying textile seat covers or hotels buying bed linen, it is a small proportion of total costs. According to Grant (ibid) the greater the importance of an item as a proportion of total cost, the more sensitive buyers will be about the price they pay. Retailers are therefore likely to be more price sensitive than buyers where the C&T product is a marginal input. Grant (ibid) further explains that the less *differentiated* the products of the supplying industry, the more willing the buyer is to switch suppliers on the basis of price. Looking at the low value added products in the industry the buyers are likely price sensitive as it is relatively easy to switch suppliers. However, the more differentiated the products are, the less willing the customers are to switch suppliers. The *competition among buyers* in the C&T industry is generally high. This means they probably have to cut cost to sustain or increase their profits. The intense rivalry between the buyers thus likely enhances their price sensitivity. The last factor affecting the buyers' price



sensitivity is the *importance of the product* to the quality of the buyer's product or service (ibid). The manufacturing firms' quality obviously has a direct impact on the retailers' quality performance. For example, if a t-shirt is of bad quality the retailer's customer (the end consumer) will most likely be dissatisfied. Thus, the end consumer's satisfaction is directly affected by the manufacturer's product quality. According to Grant (ibid) these condition would consequently reduce the buyer's price sensitivity. To sum up, the C&T buyers are in general likely to be price sensitive, but since the industry customers are diversified one can identify more and less price sensitive segments. Customers demanding highly differentiated products being the less price sensitive group.

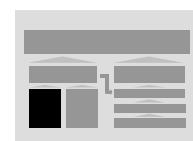
I will now move on to the second parameter determining the bargaining power of buyers, i.e. the *relative bargaining power*. The relative bargaining power is determined by three factors: *size and concentration of buyers relative to suppliers, buyers' information and ability to vertically integrate* (ibid). In the industry in general the buyers are large in *size* relative to the sellers. Furthermore, they are well *informed* about the market. The retailers do not want to *vertically ingrate* manufacturing in their business, however, in many cases they control and overlook the entire supply chain. I thus believe that the C&T buyers' relative bargaining power is strong.

### **Bargaining power of suppliers**

In order for the manufacturing firms to be able to produce, they mainly need input of raw material and labor. The firms' raw material suppliers are found both in the domestic market and in international markets. Accessibility to raw materials from local producers is poor. Furthermore, the local raw materials are relatively expensive and the level of quality is low, which means that firms often need to look outside the local market and import fabric from foreign suppliers. The present quota restriction on China has made it even more difficult finding suppliers and also made it more expensive to import. Before the quota restriction firms mainly imported fabric from China but now they have to look elsewhere in the world. The difficulty is finding reliable and quick suppliers.

The foreign suppliers' bargaining power is strengthened by three factors. Firstly, the SA firms represent a small market, and are therefore not "important" for the suppliers business. Secondly, the SA firms are dependent on their fabric since local market cannot fully supply them with their needs. Thirdly, the material they supply is very important for the SA firms' products as it accounts for approximately half of the cost to produce a garment. The bargaining position is weakened as there are a vast number of foreign suppliers offering similar products and the switching costs are relatively low.

The local suppliers' bargaining power is probably weaker than foreign suppliers' bargaining power as opposite conditions apply in the domestic market. For one, the local raw material suppliers are dependent on the domestic clothing sector as they take up 48 percent of total textile output. Furthermore, the manufacturing firms do not rely on local suppliers because they have the option of importing. However, the bargaining positions of local suppliers are strengthened by the fact that they are local and can offer quick deliveries. On top of that, when exporting under the trade agreement AGOA and EU-SA FTA firms must source local raw material.



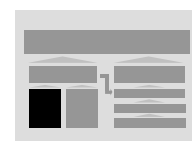
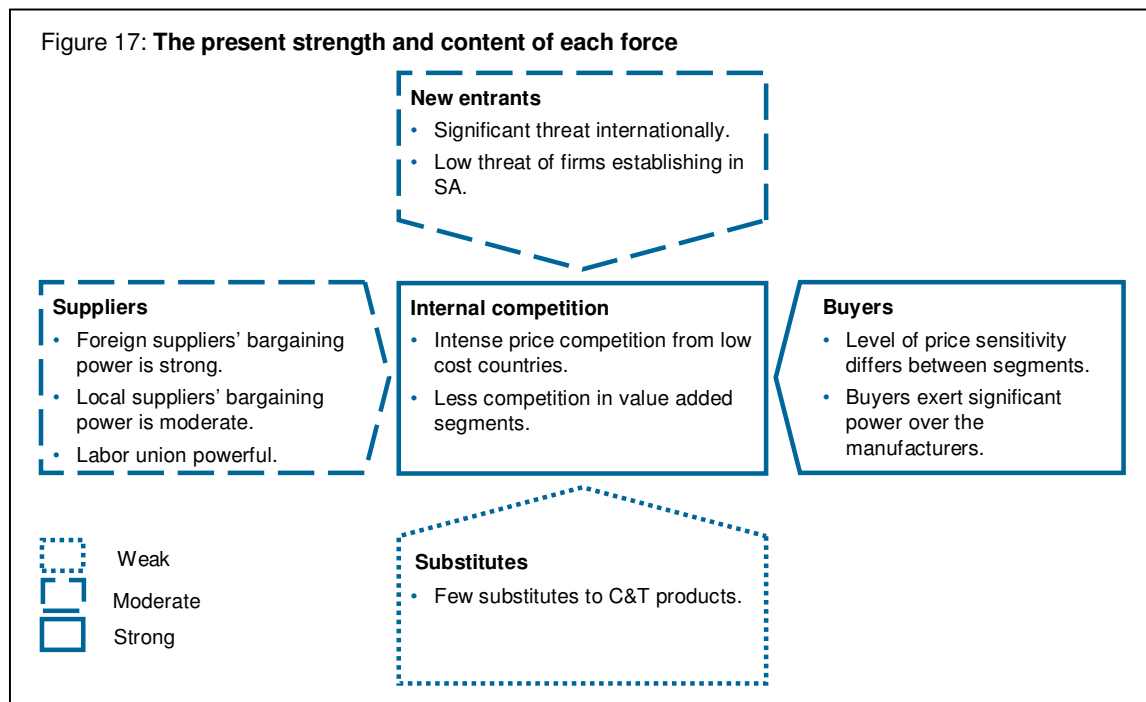
According to Grant (ibid) a high percentage of employees unionized correlates directly with low profitability. Thus, the bargaining power of the SA C&T workforce is likely affected by the fact that the majority of the firms' employees are unionized. The union, SACTWU, commands a strong position in the industry pushing for higher wages and in turn probably reducing the firms' profitability. The bargaining position of skilled labor is likely better than the position of unskilled workers since access to skilled labor is low while the supply of unskilled labor is good.

### Threat from substitute products

I have defined the industry broadly, including all firms in SA supplying the local and world C&T markets. Therefore the industry represents such a wide variety of products which makes substitute analysis difficult. Looking at the industry as a whole, I cannot find any specific substitutes that could fulfill the same function as C&T products. Moreover, none of my interviews expressed a threat from other type of industries overtaking their customers. However, in niche segments, such as industrial textiles, there might be a threat from substitute industries, where other materials might be found more favorable.

### 5.1.2 Summary of present industry structure

From the above analysis I conclude that the industry's profit potential in general is low in both the domestic and international markets. This is mainly due to an intense rivalry between established competitors and buyers exerting strong bargaining power over the firms. However, in value added products competition tends to be lower. Furthermore, rivalry between firms in the domestic market tends to be less intense than in the export markets. The main findings are summarized in Figure 17 below.



### 5.1.3 Future industry structure

Through the above analysis of the industry's five forces I have mapped the present industry structure. What is interesting for the purpose of this thesis is to analyze how the industry structure might possibly transform in the future. I will in this section analyze what impact the key global and regional trends (see Table 5) might have on the industry structure. For a full section on key trends see page 34.

Table 5: Summary of key trends presented in Chapter 4

Global trends	Regional trends
<p><i>Present trends:</i></p> <p>Growing imports but falling prices.            New sourcing rules.            Suppliers building capabilities.            Free trade agreements and safeguards.</p> <p><i>Future trends:</i></p> <p>Trade growth, stabilization and emergence of new supplying countries.            Consolidation, collaboration and relocation.            Redefinition of the traditional roles.            Speed and reliability.            Scarcity of resources would lead to development of new technologies.            Migration of skilled manpower from buying to supplying countries.</p>	<p>Emergence of new export markets.            Growing demand in SA.            Changes in retailers sourcing pattern.            Consolidation and collaboration.            HIV/AIDS.</p>

### Internal competition

There are several trends implying increased internal competition in the future. The prices are predicted to fall which would certainly increase price competition in the industry, especially in low value added products. The competition in low value added products would thus likely continue to be more intense than in higher-end segments. Furthermore, suppliers have started to build up new special capabilities and increasing investments in machinery which will most likely strengthen the competition as competitors become more diverse. As new supplier countries are predicted to emerge in the future, the internal rivalry will probably further intensify. Because of its comparatively small size, there is a chance that the SA market will not be targeted by the new suppliers. The larger customer bases of the US and the EU will likely be more popular targets. This would in turn imply that the emergence of new supplier countries will only have a modest affect on the SA domestic market.

There are two trends that may slightly hold back the increasing competition. One of them is that China and India are stabilizing their exports, consequently lessening their presence in world markets. The other one is that the global C&T trade is expected to double in size within the next six to eight years which would open up a vast amount of opportunities for manufacturers.



Another trend that could affect the internal rivalry is FTAs. Today trade agreements provide SA with a price advantage in their main export markets, but if new competing countries are provided with the same benefits in the future, competition will likely intensify in the firms' export markets.

As competitors are growing in size due to consolidation and collaboration it will probably become more difficult to compete with them on large orders. However, at the same time opportunities could develop for SMMEs as they become relatively flexible, possibly decreasing the internal rivalry in that segment.

The trend of dual sourcing may also affect the internal rivalry, increasing competition in the export markets but decreasing competition in the domestic market. This is because value added products will most likely be bought from suppliers that are located close to the buyer. Thus, in export markets it would become more difficult for SA firms to compete with suppliers with proximity advantages. In the domestic market however, SA firms would benefit from dual sourcing.

Conclusively, the above-mentioned trends will most likely have an affect on the future state of the internal rivalry. When considering the above factors I believe that the competition in the export markets will likely increase, especially between large manufacturers. However, the SMME segment may be subject to less competition. In the domestic market the trends indicate that the competition will not be as intense as in the export markets. Due to the development of dual sourcing and China and India stabilizing their exports, the internal rivalry may even slightly be reduced in the domestic market.

### **Threat of entry**

The increasing demand for C&T products and services in the major consumption bases of the US and EU will likely attract new firms to the global industry. On the contrary, the trend of consolidation and the emergence of multibillion dollar firms might deter entry of firms into the industry due to the advantages of economies of scale that the large established firms experience. To compete efficiently in the future it is likely that even more capital will be required as established firms are building up their capabilities and investing in machinery, increasing the barriers of entry. However, while large firms become larger, small firms will possibly become increasingly relevant as a supplier of small and more complex niche products and as an outsourcing option for larger companies.

