

Apparel

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There are no meaningful barriers to productivity growth in this, one of the biggest industries in the Turkish economy. Operators have evolved to create an effective original equipment manufacturer (OEM) segment that has helped triple apparel exports in the past decade - apparel now accounts for more than 20 percent of Turkey's total export volumes. As, or more, significant, Turkey has become the biggest non-EU apparel exporter to EU countries, securing an important role in one of the most demanding apparel markets in the world. Manufacturers have managed this in part by controlling the input side of the productivity equation – principally labor - increasingly effectively. The shortfalls that still exist appear mainly to be a function of priorities, not of barriers, as Turkish operators focus mainly on immediate volume growth opportunities. However, there is substantial potential for productivity growth through successfully managing the output side of the equation – that is, creating greater value-added by creating more brand equity to a “Made In Turkey” image. In this respect there may be a role for government to assist the industry.

Following trade liberalization in the 1980s, the era of rapid growth in apparel began. Beyond liberalization within Turkey, several other factors also contributed to expansion. First, Turkey benefited from the migratory nature of the apparel industry, characterized by rapid shifts of production across regions/countries in search of the lowest-cost labor. Proximity to major markets, in particular the EU, also bolstered growth. Finally, after the collapse of the Soviet Union and the resulting trade liberalization in ex-Soviet and Central and Eastern European countries, demand from these markets helped to boost Turkish exports.

It is a global business and global rules dictate the results for Turkish manufacturers. First, the apparel value chain is a buyer-driven commodity system. Second, distribution of value among the various players in the chain is determined by the contribution each makes to the brand equity of the final product sold. Put another way, the less skilled an operator is beyond handcrafts (e.g. sewing), the less value it captures in the global value chain. An OEM that can create a good replica from a design created elsewhere captures more value than an assembler (façon); however, an original design manufacturer (ODM), which can create and offer new designs to distributors, captures yet more value than the OEM, and an original brand manufacturer (OBM), selling its own brands, captures more again. Turkey has evolved to the OEM stage, with a few pioneer ODMs.

The benchmark for Turkey's aspirations should be Italy, where many successful ODMs and OBMs operate and where the art of creating superior brand equity that

is reflected in output value-added has been raised probably higher than anywhere in the world. And, in terms of physical productivity, Turkey is performing quite well compared to Italy. Its OEMs and the few ODMs benchmark at about 70-75 percent of their potential in terms of physical output. However, Italian producers create from 10 percent (OEMs) to as much as 25 percent (ODMs) further value-added through the fact that: a) their products are, in any event, Made In Italy; b) at the highest rung of the ladder, OBMs can design products for their own distribution that command the highest prices.

It is the absence of a Made In Turkey equivalent that might most stand between Turkish manufacturers and the achievements of their Italian counterparts. Yes, physical productivity is still below Italian standards, but there are no barriers to lifting it and the skills are there to do so once it becomes a priority for continued export growth (informality is prevalent in Turkish apparel, mainly at the *façon* level but, since all upstream functions are outsourced by OEMs/ODMs to the *façons*, it does not create a non-level playing field within Turkey itself). In fact, neither are there specific barriers to development of Made in Turkey value-added, and many buyers for sophisticated global apparel retailers would welcome just such an occurrence.

At this point, the only relevant question for policymakers is, “Is there a role for the government in assisting the industry to enhance the value of the Made In Turkey label?” There are examples on both sides of the debate: In the Portuguese shoe industry, the industry has made major strides on its own; in Hong Kong, the government has taken a leading role in raising the profile of its apparel industry. Either might be right for Turkey, but so far there have only been fragmented efforts, none of which has had major impact to date. The potential is clear, efforts from here should be restarted with a thorough and comprehensive program to align objectives and define roles and responsibilities.

The rest of this chapter discusses these topics in detail:

- ¶ Industry overview
- ¶ Productivity performance
- ¶ Operational reasons for productivity gap
- ¶ Industry dynamics and external factors affecting productivity
- ¶ Policy recommendations and implications.

INDUSTRY OVERVIEW

Apparel is one of the biggest industries in the Turkish economy, accounting roughly for 3 to 5 percent of GDP. Total production including unrecorded production¹ reaches US \$14 billion to \$20 billion. The resulting employment in the sector is also large, occupying 5 to 10 percent of Turkey's labor force according to industry experts (Exhibit 1).