FTAs will likely affect the firms' choices of location in the future. However, the probability of new firms entering the SA industry because of the competitive advantage gained from AGOA is low due to the fact that it is difficult to find local raw materials in SA, which is a necessity for the use of AGOA.

Generally, I believe that the number of new firms entering the global industry will increase mainly due to the enhanced demand of C&T products and services. Regarding the SA industry I believe the opposite as the industry is predicted to continue declining and will therefore probably not attract many new investors.



**Bargaining power of buyers**

The demand for less price sensitive C&T products and services will most likely increase in the future. Cost will no longer be the primary target for buyers when sourcing, instead quick and reliable deliveries, flexible production and differentiated products and services will be the main determinants when selecting suppliers. In the future buyers will also look more towards outsourcing operations such as forecasting, designing, product development and logistics. Furthermore, buyers will shift from fragmented sourcing to the use of full-package suppliers and strategic long term partnerships.

Buyers in the SA firms' export markets will probably increase their bargaining power since the SA industry is predicted to become relatively smaller in size. In contrast, the bargaining power of the firms' domestic customers might decrease as they may become more dependent on local supply in the future. The regional trends imply that the sourcing patterns of the SA retailers are likely to change. To get access to speed the SA retailers will probably become more willing to source locally. Fast fashion will almost certainly also increase the retailers' demand of local supply. Furthermore, establishing long term strategic partnerships and outsourcing services may be more practical with local manufacturers due to proximity and cultural factors. Due to the above-mentioned factors I believe that there will be a more mutual dependency between suppliers and buyers in the domestic market in the coming years.

**Bargaining power of suppliers**

The scarcity of natural resources in the future could possibly affect the bargaining power of both local and foreign suppliers since there is a risk of manufacturers demanding more raw material than the suppliers can provide. This would in turn boost the power of suppliers. As the total number of firms in the SA industry is expected to decrease the SA market might become even less important as a customer base for foreign firms, increasing the bargaining power of international suppliers. The SA firm's demand for local raw material might rise due to ROO requirements, consequently increasing the bargaining power of local suppliers. On the other hand, collaboration and consolidation of manufacturing firms imply reduced domestic supplier power. The decreasing number of firms would possibly mean reduced domestic demand for local raw material, and collaboration would likely increase the manufacturers' power over their local suppliers.

The access of skilled labor in the SA C&T industry is most likely to decline in the future. SA educates few new skilled C&T workers since it is being viewed upon as an unattractive market by graduates. And also, skilled C&T workers might choose to move to a more profitable industry. However, access of low skilled labor will probably be sufficient in the future as there are presently many workers without employment. On the other hand, the HIV/AIDS epidemic will most likely have a negative impact on the size of the workforce.

**Threat of Substitutes**

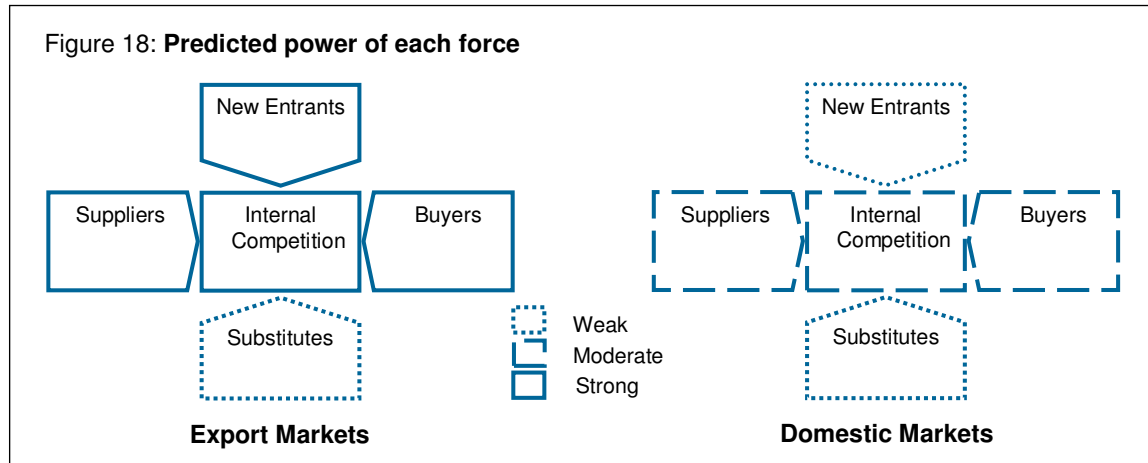
I could not identify any changes regarding substitutes.





### 5.1.4 Summary of future industry structure

From the above analysis I have recognized that the future structure of the industry and the resulting profit potential is notably different in the domestic market and export markets (see Figure 18).



#### Export markets

In the export markets I predict that the internal competition in general will likely increase. There are many factors that imply an increased rivalry; prices are predicted to fall, international manufacturers are developing capabilities and consolidating, new supplier countries are emerging, there is a risk of FTAs being granted to other countries, and dual sourcing is predicted to increase. On the other hand, global C&T trade is predicted to double in size and China and India are expected to stabilize their exports, which will probably slightly hold back the intensification of the competition. The SMMEs might even notice a decrease in competition due to the opportunities provided when large firms consolidate.

Less price sensitive markets are predicted to grow due to changing sourcing patterns of buyers. The buyers' demand is predicted to shift from cost to speed and reliability. Furthermore, the demand for differentiated products and support services will probably increase in the coming years.

The number of firms entering the market is expected to increase to fill the rise of demand from major consumer bases. Due to the scarcity of raw material and the consolidation of the SA industry, the bargaining power of suppliers will probably grow stronger. The bargaining power of buyers is predicted to rise as the SA industry will further consolidate and thus become relatively smaller in size.

Conclusively, I believe that the future profit potential in the export markets is low. However, there seems to be better opportunities for profits in supplying value added products and differentiated services, especially in the SMME segment where competition probably will be less intense in the future.



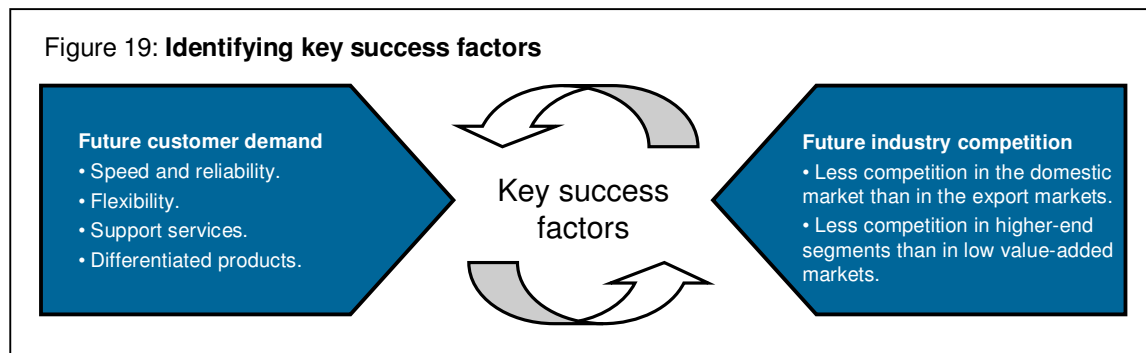
### Domestic market

The trend of falling prices will certainly also strengthen competition in the domestic market, but in contrast to the export markets there will probably not be an increasing amount of firms targeting the SA domestic market in the coming years. Internal rivalry might even decrease due to a declining presence of China and India. In the future the domestic buyers' demand for less price sensitive products and services is forecasted to increase. Moreover, their bargaining power is predicted to decline because of the increasing importance of local supply. The bargaining power of suppliers is strengthened by ROO requirements and the scarcity of local raw material, as well as poor access to labor. On the other hand, the manufacturers buying power grows as they consolidate and collaborate.

When combining the above factors I believe that the potential for profits in the domestic market might improve. There will possibly be fine opportunities for profits in higher-end segments of the domestic markets, but the present poor opportunities in low value added segments are most likely to sustain in the coming years.

### 5.1.5 Identifying key success factors

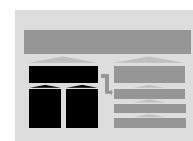
In this section I will identify the key success factors which determine the firms' ability to survive and prosper in the future industry structure. In order for success, the firms must meet customer demand and survive competition (Grant 2005). For a comprehensive description of the customers' demand see page 43.



By analyzing the future customer demand and the future industry competition I have identified the following sources of competitive advantage, i.e. key success factors (see Figure 19).

*Effective and flexible production:* To meet the customer demand of speed and flexibility manufacturers need to have an effective and flexible production in place. A lean manufacturing plant also reduces cost which is important in order to survive the future competition.

*Quick and reliable distribution:* Effective distribution will likely be a key success factor since speed to customer and on-time delivery is expected to become increasingly important in coming years.



*Product development and innovation:* The firms' demand for differentiated products is anticipated to increase and the competition in this segment is likely to be less intense than in low value added segments in the coming years. To fulfill the customers demand and survive competition, investment in product development and innovation will probably be crucial.

*Skills in support services:* The customers are also expected to increase their demand for support services, such as inventory control and design. The future industry structure implies a great potential for profits in this segment, skills in support services will therefore likely be a factor determining success in the future.

*Access to local raw material:* This factor is especially crucial for exports as it is a necessity to use local raw material for firms to gain AGOA and EU-SA FTA compliance, which provide the firms with a competitive advantage when exporting to the US and the EU.

*Strategic relationships:* Buyers are predicted to shift from fragmented sourcing towards long term strategic relationships in the coming years. For the manufacturing firms to survive the increasing competition in export markets and to prosper in the domestic market, establishing strategic partnerships and healthy relationships will probably be vital.

## **5.2 Internal analysis**

*The second part of my analysis studies the firm's internal environment. The analysis proceeds in three stages in accordance with the overall analysis model (see Figure 16). I begin with identifying the firms' key R&C using the Resource Based View framework. Secondly, I evaluate the resources against two criteria, importance and relative strengths. Lastly, the firms' key strengths and weaknesses are identified.*

### **5.2.1 Identifying key resources and capabilities**

It is important to note that identifying a firms' R&C in practice is not obvious as some are hidden deep within the organizational processes and composed of tacit components such as skills and experience (Slack and Lewis 2002). Based on the key success factors presented in the previous section, the manufacturing firms' value chain activities, interview responses, and my own perceptions, I believe I have identified the firms' key R&C. I will start with presenting the key resources and continue with describing the key capabilities. The resources are organized using Grant's (2005) classification of resources into tangible, intangible and human resources (see Table 6).



Table 6: **Classification of resources**

<b>Tangible</b>	<b>Intangible</b>	<b>Human</b>
Plant and equipment Location Financial resources	Distribution Motivation Reputation Technology Organizational structure	Skills and knowledge

### **Tangible resources**

*Plant and equipment:* The production plants in general are not up to the modern high standards, because the firms have not invested enough in upgrading the plants. However, there are a few cases of high class production facilities. The accessibility to local raw material used in production is poor and imported fabric is relatively expensive which weakens the manufacturing firms' ability to compete.

*Location:* Another important resource is the location of the manufacturing plant, since proximity to customers is crucial to minimize delivery time. In the domestic market firms have an obvious distance advantage over foreign firms. Firms also have an advantage over Asian competitors in terms of proximity to the EU, SSA and Eastern seaboard US markets. On the other hand, Mexico and the Caribbean Basin have a geographical advantage over SA as they are closer to the US, Eastern Europe and North Africa. Furthermore, Asian competitors also have a distance advantage when exporting to Australia, Japan and the Middle East. The manufacturing basis in the EU supplying the EU market clearly has an advantage over SA. In South Africa the ports are to a large extent inefficient and the firms also face expensive shipping costs which weakens the firms' location for exports. Thus, the export firms' location in general is a weakness.

*Financial resources:* In the C&T industry in general capital requirements are high as there is need to continually upgrade equipment. However, the SA firms have poor access to financial resources because banks are reluctant to lend money to the industry. The high cost of capital due to souring interest rates further aggravates the financial situation of the firms. The CMTs find it difficult to meet the borrowing criteria of the banks thus worsening their borrowing situation. Furthermore, insufficient government support for C&T firms compared to the levels of support provided by competitor economy governments is a detriment to the financial situation of the firms.

### **Intangible resources**

*Distribution:* In the domestic market the distribution channels are poor. This is mainly due to the tense relationship between the manufacturing firms and the retailers. The retailers have the last few years expanded significantly by increasing their imports from foreign low cost countries. The SA manufacturers have not grown at the same pace as the retailers. As statistics show the SA manufacturing sales have been stagnant the last few years. The manufacturing firms are thus distressed by the retailers increasing imports. In contrast the retailers are troubled by the manufacturing firms' ineffectiveness. Therefore



importing has been the most profitable choice for the SA retailers. However, the distribution channels are improving due to the CCTC which facilitates a healthy dialog between manufacturers and retailers. The cultural similarity between the manufacturing firms and domestic customers is a firm strength for distribution in the domestic market.

In the export markets firms have well-established connections with buyers in the EU and US markets. Trade agreements (SA-EU FTA and AGOA) can be considered strengths as they provide the firm's with a competitive advantage. When negotiating with the EU and US customers South Africa's dominant western culture and English language proficiency is a vital resource. However, there is a lack of strategic partnership between the governments in export markets and SA C&T firms in the pursuit of exports. Furthermore, the SA firms' position in export markets is relatively weak and there is low activity in exploiting new distribution channels in export markets.

*Motivation:* The industry management as well as workers lack of motivation which is partly due to the mindset of the CEOs and the reward systems used in the industry. The low motivation of workers is probably also affected by the general view that C&T are (so-called) sunset industries.

*Reputation:* South Africa has a good name overseas as the country complies with international social and labor standards and the country is also known for good quality. However, in the domestic market the manufacturers have a reputation of being ineffective, inflexible and unreliable.

*Technology:* The textile sector has invested more capital in new technology and R&D than the clothing sector. The manufacturing firms in general have spent insufficient amounts of capital on new technology and innovations. The result of that is that the firms' production effectiveness decreases relative to their overseas competitors. Furthermore, it reduces the level of product development and innovation in the industry.

*Organizational structure:* The organizational structure of the manufacturing firms in general is ineffective. The general opinion from my interview respondents was that the organizational structure is too hierarchical and bureaucratic.

### **Human recourses**

*Skills and knowledge:* The industry in general has experience and cumulative knowledge. On firm level however, skills at all management levels are low. Managers at top level often lack a long-term vision/strategy and do not have the knowledge of how to develop an international competitive business. Knowledge about new export markets is also low. Access to technical- and higher order management skills is poor and there is few new skilled people entering the industry. However, access to unskilled labor is good but on the other hand the unskilled labor is relatively expensive and inflexible.

### **Capabilities**

When identifying the firms' different capabilities I have used the performance based approach classifying the capabilities into measures of *quality*, *delivery*, *flexibility* and *cost* (Hallgren 2007). While these performances only offer a static view of the firms'



capabilities; it is important to understand the firms' capability to adjust to changing circumstances. Thus, I will also identify the firms' capability to change, i.e. the firms' *dynamic capability* (Teece et al. 2000).

*Quality:* SA C&T firms have in general good conformance quality as they produce products with reliable and consistent quality. However, the specification quality is poor because firms in general are not capable of manufacturing the products demanded by the retailers. The products' characteristics are in many cases not inline with the customer's demand of differentiation.

*Delivery:* Delivery has two different performance dimensions, speed and reliability. The manufacturers speed performance is poor because the production lead time is generally long. Regarding reliability the general view is that the manufacturers also have problems with on-time delivery which is linked to the firms speed performance. Thus, the delivery performance of manufacturers is poor.

*Flexibility:* Flexibility is the ability to adjust manufacturing volume and the ability to change between product runs (ibid.). The SA manufacturers are capable of producing small runs which make them flexible in terms of switching between product runs. However, the manufacturers are not capable of producing large runs and therefore lack capacity to supply large export buyers. Thus, the manufacturers have the ability to change between products but do not have the capacity to adjust manufacturing volume to larger runs, which in turn reduces their flexibility.

*Cost:* The manufacturing firms in general are not low cost producers due to several factors. Firstly, the firms have inefficient production as they have insufficient application of modern manufacturing standards with high inventory levels and high rates of absentees. Secondly, as factories often do not run consistently the capital-intensive textiles industry incurs considerable machine start-up costs. Thirdly, the high cost of labor, and overtime pay to ensure continued production, substantially raises costs. Lastly, the cost of capital further aggravates the situation. However, there are a few cases of world class manufacturers in SA running at optimal levels with low unit cost.

*Dynamic capabilities:* The firms' dynamic capabilities have been highly affected by the country's history of isolation. The manufacturers do not have a culture of change as it has not been necessary to adjust in the past when operating in a protected environment. The firms that have been closed down have not reacted or reacted too slowly to the changes in the environment as they have a tradition of being protected by governmental policies. The manufacturing firms in general are not proactive and have poor ability to respond to the shifts in consumer habits. Weak motivation among management and workers are examples that impede the firm's ability to change. What might further reduce the dynamic capability of the firms is the rigidity of their R&C as they have been built up during a long period of time. According to Grant (2005), "the more highly developed a firm's organizational capabilities are, the narrower their repertoire and the more difficult it is for the firm to adapt them to new circumstances" (p. 116). A positive aspect is that some manufacturers that are left in the industry have started to understand the importance of change and show a willingness to change. This is evident when looking at the growing



membership in the CCTC as the clusters' main purpose is to help firms to change to become international competitive.

### 5.2.2 Assessing key resources and capabilities

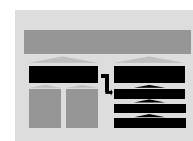
When assessing the R&C I will study their importance for sustaining a competitive advantage as well as their strengths in relation to the firms' competitors. The evaluation of the R&C relative strength is based on interview responses, industry reports and my own analysis. To evaluate the importance of the R&C I have used Grant's (ibid) framework for appraising the profit-earning potential of R&C, i.e. *scarcity, relevance, durability, transferability, and replicability* (see page 15 for a full explanation of Grant's framework). To evaluate the *relevance* of the resource or capability I have in accordance with Grant's framework studied how closely they are linked to the key success factors in the industry (see page 67 for a description of the key success factors).

#### Assessment of resources

*R1. Plant and equipment:* For the SA firms this resource is one of their major weaknesses because the SA firms in general lack world class production facilities, equipment and access to local raw material. This resource is essential for competing but is not a sufficient basis for competitive advantage since effective plant and equipment widely exists in competing countries. The resource is however linked to two success factors, (effective and flexible production, and access to local raw materials), which give the resource high relevance. Plant and equipment is not very durable and relative easy to transfer and copy which decreases its importance.

*R2. Location:* One of the firms' major strengths in the domestic market is location, since they are often closely tied with local customers. For exports the location is a disadvantage which reduces the relative strength of this resource. Location is a strong competitive advantage that SA firms have over foreign competitors in the domestic market. The resource is also highly relevant as it is directly related to quick and reliable delivery, which is one of the key success factors. The location advantage is durable and not transferable. Foreign firms of course have the possibility to move to SA to compete with them in the local market. This however is unlikely to happen as the threat of entry is low in the domestic market thus making this a sustainable competitive advantage in the domestic market. In contrast the location of firms is not a basis for competitive advantage in the export market reducing the relative importance of this resource.

*R3. Financial resources:* The difficulty to get bank loans and weak government support is a serious weakness for the SA firms. Financial resources are naturally a basis for a competitive advantage. Firstly, financial resources are scarce as they are not widely available. Secondly, financial resources are highly relevant as they are vital for establishing an effective and flexible production, as well as for investing in product development and innovation, which are key success factors in the industry. Thirdly, financial resources are durable. However, capital is transferable and replicable which reduces the possibility for financial resources to be a basis for a sustainable competitive advantage.



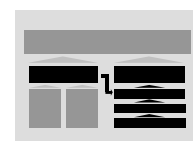
*R4. Distribution:* Presently, the access to distribution channels in the domestic market is poor. The relationship between the SA firms and the domestic buyers is however improving and the cultural similarities between the firms and local buyers is a strength. In export countries distribution linkages are well established and the trade agreements, AGOA and EU-SA FTA, are export strengths. However, access to local raw material is poor which worsen the firm's possibility for trade agreement compliance. Furthermore, there is low activity in pursuing new export markets. Thus, this resource is neither an obvious strength nor a clear weakness for the firms. Distribution channels are critical to attain and sustain a competitive advantage as they can not be easily acquired or internally developed by other firms. Furthermore, the resource is very relevant as it is closely connected to two of the key success factors, namely strategic relationships and access to local raw material.

*R5. Motivation:* Lack of motivation among management and workers is a major weakness. Motivation is an important source of sustainable competitive advantage because it is difficult to imitate and highly relevant for achieving all of the key success factors.

*R6. Reputation:* The firms in general have a good reputation overseas but in the domestic market the reputation is poor. Thus, in export markets the reputation is a strength while in domestic market it is a weakness. Reputation is relevant because it is important for establishing strategic relationships, which is one of the key success factors. Furthermore, the resource is durable and something that rivals can easily imitate which consequently makes it a sustainable advantage.

*R7. Technology:* In comparison to international competitors the firms' investments in technology is low. Thus, their technology asset is limited and consequently a weakness. Technology is important for developing and innovating new products which is a key success factor. Moreover, technology is used for improving the production and delivery efficiency which also are key success factors. If a firm develops a cutting edge technology it can be a sufficient basis for competitive advantage. However, the technological advantage is probably difficult to sustain due to the increasing pace of technological change. Furthermore, if the technology is not patented it can be relatively easily acquired and internally developed by rivals.