Rapid growth in production has been fueled by export opportunities around the world, especially to the European Union (EU). After Turkey's foreign exchange liberalization and following the transition to an export-driven growth model in the first half of the 1980s, apparel exports tripled within 10 years – going from US \$2.1 billion in 1989 to US \$6.5 billion in 1999, and accounting for 23 percent of total exports. These export figures do not include the unrecorded exports, which boomed after the collapse of the Soviet Union and the resulting trade liberalization in the ex-Soviet and Central and Eastern European countries. With no accurate calculation or recording, these unrecorded exports are estimated to have reached US \$10 billion before the 1999 Russian crisis and still constitute a significant amount (Exhibit 2). Yet even without the unrecorded exports, Turkey is the biggest non-EU apparel exporter to the EU; worldwide it ranks sixth after China/Hong Kong, Italy, the US, Mexico, and Germany with 3 percent of global apparel exports (Exhibit 3).

The global apparel industry is composed of a large number of participant segments, each of which creates and captures value in different ways. The relationships among players govern each country's role in the industry, so it is important to fit Turkey's activities into a clear taxonomy for the sector. We do this in the remainder of this chapter by elaborating upon the global industry structure under the following headings:

- ¶ **Product segmentation** – the industry from the point of view of the physical product, in turn viewed from two different angles: price-based segmentation and segmentation according to fashion responsiveness.
- ¶ **The global apparel value chain** (fast-moving items) – understanding the nature of vertical integration within that portion of industry that represents Turkey's future market opportunities by viewing it through two lenses: the nature of brand ownership and the distribution of market power, and segmentation of manufacturers.
- ¶ **The Turkish apparel sector's position in the global value chain** – characterization of where Turkey currently fits in the value chain

¹ Production value that is not reported in formal company books.

Exhibit 1

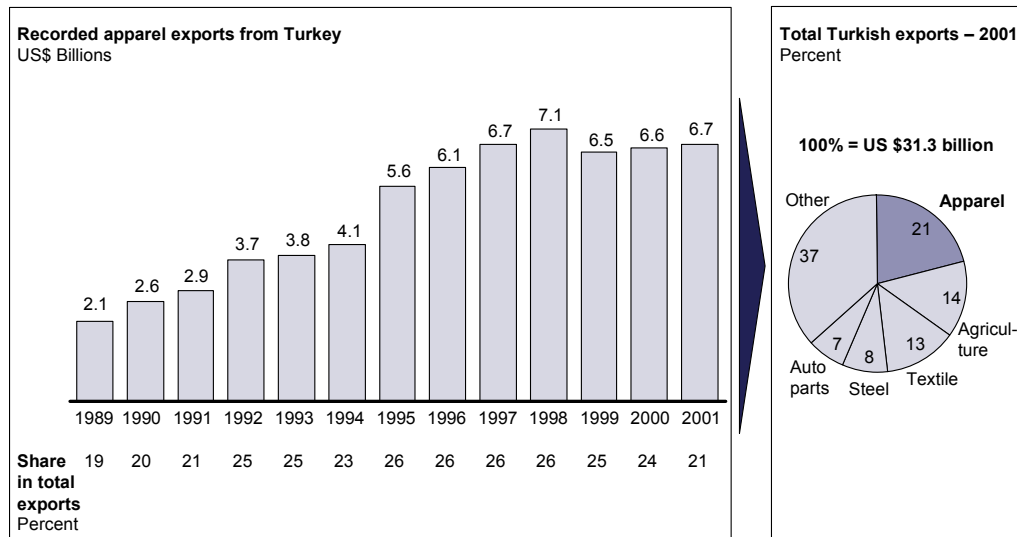
APPAREL SECTOR – SIZE AND SHARE OF EMPLOYMENT



* 70% of domestic is exported as cut parts for assembly to CBI, Mexico, and Colombia
 ** Based on expert estimates
 *** Based on input/output (value add) ratio of 39% calculated by State Institute of Statistics
 Source: Country sources; UN International Trade Statistics; Turkish Parliament Textile Commission report