*R8. Organizational structure:* This resource is a weakness because the firms have relatively ineffective organizational structures. The importance of the asset is high because it is linked to two success factors; effective and flexible production as well as quick and reliable distribution. The organizational structure has a significant effect on how the production flows and directly affects the speed and reliability of delivery (Slack and Lewis 2002). Thus, an effective organizational structure is needed to compete in the industry and I believe it could also be a sufficient basis for competitive advantage if it significantly increases the production and delivery efficiency. To imitate an organizational structure may be relatively easy but its usefulness will vary depending on a range of firm specific factors. Thus, I believe a well functioning organization can establish and sustain a competitive advantage.





*R9. Skills & knowledge:* Knowledge of management is poor and access to advanced technical skills is limited. Thus, this resource is a weakness. Skills and knowledge is important for managing each and every success factor making it a very relevant resource. Because skills and knowledge are scarce this resource fulfills both conditions for establishing a competitive advantage, i.e. scarcity and relevance. I also believe that this resource has the potential to sustain a competitive advantage because of the difficulty of imitating it and its relative durability. However, some knowledge can be acquired by hiring new people or from specialized consultants.

### **Assessment of capabilities**

Regarding capabilities in general they are less mobile and replicable than individual resources because they are based on teams of resources and complex organizational routines (Grant 2005). According to this view, all of the capabilities identified are sufficient basis for sustaining a competitive advantage.

*C1. Quality:* The firms' conformance quality is good but specification quality is low. Therefore, I believe that the conformance quality performance is a strength and specification quality is a weakness. Specification quality is especially relevant because it is linked to one of the key success factors, namely product development and innovation. Firms need to invest in product development and innovation to be able to meet the customers' demand on specification quality. I believe that the quality performance is essential to compete and could also be a sufficient basis for competitive advantage if the firm develops a specification quality that is scarce.

*C2. Delivery:* The SA firms' general delivery performance is poor compared to their international competitors even in the domestic market where the local firms have a location advantage over foreign firms. Thus, I believe the firms' delivery performance is a weakness. I believe that this capability is critical to attain and sustain a competitive advantage in the domestic market. The capability is highly relevant because it is a key success factor. Furthermore, the capability is not widely available in the SA domestic market because foreign firms have to ship their products long distances which reduces their possibility on improving their delivery capability. Thus, if an effective delivery capability is developed by local firms it can be a winning factor in the domestic market. However, in the export markets I believe effective delivery is needed to compete but not sufficient to win as the capability is more widely available.

*C3. Flexibility:* The general small size of the SA firms make them relatively flexible in terms of changing between product runs but weak when it comes to adjusting production volume. Thus, flexibility is a strength in terms of changing between products but capacity flexibility is a weakness. Flexibility is essential to compete but I do not believe it is a sufficient basis for competitive advantage because many firms globally perform well in regards to flexibility. Flexibility is however very relevant as it is a key success factor.

*C4. Cost:* The SA firms' cost performance is poor compared to international competitors. Thus, the firms' cost features are a weakness of the firms. In low value added products cost is very important. However, the more value added the products are the less important



the cost performance become. Thus, I believe that in value added segments cost is essential to compete but in the low value added segments cost can be a sufficient basis for establishing a competitive advantage.

*C5. Dynamic capabilities:* In general the SA firms do not have a tradition to change. Thus, the firms' dynamic capability is a weakness. However, many firms have realized the importance of change which gives hope for the future. Dynamic capability is essential for the firms to achieve any of the key success factors. Thus, dynamic capability is highly relevant. Dynamic capabilities are far from common (ibid) thus making it a basis for establishing a competitive advantage.

### 5.2.3 Summary of the internal analysis

The assessment of R&C is summarized in Table 7 and 8 and Figure 20 below. The ratings in Table 7 and the exact positions in Figure 20 of the R&C are not completely accurate. This is because the identified key R&C contain both strengths and weaknesses with different levels of importance and relative strengths. Furthermore, the ratings are based on my subjective judgment. Therefore, the reader should neither put too much emphasis on the exact numbers nor the precise position of each individual resource or capability. Rather, the purpose of Figure 20 and Table 7 is to show a general picture of the firms' competitiveness. Through my analysis, it is clear that the firms have significantly more weaknesses than strengths. Thus, I conclude that the firms' internal environment is highly uncompetitive.

I have through the internal analysis identified a few key strengths which the firms need to exploit to improve their competitive position. For instance, their location in the domestic market and their reputation in the export markets. I have also identified numerous key weaknesses which the firms need to manage to improve their competitiveness. Some of the firm's most obvious key weaknesses are the lack of skills, delivery performance and dynamic capability. The firms' key strengths and weaknesses are all summarized in Table 8.



Table 7: **Assessment of the R&C relative strength and importance (both scales range from 1 to 10 (1 = very low, 10 = very high))**

Resources (R)	Relative strength	Importance
R1. Plant and equipment	4	6
R2. Location	8	8
R3. Financial resources	3	8
R4. Distribution	5	8
R5. Motivation	3	9
R6. Reputation	7	7
R7. Technology	3	7
R8. Organizational structure	4	7
R9. Skills & knowledge	2	9
<b>Capabilities (C)</b>		
C1. Quality	5	8
C2. Delivery	4	9
C3. Flexibility	5	6
C4. Cost	3	6
C5. Dynamic capability	5	9

Figure 20: **The R&C mapped in relation to their relative strength and strategic importance. The table is based on the ratings of R&C in Table 7.**

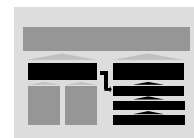
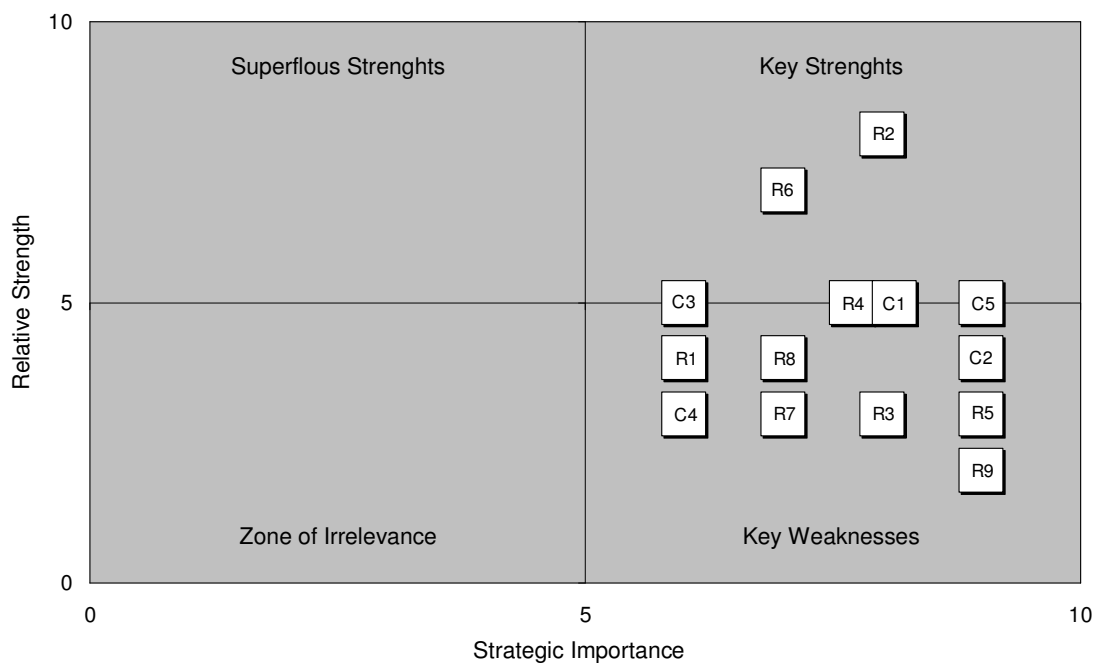


Table 8: The firms' key strengths and weaknesses

Key strengths	Key weaknesses
Location advantage in the domestic market Location advantage in the SSA market Overseas reputation Flexible in terms of changing between product runs Distribution channels in the EU and the US Access to low-skilled labor Conformance quality Cultural similarities with local customers Trade agreements (AGOA and EU-SA FTA)	Location for exports to the EU and the US Poor access to financial resources Reputation in domestic market Inflexible in terms of production capacity Distribution channels in domestic market Access to skilled labor Specification quality Delivery performance Management skills and advanced technical skills Relationship with domestic retailers Access to local raw material Knowledge about potential new export markets Productivity Technology Dynamic capability Organizational structure Motivation Production facilities

### 5.3 Strategy implications

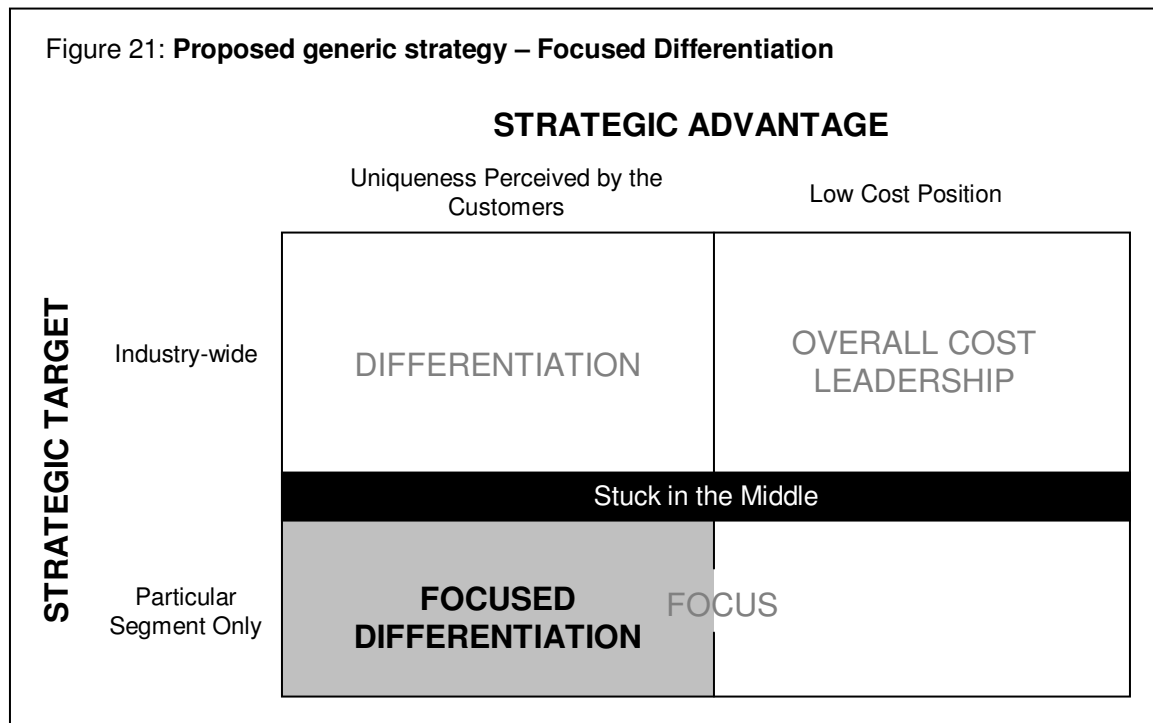
*I have in the previous parts examined the firms' external and internal environment. Through the external analysis I have examined the present and future industry structure and identified the key success factors. The firms' key strengths and weaknesses have been recognized through a careful internal analysis. I thus believe that the secondary purpose of this thesis is accomplished. In this chapter I aim to fulfill the primary purpose by adding the conclusions from the previous analyses. Firstly, I propose a general strategy for the firms to pursue and also recommend four specific segments for them to target. Next, I discuss the requirements and risks for implementing the proposed strategy and for targeting the proposed segments.*

#### 5.3.1 Proposed general strategy – Focused Differentiation

When reconciling the information from the previous analyses I conclude that the C&T manufacturing firms in general are neither high-end first-world suppliers, nor low-cost third world actors. The firms have neither been able to supply the high volume customers who demand low prices nor the customers pursuing differentiated products. Furthermore, the firms lack motivation among workers due to a vague organizational culture and poor motivation system. The firms are thus in a situation comparable to the position that Porter (1980) refers to as *stuck in the middle* (see Figure 21). According to Porter this position is poor and will almost definitely guarantee low profitability. Once stuck in the middle a firm must make a fundamental strategic change (ibid). Porter (ibid) suggests three alternative strategies. The manufacturing firms can either take the route towards low cost leadership (Low cost leadership strategy); or they must orient themselves to a particular segment (Focus strategy); or they can achieve some uniqueness (Differentiation strategy).



Firstly, the manufacturing firms need to choose a competitive scope; they can either participate on a global scale or focus on specific segments. When considering the firm's strengths and weaknesses it is quite clear that the firms cannot pursue a global strategy. They are in general too small, they do not have the economies of scale, or has the productivity to compete on a global industry wide basis. Thus, the firms need to *focus* on specific segments in order to succeed. Within the focus strategy the firms can either choose to compete on cost leadership or on differentiation, or both (ibid). In the external analysis I have concluded that the potential for profits in low value added segments is poor. When also considering the firms R&C it becomes clear that a cost leadership strategy will not be viable. The wages are too high and the SA C&T industry does not have the economies of scale nor the productivity to compete solely on cost.



A *differentiation* strategy is likely the most rational option. I have in the external analysis concluded that there are better opportunities for profits in higher-end segments. The identified key success factors also imply a differentiated route with increased focus on product development, innovation and support service skills. A differentiation strategy is also the best option for the firms to manage their weaknesses of high cost and low productivity as it allows a higher cost structure and is subject to less price competition. Thus, both the internal analysis and external analysis imply a differentiation strategy. I therefore propose a move towards offering differentiated products and services. More specifically I recommend the firms to focus on supplying more complex and technical fabrics and produce differentiated products such as smart textiles, high fashion garments and sports wear equipment. I also propose that the firms should examine the possibility of offering differentiated support services, such as forecasting, designing, product development, warehouse and logistics. Conclusively, I recommend the firms to move



from their apparent inviable stuck in the middle position towards a *Focused Differentiation* strategy.

It is important to note that the Focused Differentiation strategy is a general proposition based on general conclusions. Thus, a Focused Differentiation strategy might not be the most suitable option for all firms in the industry. However, I believe it is the most feasible strategy for the vast majority of firms.

### 5.3.2 General requirements

To pursue the proposed general strategy the firms must develop features to meet the basic requirements of a differentiation strategy (ibid). Apart from the generic requirements proposed by Porter I suggest three industry specific requirements that I believe are particularly important for the SA C&T manufacturing firms (see Table 9).

Table 9: Requirements of the proposed strategy

Porter's generic requirements	Industry specific requirements
Strong marketing abilities	Collaboration
Product engineering skills	Improve productivity
Cross-functional coordination	Access to capital
Creativity and research capability	
Incentives linked to qualitative targets	
Total commitment	

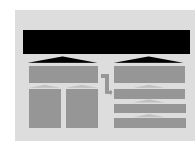
In the following section I will give general suggestions how the firms can apply their key strengths and manage their key weaknesses to fulfill each of the above-mentioned requirements.

#### Marketing

To pursue a differentiated strategy a firm will need strong marketing abilities (ibid). The SA manufacturing firms' marketing abilities are in general poor. Due to their history of isolation the firms have developed a tradition of being production focused. Thus, to meet this requirement firms must become customer focused by developing knowledge about the customers they aim to target and by pro-actively targeting new customers. To market themselves in export markets the firms need to use their overseas reputation strength. In the domestic market however, they need to manage their poor reputation through powerful marketing.

#### Product engineering skills

Porter (ibid) also emphasizes the importance of product engineering skills to succeed in supplying customers with unique products and differentiated services. In the present the firms have little access to high-skilled labor and the pool of advanced skills is declining in South Africa. Thus there is a serious need for firms to develop or gain access to higher knowledge. Because the pool of high-skilled labor in SA is small and declining, firms may need to look overseas to find the talent needed. Securing skills in SA for the C&T



industry in the future is to a large degree a governmental issue. How the SA Government should act to secure skills in the future however, is beyond the scope of this thesis.

### **Cross functional coordination**

According to Porter (ibid) firms must be well coordinated within the functions of R&D, product development and marketing. To fulfill this requirement I believe that the common hierarchical and bureaucratic organizational structure of the manufacturing firms needs to be changed to a more flat organizational structure with decentralized functions. Furthermore, cross functional coordination will likely require skilled middle and top managers. The firms lack management skills at both levels and thus need to improve in this area. To develop the skills of management, firms can conduct in-house management courses and cooperate with the CCTC or CLOTEX which support firms to adopt modern management techniques.

### **Creativity and research capability**

Two other features that Porter (ibid) believes are crucial for pursuing a differentiated strategy are creativity and research capabilities. The firms' present research capability and capability to produce creative products is poor due to lack in investments in R&D and technology. Thus, the firms need to start investing in technology and focusing on product development and production innovation. To develop more innovative ways of production, there needs to be a focus on investing in R&D capabilities. Further, the firms need to source innovative fabric, develop design capability and invest in high-tech equipment, to move towards developing more creative products.

### **Incentives linked to qualitative targets**

Another requirement suggested by Porter (ibid) concerns incentives. According to Porter workers should be rewarded according to their qualitative performance. In the SA C&T industry firms are in general not rewarded at all. This is largely due to a reward system used, which is linked to the annual profits which in general have been negative or small the last few years. Thus, to increase the workers motivation the firms need to develop a better reward system, for example separating the different functions' performances in the organization, such as design, merchandising, selling etc. Workers in functions that have excelled can thus be rewarded even though other functions have impeded the overall profits. Furthermore, as Porter (ibid) suggests, firms should focus on rewarding on a qualitative basis.

### **Improve productivity**

The productivity in the firms is poor mainly due to low labor productivity and poor production facilities with outdated technology. The low productivity increases the firms' costs substantially and limits their flexibility and delivery performance. These are all important parameters for competing in the future. Thus, I believe there is a serious need for the firms to improve their productivity. To increase productivity the production plants need to be re-engineered to meet the modern high standards. This will imply significant investments in new technology. Focus should also be on minimizing lead time to improve the production effectiveness within the firms. The workers productivity can be improved by lowering the absenteeism rates and by increasing the workers motivation. In order to



initiate some of these changes the CCTC works as a good platform. The CCTC benchmarks its members against the best manufacturers domestically and internationally and also identifies best practice.

**Access to capital**

To fulfill the above requirements the firms need to make significant capital investments. Access to capital is however one of the firms' key weaknesses. It is quite clear that to improve the financial situation of the firms' external help will to some extent also be required, such as governmental incentives. What actions the government should take though, lies outside the scope of this thesis.

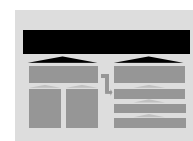
**Total commitment**

To pursue a Focused Differentiation strategy it is apparent that the firms need to undergo a number of changes. Some managers in the industry have understood that they have to change and have also showed a willingness to change. However, understanding the importance of change or having the eagerness to change is not the same as being committed to change and certainly not equivalent to successfully implementing change. Fundamentally changing the way the firms are used to work will require total commitment from each and every employee. Naturally the managers and workers general lack of motivation will reduce the firms' capability to change. Furthermore, change is not a natural part of the firms' corporate values. Thus, to improve the workers motivation and commitment to change I believe the firms need to develop a new reward system and change their organizational culture wherein change should be one of the core values.

**Collaboration**

Collaboration between the SA industry's actors (suppliers, manufactures and buyers) is another requirement that I believe is crucial for implementing the proposed strategy. A few players in the industry have started to collaborate but far from the majority. Through alliances industry actors can learn from each other and share their best practices thus consequently increasing the overall skill level in the industry. For example, if the manufacturing firms collaborate and establishing long term strategic partnerships with customers the manufacturing firms will probably increase their knowledge of the customers' demand while the customers will likely better understand the manufacturers' needs.

The proposed strategy will likely also require collaboration between the manufacturing firms in general and smaller manufacturers in particular. The manufacturers probably need to share and combine resources to manage some common weaknesses. For example, if the manufacturing firms combine their R&C they can jointly improve their marketing abilities and manage more powerful marketing campaigns. Through partnerships small manufacturing firms can also attain economies of scale and widen the production capacity and thus also manage larger orders. Collaboration is probably also one solution for improving the firms' financial situation because the manufacturing firms can combine their financial resources. Together they also probably have a better chance to lobby for governmental financial aid. For initiating collaboration I recommend becoming a member of the CCTC or cooperating with CLOTEX. Both organizations are good platforms for





creating partnerships and alliances. The CCTC suits large to medium firms while CLOTEX better suits small and micro sized firms.

### 5.3.3 Proposed strategic targets

In this section I will narrow the proposed general strategy into four specific segments that I suggest for the firms to target. Two of the segments are in the domestic market (Domestic retailers and Domestic niche) and two are in export markets (Export niche and The SSA market). I generally believe that it is in these segments that firms most likely can use their key strengths and where they have the greatest potential of establishing and sustaining a competitive advantage. The segment specific key strengths and weaknesses will be examined in each segment and summarized at the end of this section

#### Domestic retailers

This segment implies exclusively focusing on serving the domestic retailers, which are predicted to expand significantly in the future due to growing middle class in South Africa. The bargaining power of the domestic retailers is forecasted to decrease because they will likely become more dependent on local supply. Thus, domestic retailers will probably increase their sourcing of local products. For those reasons I believe that the domestic retailers is a lucrative segment. By supplying the local retailers the firms have the potential of speedy deliveries since they are situated closely to them. Pursuing this strategy thus allows the firms to make good use of their key strength in the domestic market, i.e. their location advantage. By exclusively focusing on the local retailers the firms also have the potential of establishing a close relationship with their customers and fully understanding their demands. The proximity between the suppliers and customers as well as the cultural similarities provides a good platform for a well functional partnership. Segment specific weaknesses that the firms must manage are poor relations with the local retailers and the firms' poor reputation in domestic market.