Exhibit 2

APPAREL IN TURKISH EXPORTS

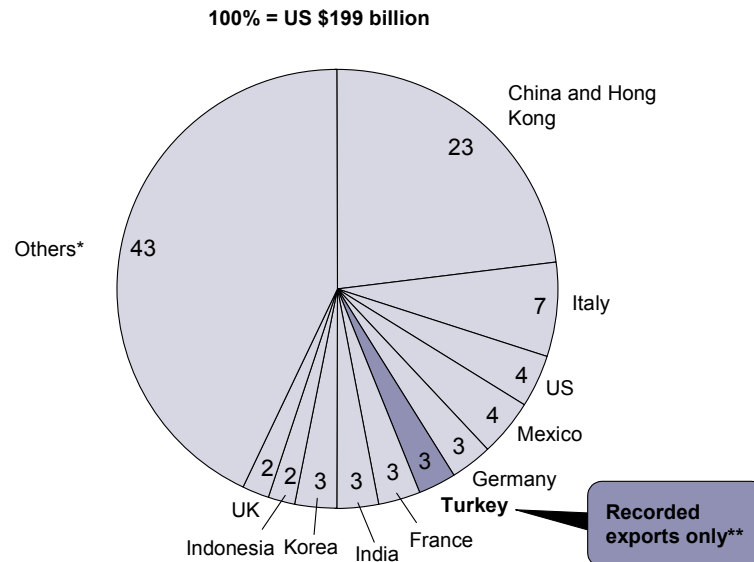


Source: Treasury; Foreign Trade Directorate

Exhibit 3

TURKEY'S SHARE IN WORLDWIDE APPAREL EXPORTS – 2000

Percent



* All the countries in the "other" category have less than 2% share of the market

** Does not include the cross-border exports to ex-Soviet and CEE countries

Source: World Trade Organization international trade statistics

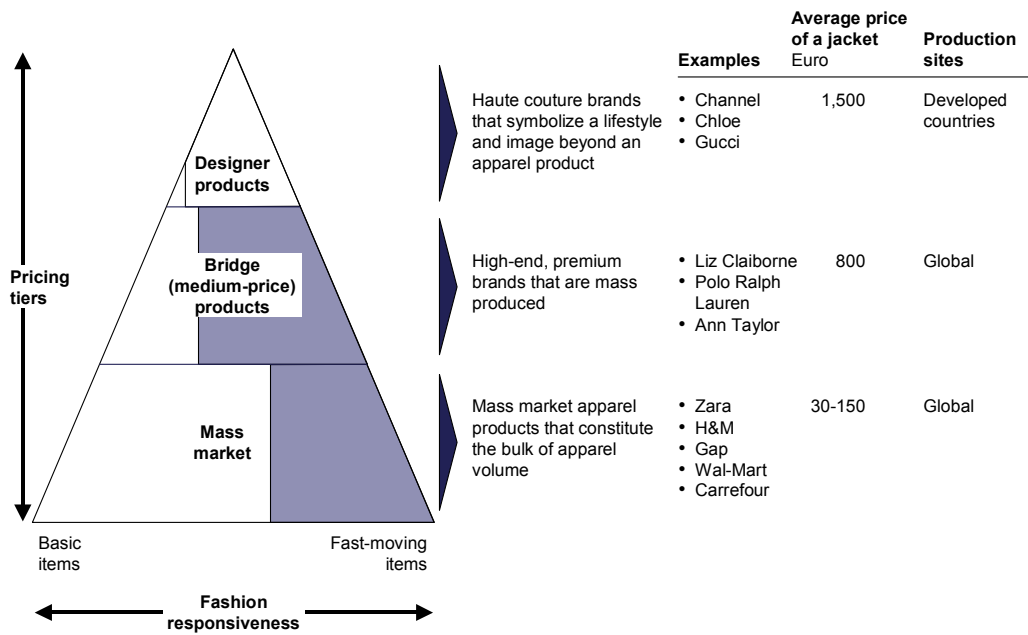
Product segmentation

Pricing is a clear differentiating element in apparel. Working with experts in this sector, both in Turkey and abroad, we have identified three price-based product clusters:

- ¶ **Designer.** These are the upscale, haute couture brands such as Chanel, Gucci, and Chloe that symbolize a lifestyle and image that go beyond just the characteristics of the product itself. As a pricing benchmark, the average price of a jacket is around 1,500 euros. These products are usually manufactured in developed countries for two reasons. One is that consumers take production in these countries as a sign of higher quality. And the other, the higher production cost is an insignificant portion of the selling price.
- ¶ **Bridge.** Still located at the high end of pricing, with the average price of a jacket at about 800 euros, these are premium brands that are mass produced. Examples include Liz Claiborne and Polo Ralph Lauren. Production is globally sourced with quality being the major buying criteria.