#### Domestic niche

This segment refers to the niche customers in the domestic market who demand medium to high value added products and services. The regional trends imply that the demand for differentiated products and services in the domestic market will increase, thus opening up opportunities for the firms. The domestic C&T market in general is forecasted to grow due to the untapped demand of the growing middle income consumers. Furthermore, competition in the domestic market is likely to decrease in the future. For those reason I believe this makes for a potential strategic target for the firms. By focusing on the domestic market the firms have a potential of achieving quick and reliable deliveries. Thus, this strategy allows firms to draw from their key strength of location. However, to successfully pursue this strategy the firms face specific challenges. They will probably need to improve and develop new local distribution channels. Furthermore, they will likely need to work on improving their poor domestic reputation.

#### Export niche

This segment implies focusing on middle and high-end customers in the firms' present export markets. The global trends show that imports into these countries will grow the coming years, thus making it an interesting segment for the SA firms to target. This



segment allows firms to use one of their key strengths, namely the trade agreements (AGOA and EU-SA FTA) in export markets. These trade agreements provide the SA firms with a competitive advantage since their products are not subject to import duties. When targeting this segment the firms can also make use of their overseas reputation. The firms have a good product quality reputation overseas and are viewed by export countries as a humanitarian choice because the firms comply with international social and labor standards. When targeting this segment the firms can also make use of their flexibility strength. The firms are relatively small in size and are thus flexible in terms of changing between product runs. This performance will become increasingly important in the future as fast fashion is predicted to continue to grow and thus pushing customers to change products quickly. An additional strength is that the firms have well established distribution channels in their present export markets of the EU and the US. Targeting export niche customers will however probably be more challenging than supplying the domestic segments presented above. Firstly, competition in export markets in general will likely be more intense and the buyers are predicted to increase their bargaining power. To combat the increased competition it will be vital to establish close relationships with export customers. Secondly, the firms need to secure access to local raw material to gain AGOA and EU-SA FTA compliance. The supply of locally produced fabric is poor and is thus a weakness for pursuing this strategy. Furthermore, the firms have a location disadvantage when exporting to the EU and the US.

### **The SSA market**

This segment suggests for the firms to focus on a new export market, the SSA countries, which today have become increasingly available due to the infrastructural development and economic development in the region. This market is predicted to grow significantly in the coming years and the domestic retailers are presently expanding into these countries. Thus, I believe there are opportunities in this market worth exploring. When pursuing this strategy the firms have a location advantage over Asian competitors and their overseas reputation can be considered a strength. However, the firms' poor knowledge about new export markets in general is a clear weakness, therefore they particularly need to develop their knowledge about the SSA region when targeting this segment.

### **5.3.4 Segment specific requirements**

To pursue any of these proposed strategic targets the firms will need to fulfill the general requirements of a Focused Differentiation strategy. However, from the above analysis it is apparent that there also are a number of segment specific requirements. Some strengths and weaknesses are more vital than others for targeting a specific segment. The firms' key strengths, which they are proposed to make use of, and their key weaknesses that they need to manage to successfully target each segment, are summarized in the Table 10 below.



Table 10: Segment specific requirements

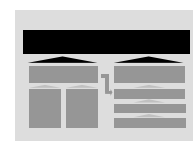
Segment	Strengths to exploit	Weaknesses to manage
<i>Domestic retailers</i>	Location advantage in the domestic market. Cultural similarities with domestic customers.	Relationship with domestic retailers. Reputation in domestic market.
<i>Domestic Niche</i>	Location advantage in domestic market.	Distribution channels in domestic market. Reputation in domestic market.
<i>Export Niche</i>	Trade agreements (AGOA and EU-SA FTA). Flexible in terms of changing between product runs. Overseas reputation. Distribution channels in the EU and the US.	Access to local raw material. Location for exports to the EU and the US.
<i>The SSA market</i>	Location advantage in the SSA market. Overseas reputation.	Knowledge about potentially new export markets.

### 5.3.5 Risks of pursuing the proposed strategy and segments

I will in this section discuss some of the risks of pursuing the proposed strategy and segments. Note that the aim with this section is not to identify all of the firms' risks because such an analysis would be too extensive and outside the scope of this thesis. I will however provide some examples of risks that I believe that the firms should consider. According to Porter (ibid) one main risk with the generic strategies is failing to attain or sustain the chosen strategy. It is abundantly clear that the SA manufacturing firms do not fulfill all of the requirements of the proposed strategy. They need to change significantly to develop the features that are required. Implementing change in an organization is by no means a simple task, and there is a real risk of not being able to succeed in this strategy. If the firms manage to attain the Focused Differentiation strategy I believe they have good potential to sustain it over time because they then evidently have the capability to change. A differentiation strategy is also in general a more sustainable strategy than a low cost approach (Grant 2005).

There is also a risk of the value of the advantages provided by the strategy to erode as the industry structure changes (Porter 1980). The competitive advantage provided by the firms' proximity in the domestic market might diminish if the firms fail to develop delivery speed and foreign competitors further improve in that area. Furthermore, the competitive advantage provided by AGOA and EU-SA FTA is eliminated when the trade agreements run out or if competitors are provided with same preferences.

When pursuing a focused approach the firms run a risk of the targeted segments changing over time (Grant 2005). The buyers' demand for the differentiation factor might fall or the differentiated products or services may become too costly for the buyer (Porter 1980). For example, firms that choose to target one domestic retailer will become strongly dependent on them for their success. If the retailer's need for differentiation vanishes, or if they need to make large cost savings and need to sacrifice some of the differentiated features and services provided by the firms, the manufacturers run the risk of losing a large share of their business. However, according to the regional trends this will not likely be the case in coming years.



## 6. Conclusions and discussion

*This chapter summarizes the main findings from the previous analyses. First, the key aspects of the thesis are summarized. Secondly, the main findings are presented. Next, the findings are critically assessed, and finally suggestions for future research are presented.*

### 6.1 Summary of the thesis's main parts

*In this section the main parts of the thesis are summarized with the aim to give the reader a quick overview of the thesis to better understand the findings.*

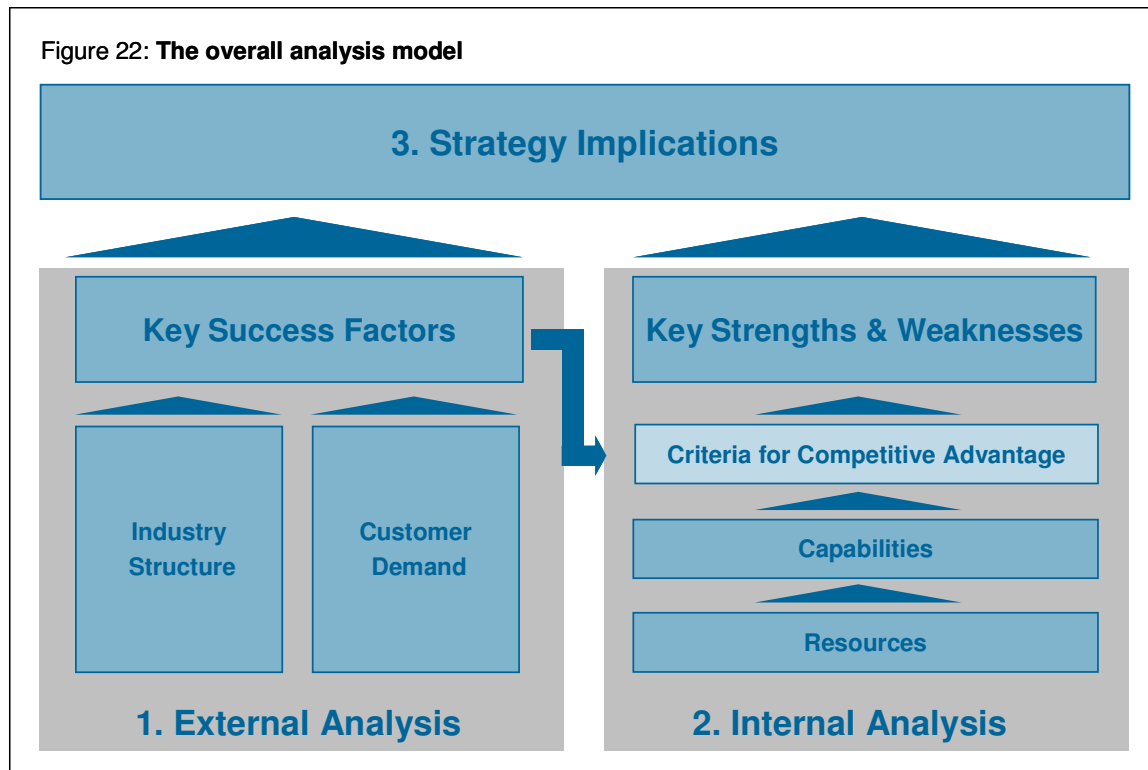
#### Purpose and research questions

The thesis has both a primary and a secondary purpose. The thesis starts off with the secondary purpose, which consists of creating a broad understanding of the manufacturing firms' internal and external environment. After that objective is completed, the resulting conclusions are used to fulfill the primary purpose, which is to develop a general strategy for the firms to improve their competitiveness. To fulfill the above motives the following research questions were chosen. The first three questions are linked to the secondary purpose and the last question to the primary purpose.

- What is the future profit potential in the industry?
- What factors determine success in the industry in the future?
- What are the firms' key strengths and weaknesses?
- How can the firms improve their competitiveness?

#### Theoretical Framework

The theories used in this thesis are gathered from the two main schools in the Strategic Management field, i.e. the Industrial Organization (IO) perspectives and the Resource Based Views (RBVs). According to several strategic management theorists (e.g. Foss 1996, Grant 2005, Quinn 1992, and Slack and Lewis 2002) it is crucial to have an understanding of both the firms' external and internal environment to develop a successful strategy. In the external environment IO theorists stress that the main aspect in strategy formulation is to analyze the industry's present and future structure, which in turn determines the profit potential of the industry (Porter 1980). In the internal environment RBVs theorists emphasize the importance of understanding firms' R&C determining the firms' performance (Barney 1991). By combining the two perspectives of strategy analysis I developed a model which has been used as the structural framework for my analysis (see Figure 22).



### Methodology

To fulfill the thesis purpose I have conducted a multiple case study including six companies at all stages in the SA C&T industry value chain. I have also performed eight interviews with industry informants. In addition, I have comprehensively studied previous reports on the SA C&T industry which have been the main source of the secondary data.