Exhibit 4

SEGMENTATION OF APPAREL PRODUCTS



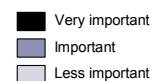
Source: Interviews, MGI analysis

¶ **Mass market.** The mass market constitutes the bulk of global apparel volume. There are several pricing layers, ranging from Zara, H&M, and Gap at the upper end, to the private labels of Wal-Mart and Carrefour at the bottom end. The average price of a jacket ranges from 30 to 150 euros. Sourcing is truly global as players search for the lowest production cost (Exhibit 4).

Fashion responsiveness – i.e., the extent to which changing trends dictate product changes – is the other axis that defines apparel product segments. At the extremes there are two such segments:

¶ **Basic items.** Constituting 70 percent of worldwide export markets, these are the basic products for which consumer demand can be easily and accurately forecast in advance, enabling large lot sizes and long lead times for production. As a result, scale is key in production. There are no major workforce qualifications required and cost is the primary criterion for supplier selection. As a working estimate, 30 percent of Turkish exports can be classified under this category.

Exhibit 5
SEGMENTATION OF FASHION RESPONSIVENESS IN APPAREL PRODUCTS



	Description	Size in worldwide export markets*	Size in Turkey's export**	Relative importance of buying factors
Basic items	<ul style="list-style-type: none"> Consumer demand can be forecast accurately in advance Supplier orders can be placed in big lots and with long lead times before the season starts There is little lead-time sensitivity and cost is the number one determinant for supplier selection Does not require qualified workforce Production scale is key 	~70%	~30% of total exports (~90% of exports to US and ~20% of exports to EU)	
Fast-moving items	<ul style="list-style-type: none"> Consumer demand is very difficult to forecast Orders are placed in small lots according to sales trends within the season There is high lead-time and quality/design sensitivity as a result of concerns for optimized stock levels and minimized unsold items Qualified workforce required Flexible production capabilities are key 	~30%	~70% of total exports (~10% of exports to US and ~80% of exports to EU)	

* With the assumption that items with fluctuating demand would be supplied from countries nearby offering shorter lead time. Assumption is based on the expert view and calculation is made by using World Trade Organization figures

** Based on expert views

Source: World Trade Organization; interviews, MGI analysis

¶ **Fast-moving items.** Constituting the remaining 30 percent of world export markets, these are the fashion-driven items for which consumer demand cannot be forecasted accurately, and for which orders can only be placed when sales trends are realized. Therefore, short lead time is the key criterion for supplier selection. For manufacturers, flexibility in production and the availability of a qualified workforce are key requirements to operate in this segment (Exhibit 5).

To summarize the dynamics between the two types of segments: fashion responsiveness tends to fall as prices fall. Almost all designer and bridge brands fall into the fast-moving category. Within the mass market, the share of fast-moving items increases as prices increase.

For our sector study, we have focused on the fast-moving items in the bridge and mass market price tiers. These items represent a large and growing part of the Turkish apparel sector today (70 percent of total exports). More importantly, they represent the only part of the industry in which Turkey will be able to operate sustainably in the future as countries with dramatically lower labor costs dominate the basic items segment of the market. Given the relatively high average formal hourly labor costs (US \$ 0.91) in Turkey versus less-developed countries such as India (US \$ 0.38), China (US \$ 0.63), or Romania (US \$ 0.87), Turkey does not have a sustainable position in this segment. However, in the fast-moving items segment, where manufacturing site selection criteria reflect capabilities beyond cheap labor, Turkey has a greater chance to build a sustainable position. Thus, in

the rest of the chapter we elaborate on the fast-moving items segment, choosing Italy as the benchmark since it is the leading country in this segment.

Global apparel value chain (fast-moving items)

The global apparel value chain is buyer-driven – with retailers and branded marketers, rather than manufacturers, playing the leading roles. Leading players in the chain have four core competencies: understanding end-user preferences; designing products and creating a collection that reflects the appropriate brand characteristics; forming cost-efficient, global sourcing networks; and marketing the finished products with the right distribution plan.

The chain is vertically disintegrated, one in which leading players are positioned close to the end-user market. They focus on the front end (designing and planning) and the back end (marketing and retailing) in line with their core competencies, and outsource production to less-developed countries with abundant, inexpensive labor.