### Empirical Presentation

The empirical presentation partly fulfills the secondary purpose as it provides an understanding of the complex environment of the SA C&T industry in which the manufacturing firms exist. I have presented the main trends in the global C&T trade. The SA C&T industry has been comprehensively examined from the manufacturing firms' point of view. The focus has been to explain the manufacturing firms' situation and characteristics. The interviewees' strategy suggestions and future outlook of the industry have also been presented.

### Analysis

The analysis has followed the structure of the overall analysis model (see Figure 22). Part 1 (External Analysis) has investigated the firms' external environment by applying the empirical findings on Porter's (1980) Five Forces of Competition framework. The external analysis examined the present and future profit potential of the industry and identified the key factors for success in the coming years. Part 2 (Internal Analysis) has studied the firms' internal environment by identifying their key R&C which later were assessed against their relative strength and importance using Grant's (2005) criteria for competitive advantage. At this stage of the analysis the key success factors identified in

the external analysis fulfilled the purpose of partly determining the importance of the firms' R&C. From the resulting understandings of the external and internal analyses part 3 (Strategy Implications) propose a general strategy for the firms' to pursue as well as specific segments for them to target.

## **6.2 Summary of findings**

*In this section the main findings of the analysis are presented. I have chosen to divide the summary according to the thesis purpose and research questions. I will start with highlighting the secondary purpose by answering the first three set of research questions. By answering the last research question I shift focus towards the primary purpose of this thesis.*

### **6.2.1 What is the future profit potential in the industry?**

The potential for profits in the future seems likely to be notably different in export markets and the domestic market. In the export markets the profit potential will continue to be low and maybe even be reduced, especially in low value added segments. In the export markets there seems to be better opportunities for profits in supplying value added products and differentiated services, especially in the SMME segment where competition probably will be less intense. In the domestic market I believe that the potential for profits will most likely improve. There will presumably still be poor opportunities for profits in low value added segments but possibly fine opportunities in higher-end segments of the local market in the future.

### **6.2.2 Which factors determine success in the industry in the future?**

I have through analyzing future customer demand and the industry competition identified the following factors determining success in the industry in the future.

- Effective and flexible production.
- Quick and reliable distribution.
- Product development and innovation.
- Skills in support services.
- Access to local raw material.
- Strategic relationships.

### **6.2.3 What are the firms' key strengths and weaknesses?**

The firms' internal environment is remarkably uncompetitive because the firms have significantly more weaknesses than strengths. Some of the firms' key strengths are the firms' location in the domestic market and their reputation in the export markets. Examples of the firm's most obvious key weaknesses are the lack of skills, delivery performance, and dynamic capability. The firms' key strengths and weaknesses are all summarized in Table 11 below.

Table 11: The firms' key strengths and weaknesses

Key strengths	Key weaknesses
Location advantage in the domestic market Location advantage in the SSA market Overseas reputation Flexible in terms of changing between product runs Distribution channels in the EU and the US Access to low-skilled labor Conformance quality Cultural similarities with local customers Trade agreements (AGOA and EU-SA FTA)	Location for exports to the EU and the US Poor access to financial resources Reputation in domestic market Inflexible in terms of production capacity Distribution channels in domestic market Access to skilled labor Specification quality Delivery performance Management skills and advanced technical skills Relationship with domestic retailers Access to local raw material Knowledge about potential new export markets Productivity Technology Dynamic capability Organizational structure Motivation Production facilities

#### 6.2.4 How can the firms improve their competitiveness?

The firms' present competitive position is poor and comparable to Porter's (1980) *stuck in the middle* position. This means that the firms have neither successfully managed to pursue a focus strategy, differentiation strategy nor a low cost leadership strategy. For the firms' to improve their competitiveness I generally propose a *Focused Differentiation* strategy where the firms are suggested to *target four specific segments*. More specifically I recommend the firms to focus on supplying more complex and technical fabrics as well as producing differentiated products such as smart textiles, high fashion garments and sports wear equipment. I also propose that the firms should look at the possibility of offering support services, such as forecasting, designing, product development and logistics. The suggested strategic targets are summarized below:

- *Domestic Retailers*: This segment implies exclusively focusing on serving the domestic retailers.
- *Domestic Niche*: This segment refers to the niche customers in the domestic market who demand medium to high value added products and services.
- *Export Niche*: This segment implies focusing on middle and high-end customers in the firms' present export markets.
- *The SSA Market*: This segment suggests the firms to focus on a new export market, the SSA region.

### 6.3 Critical assessment of the findings

Due to the delimitations of the thesis some external factors have not been fully investigated, such as governmental actions, the general economic development in South Africa, the value of the Rand, and the HIV epidemic. These factors will likely have a

significant impact on the firms' chance of improving their competitiveness. Thus, the findings are based on a slightly simplified version of reality and are not completely valid. Nevertheless, I believe my findings are still of value because a number of important factors influencing the firms have been covered.

To provide the reader with a general and understandable picture I have also simplified a few aspects of the C&T industry. Firstly, I have reduced the different types of manufacturers, dividing the firms into two groups (Full C&T manufacturers and CMTs). The industry however, being as large and complex as it is, contains almost every single different type of manufacturer. The C&T supply chain has also been simplified only including three stages; suppliers, manufacturers and customers. In reality though, the value chain is vastly more complex and includes several other players. Even though some aspects of the industry are presented in a simplified way I believe I have correctly examined the main aspects of the SA C&T industry.

Further, a thorough analysis of the firms' international competitors would have provided a better understanding of the firms' situation. But due to resource limitations I have not conducted a comprehensive competitor analysis.

Another disadvantage of the study is that all of the case study firms are situated in one specific geographical area, namely the metropolitan area of Cape Town in the Western Cape Province. In reality, there are differences in wages and the manufacturers' characteristics between the metropolitan and urban areas and within the provinces in South Africa. Even though these differences exist I believe that my conclusions are on such a high general level that most of the findings are applicable on all provinces in SA.

It is also important to note that I have not performed case studies with manufacturing firms that are obviously uncompetitive. To manage this validity weakness I have used multiple sources of evidence. Except from the case studies performed with suppliers and buyers and prospering firms, I have conducted interviews with people that are well-informed about the manufacturing firms' general situation. The answers were notably also almost entirely unanimous which increases the significance of the findings.

Lastly, my conclusions and suggestions are on a general level and will naturally not represent all of the manufacturing firms in the SA C&T industry. However, because I have covered many different aspects of the manufacturers' internal and external environment, I believe that the findings correspond in some way to the vast majority of the manufacturing firms.

#### ***6.4 Suggestion for further research***

I have chosen one of several possible angles to study the SA C&T industry from. Below follows different perspectives to further investigate the manufacturing firms' situation, which I have reflected on during the writing of this thesis but goes beyond the scope of the thesis and/or that I have not had the resources to investigate any further.



This thesis provides some general suggestion for how the firms should meet the requirements of the proposed strategy. However, I have not in detail examined how the firms should realize the proposed strategy. Therefore I suggest further research on a more specific level on how the firms can implement the proposed strategy. From reviewing my findings there are several areas that I believe require further investigation. For example, I suggest studying how the manufacturing firms can improve their financial situation, how to secure skills in the industry, and how to increase the workers motivation. I also suggest further research on how the large domestic retail chains can help improve the manufacturers' situation. I further recommend research focusing on the different types of manufacturers. Are there other opportunities and threats for small CMTs than for large textile manufacturers?

As mentioned earlier one of the weaknesses of this thesis is that some factors in the firms' external environment are not fully analyzed. I thus suggest complementing my thesis with macro level research focusing on factors such as infrastructure, government actions, industry policies, HIV/AIDS, and currency fluctuations etc. Moreover, I suggest a comprehensive competitor analysis to fully understand the firms' competitive position.

I further suggest research comparing the SA industry to other successful C&T industries, which have gone through a similar path as the proposed strategy. Research like this would possibly further provide the manufacturing firms with ideas to improve their competitiveness. Sweden and Mauritius are two examples of C&T industries that have moved up the value chain. What can the SA C&T manufacturing firms learn from those industries?

One can also use other theoretical approaches to study the SA C&T industry. For example, one can take a network theory perspective and view the SA C&T industry on a higher level as a part of an Industrial Network and study what the options are for the industry as a whole to combat the challenges of the ongoing crisis. Furthermore, one can view the industry from a cluster theory perspective and investigate the industry's regional clusters and how they contribute to the overall competitiveness of the industry.

Lastly, I believe it would be interesting to do a parallel research in six to eight years from now to evaluate the changes that have occurred in the industry. A longitude study in this fashion may also provide some insight into the Strategic Management field and how well the IO perspectives and RBVs combined can be used to develop strategies in declining industries. Were my proposed strategy and the suggested strategic targets the correct ones? What has happened to the firms that adopted a change process, did they survive or not? Is it possible to change even though change is not a natural part of the firms' corporate values?

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## 8. Appendix

### ***A. Presentation of case companies***

#### **Firm 1. Large CMT – Retailer focus**

Firm 1 is a large CMT business and one of the industry's success stories. The firm manufactures products, such as outdoor wear, knitwear, intimate wear, exclusively for one specific retailer. The firm was founded by the present Managing Director with 6 employees in the 1980s. The Managing Director began his careers as a box packer in the manufacturing industry. He disagreed about how the workforce was treated and when he was 27 years old he got the chance to start his own manufacturing firm. The first year they grew from 6 to 26 workers. The MD introduced some unique structure benefits for his workers such as subsidising their school fees and providing tee and coffee. These benefits won the heart of the workers and created a unique culture of caring and sharing. Today 500 workers later none of the employees are unionized. The MD has re-engineered his business with the help experts from top German engineering schools. The firm is annually being benchmarked against the best manufacturers worldwide with the help of CCTC. Another factor for their success is significant investment in technology (especially IT) and continually upgrading equipment. Today Firm 1 is one of the most productive and flexible CMTs in SA. For example, an average CMT takes 3 weeks to deliver, Firm 1 deliver within 3-5 days.

#### **Firm 2. Small CMT – Hospitality industry focus**

Firm 2 is a small CMT business serving the hospitality industry in the Western Cape with high quality customized bed and table linens. The firm was founded by the Manager in 1994. During the first six years the products were manufactured at home in a space of 95 square meters. From the modest start up the firm began to flourish and reap the benefits in the past few years, landing some large bed and table linen orders from some prominent customers. The firm is now situated in a factory of 800 square meters and employs 16 workers. The annual turnover of the company is slowly increasing.

#### **Firm 3. Micro C&T manufacturer - Corporate focus**

Firm 3 is a new and vibrant upcoming company that focuses on corporate branding by supplying branded customized C&T products, for example branded corporate apparel. The firm was started by the Manager and her husband in 2004. Both founders have a background in the financial asset industry and thus spent 18 months doing research about the C&T industry as they did not have any previous knowledge about it. The reason why they started a firm in the C&T industry is because they felt that they needed to give back to society. The employees come from a background where they have been doing the same thing for years and not been able to build self confidence. In Firm 3 the workers are taught to perform several activities and the employees own a share in the business. The firm employs three fulltime workers and during demand peaks casual people assist them and sometimes production is outsourced to CMTs. The firm is slowly expanding and is today busy with doing an online catalogue.