Since the core competencies of successful players include a major element of branding and marketing, it is important to understand the nature of brand ownership and product design direction setting in this market. From a branding standpoint, there are three main categories of players for fast-moving items:

- ¶ **Retailers.** These players have retail brand names that are represented in the shopping experience they provide their customers and are reflected in their product portfolios and location designs. Retailers consume 50 percent of the total apparel exports in Europe. They offer private, branded apparel products carrying others' brand names (see OBMs below) in addition to private labels for which they leverage their own retail brand name (e.g., Altimod brand of Çarşı). Examples include Saks Fifth Avenue, UPIM, and Çarşı (Exhibit 6).
- ¶ **Original brand manufacturers (OBMs).** OBMs own a private brand name through which certain values and/or lifestyle perceptions are attached to the physical products they produce. They may manufacture part of their own production volume, but their main source of profits is branding and marketing. They provide the design to the manufacturer to be reproduced. Examples include Levi's, Zara, and Gap.
- ¶ **Branded marketers.** Branded marketers are similar to OBMs in that they derive value from a private brand name. The key difference between the two types of players lies in the origin of the brand. Branded marketers leverage a brand name built outside of apparel (e.g., Reebok, Nike), while OBMs are known primarily and originally for their apparel brands.

Exhibit 6

ORGANIZATION OF THE APPAREL VALUE CHAIN

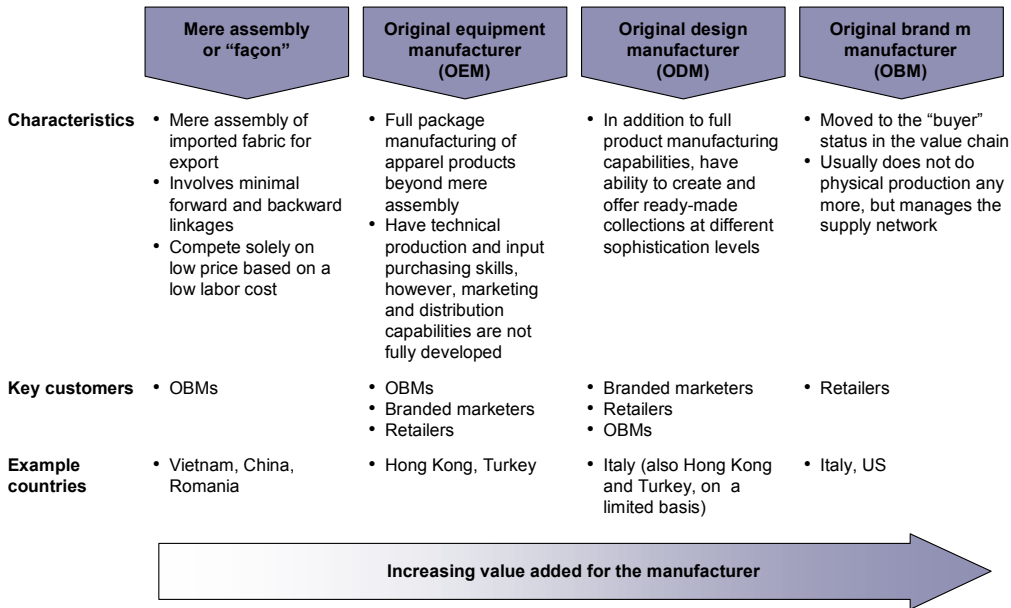
Buyers	Production characteristics	Examples	Share of apparel imports in Europe Percent
Retailers	<ul style="list-style-type: none"> Prefer to buy ready-made designs consistent with their retail brand equity For cost reasons, also sub-contract part of the production of the ready-made design to cheaper-labor countries 	<ul style="list-style-type: none"> JC Penney UPIM Çarşı Wal-Mart 	~50
Original brand manufacturers	<ul style="list-style-type: none"> Still perform part of production but main source of business is marketing and sale of the private brand name Usually supply fabric and accessories for assembly to extensive network of suppliers 	<ul style="list-style-type: none"> Levi's DKNY Zara Gap 	~30
Branded marketers	<ul style="list-style-type: none"> Focus on marketing of a private brand name Buy ready-made designs consistent with the private brand name equity, sometimes also give design support 	<ul style="list-style-type: none"> Liz Claiborne Reebok 	~20

Source: G. Greffi, "International Trade and Industrial Upgrading in the Apparel Commodity Chain," 1999; E. J. Lee, "Export Positions in the Apparel Commodity Chain and Product Import Values," 2001