**Fabric supplier**

The local fabric supplier is a knitting mill that has been running for more than two decades mainly supplying fabric to the fashion industry. The local fabric supplier has started to shift focus towards the industry's bulk sector, producing advanced textiles and industry textiles. The firm employs around 300 people and has a significant share of the South African market.

**Retailer 1**

Retailer 1 was founded is today one of leading retail chains store groups in South Africa. They sell a wide range of products including clothing, food, beauty, home ware and more under its own label. The Retailer 1 has stores nationwide and also distributes its products through franchise partners in Africa and the Middle East. Regarding the clothing products they focus on targeting fashionable, up-and-coming business men. The retailer is thriving thanks to a growing demand which has significantly increased its profits the last years.

**Retailer 2**

The company is also one of the leading retail chains store groups in South Africa. The company retails clothing, jewellery, cosmetics, sporting equipment and home wares to the broad middle income group throughout South Africa and in a few other African countries. The retailer has flourished over the last decade increasing its annual revenue substantially.

## ***B. Letter of Introduction***



Peter Grafström  
Student at Stockholm School of Economics  
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### **Letter of introduction**

South Africa, September 2007 – Mars 2008

My name is Peter Grafström and I am a student at the program for Management and Organization at Stockholm School of Economics, Sweden. I am in my final year of my master studies and currently conducting my Master Thesis. Financed by a scholarship from the Swedish International Development Cooperation Agency (Sida), a government agency responsible for Swedish Development Cooperation, I have been given the opportunity to do my thesis in Cape Town. I will study the South African clothing and textile industry. My supervisor in South Africa is Linda de Vries at the University of the Western Cape.

The purpose of my visit to South Africa is to get a greater understanding of the textile and clothing manufacturers' situation and also to observe what strategies the manufacturing firms are pursuing or would need to develop to improve their competitiveness.

My research method mainly consists of conducting six to eight case studies with manufacturers, raw material suppliers and retailers situated in the Cape Town area. When carrying out the different case studies my focus will be to interview key personal at management level, which will be about one to four employees in each company. To get a general understanding of the industry I will also interview key figures in industry's support organizations. Documentation and reports written about the industry will also be an important source of information.

I would appreciate any assistance that can be offered in the pursuit of my task.

Best Regards  
Peter Grafström

#### **Tutor, Sweden**

John Söderström  
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#### **Supervisor, South Africa**

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## ***C. Interview guides***

### **I. Guide for interviews with industry informants**

#### **Interviewee background**

Name:

Organization:

Title:

Years worked in the organization:

Education:

Age:

#### **What is the present and future profit potential in the industry?**

What are the opportunities for the manufacturers?

What are the threats for the manufacturers?

Which segments of the market do you believe the manufacturing firms should target?

How should the manufacturers compete in the domestic market?

How should the manufacturers compete in the export markets?

Which actors/companies do you regard as having the leading role and main influence in the industry?

#### **Which factors determine success in the industry in the future?**

What capabilities do the firms need to develop to be successful in the future?

#### **What are the firms' key strengths and weaknesses?**

What are the main challenges that the manufacturing firms are facing?

What are the advantages/disadvantages of C&T manufacturers to be located in South Africa?

What are the manufacturing firms' strengths?

What are the manufacturing firms' weaknesses?

#### **How can the firms improve their competitiveness?**

What strategies are the manufacturing firms pursuing today?

What strategies do you think the manufacturing firms need to pursue?

What is your view on the protection of clothing and textile manufacturers?

How do you think that the industry will develop in the coming six to eight years?



## **II. Guide for interviews with manufacturing firms**

### **Company information**

Company name:

Short description of the company:

Turnover:

People employed in the company:

Market share:

### **Interviewee background**

Name:

Company role:

Years worked in the company:

Education:

Age:

### **Company specific questions**

#### *General questions:*

How has the industry's current crisis affected your company?

How has the company developed over the last few years?

What factors are most important for your success? (Quality, Speed, Reliability, Flexibility and Cost)

What are the advantages/disadvantages of being located in South Africa?

What are the main reasons for the company to become a member of the Cape Clothing and Textile Cluster? What have been the results of being a member of the CCTC?

What do you regard as the company's strengths/weaknesses/opportunities/threats?

What is your company's goal?

What is your future business strategy?

#### *Customers:*

Who are your main customers?

Do you get any complaints from customers? If so, what do they usually complain about?

What do you think the customers value the most?

What will your customers demand in the future?

How do you keep yourself updated on customer demand?

How do you market yourself?

#### *Suppliers:*

What do you demand from your suppliers?

Who are your main suppliers?

What do you value the most with your suppliers?

#### *Competitors:*

What companies do you consider as your main competitors?

In what areas do you think that the company is better/poorer than your competitors?

### **III. Guide for interviews with suppliers**

#### **Company information**

Company name:

Short description of the company:

Turnover:

People employed in the company:

Market share:

#### **Interviewee background**

Name:

Company role:

Years worked in the company:

Education:

Age:

#### **Company specific questions**

##### *General questions:*

How has the industry's current crisis affected your company?

How has the company developed over the last few years?

What are the advantages/disadvantages of being located in South Africa?

What are the main reasons for the company to become a member of the Cape Clothing and Textile Cluster? What have been the results of being a member of the CCTC?

##### *Customers:*

Who are your main customers?

Do you get any complaints from customers? If so, what do they usually complain about?

What do you think the customers value the most?

What will your customers demand in the future?

How do you keep yourself updated on customer demand?

##### *Suppliers:*

What do you demand from your suppliers?

Who are your main suppliers?

What do you value the most with your suppliers?

##### *Competitors:*

What companies do you consider as your main competitors?

In what areas do you think that the company is better/poorer than its competitors?

## **IV. Guide for interviews with buyers**

### **Company information**

Company name:

Short description of the company:

Turnover:

People employed in the company:

Market share:

### **Interviewee background**

Name:

Company role:

Years worked in the company:

Education:

Age:

### **Company specific questions**

#### *General questions:*

What companies do you consider as your main competitors?

What are the advantages/disadvantages of being located in South Africa?

What are the main challenges in retail in the coming six to eight years?

What are the main reasons for the company to become a member of the Cape Clothing and Textile Cluster? What have been the results of being a member of the CCTC?

How can the company contribute to improve the competitiveness of South Africa's clothing and textile manufacturers?

#### *Customers:*

Who are your main customers?

Do you get any complaints from customers? If so, what do they usually complain about?

What do you think the customers value the most?

What will your customers demand in the future?

How do you keep yourself updated on customer demand?

#### *Suppliers:*

Who are your main suppliers?

What do you demand from your suppliers? (Quality, Speed, Reliability, Flexibility and Cost)

What performance do you value the most from your suppliers?

What are the reasons for importing from other countries than South Africa?

What type of products do you believe the company will source in the future?

#### *Competitors:*

What companies do you consider as your main competitors?

In what areas do you think that the company is better/poorer than its competitors?

## ***D. Industry support organizations***

### **CLOTEX**

CLOTEX is a sector specific local economic development agency operating in the C&T industry in the Western Cape in South Africa. Initially set up in 1994, CLOTEX's current role is to focus on increasing employment through the development needs of entrepreneurs operating small, medium and micro enterprises (SMMEs). For full profile of CLOTEX visit [www.clotex.co.za](http://www.clotex.co.za).

### **Centre for Chinese Studies**

The Centre for Chinese Studies (CCS) is the first institution devoted to the study of China in Sub-Saharan Africa. The centre promotes the exchange of knowledge, ideas and experiences between China and Africa. The center's main task is to evaluate China's developmental role in Africa that is felt in various capacities ranging from trade and investment to humanitarian assistance. For full profile of CCS visit [www.ccs.org.za](http://www.ccs.org.za).

### **Cape Clothing & Textile Cluster**

The Cape Clothing and Textile Cluster (CCTC) is a not-for-profit association of clothing, textile and CMT manufacturers. The cluster was founded in 2005 to bolster the competitiveness of the C&T industry. The cluster provides a platform for industry players to co-operate with one another to develop mutual competitive advantage, overcome generic problems and exploit joint opportunities. There are currently 40 members in the cluster including full C&T manufacturers, CMTs, raw material producers and some of the country's leading retailers. For more information on the CCTC visit [www.capeclothingcluster.org.za](http://www.capeclothingcluster.org.za).

### **Council for Scientific and Industrial Research**

The Council for Scientific and Industrial Research (CSIR) in South Africa is one of the leading scientific and technology research, development and implementation organizations in Africa. Partly funded by the Government it undertakes directed R&D for socio-economic growth. For full profile of CSIR visit [www.csir.co.za](http://www.csir.co.za).

### **South African Clothing and Textile Workers Union**

The South African Clothing and Textile Workers Union (SACTWU) is the biggest union in the C&T industry with more than 100 000 members. It is officially 18 years old even though it has roots in the early 1940s. SACTWU negotiates wages for the vast majority of the workers in the C&T industry and provides its members with funeral cover, health care fund and bursary fund. For more information on SACTWU visit [www.sactwu.org.za](http://www.sactwu.org.za).

### **Trade Law Centre for Southern Africa**

Trade Law Centre for Southern Africa (Tralac) is a not-for-profit organization that follows an interdisciplinary approach to building trade law and policy capacity in Southern and Eastern Africa in order to facilitate effective participation in the global economy. For full profile of Tralac visit [www.tralac.org](http://www.tralac.org).

## ***E. Policy Framework***

### **The African Growth and Opportunity Act**

The African Growth and Opportunity Act (AGOA) permits 37 SSA countries to export their products to the US without incurring import duties or quota restrictions (Salm 2002). In order for SA firms to gain access to the opportunities provided by AGOA they must fulfill the Rules of Origins (ROO) requirements. The ROO require the yarn and fabric to be produced locally or to be sourced from the US. The end product must be assembled in SA. (Barnes 2005). AGOA runs out in 2010 (Salm 2002).

### **SA-EU Free Trade Agreement**

The SA-EU Free Trade Agreement (SA-EU FTA) provides SA firms with the opportunity to export products to EU countries without incurring import duties. The ROO requirements are less, compared to the AGOA, as the SA-EU FTA only require the fabric to be regionally sourced. Thus, the yarn can be imported from any location. The product must however be assembled in SA to comply with the requirements (Salm 2002).

### **The Duty Credit Certificate Scheme**

The Duty Credit Certificate Scheme (DCCS) was designed with the purpose of encouraging firms to become export oriented by allowing firms to claim a remission on duties paid on imported material used for export purposes (Gibbon 2002). The DCCS has not been a successful export instrument because the certificates issued have not been used for their initial purpose. The duty credit certificates have in the majority of cases been sold at a discount to SA retailers which the retailers have used to import garments at a lower cost, thus consequently reducing the demand for locally produced products (Barnes 2005). The DCCS expired in 2005 and yet no other similar export instrument exists (Harztenberg).