Product supply segmentation can best be understood in terms of the extent to which a player contributes to the value added of the final end product (including product design and branding). There are four types of players in the production of finished goods:

- ¶ **Simple assemblers (façon).** These manufacturers only sew the cut fabric parts provided by the buyer, with minimal forward and backward linkages. They are able to contribute only to some part of the physical production of the product and, therefore, are able only to serve other players in the value chain, who dictate the price. Low cost of labor is the key success factor for these manufacturers.
- ¶ **Original equipment manufacturers (OEMs).** These manufacturers have the ability to produce a replica of a given sample product. They have technical skills to produce the product, purchasing skills to organize the upstream, and the financial strength to purchase raw materials. Therefore, OEMs are able to deliver the whole physical production. Primarily OBMs, but also branded marketers and retailers, are the clients who provide OEMs with design samples to manufacturer on their behalf.

Exhibit 7
SEGMENTATION OF PLAYERS IN THE APPAREL PRODUCTION VALUE CHAIN



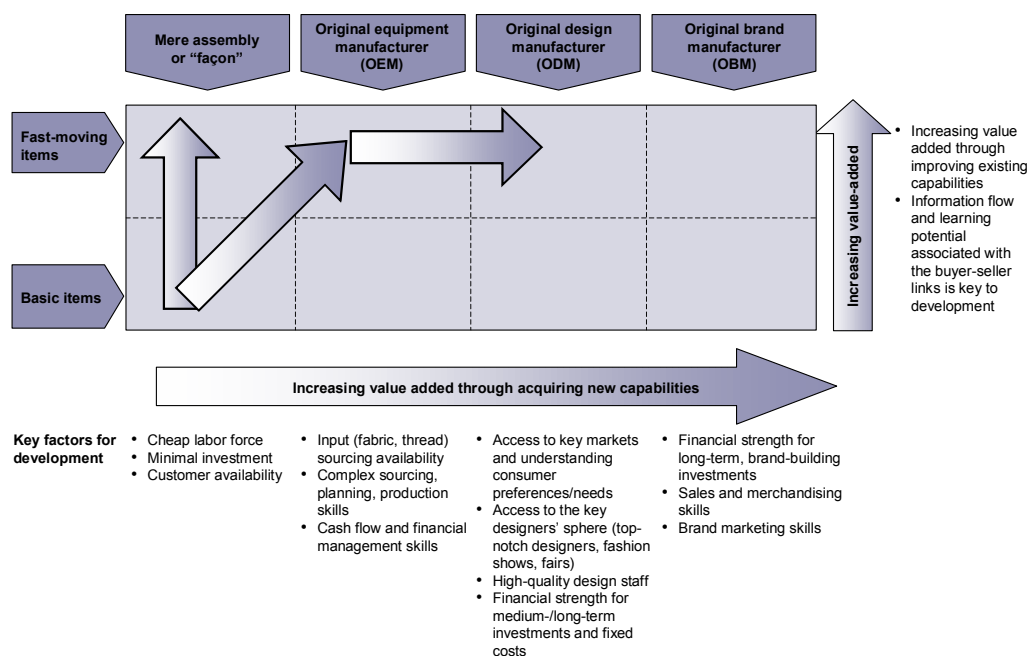
Source: G. Greffi, "International Trade and Industrial Upgrading in the Apparel Commodity Chain," 1999; interviews; MGI analysis

¶ **Original design manufacturers (ODMs).** These are OEMs that have the capabilities to contribute not only to physical production, but also to branding by developing designs that reflect the values of the private brand names they serve. They are capable of offering ready-made collections to buyers, which include retailers, branded marketers, and to a lesser extent OBMs.

¶ **Original brand manufacturers (OBMs).** This is the group that is already transformed into "buyer" status as discussed above. They combine their manufacturing capabilities with a private brand name. They are moving out of production, focusing instead on design and marketing/retailing, in which the value added that is created is disproportionately high compared to their levels of physical production (Exhibit 7).

In the global value chain, manufacturers can increase their share of value-added in two ways. They can move from producing basic items to fast-moving items, or they can move up the skill ladder from mere assembly toward becoming an OBM (Exhibit 8).

Exhibit 8

INCREASING VALUE ADDED IN APPAREL

Source: Interviews; MGI analysis

The Turkish apparel sector in the global value chain

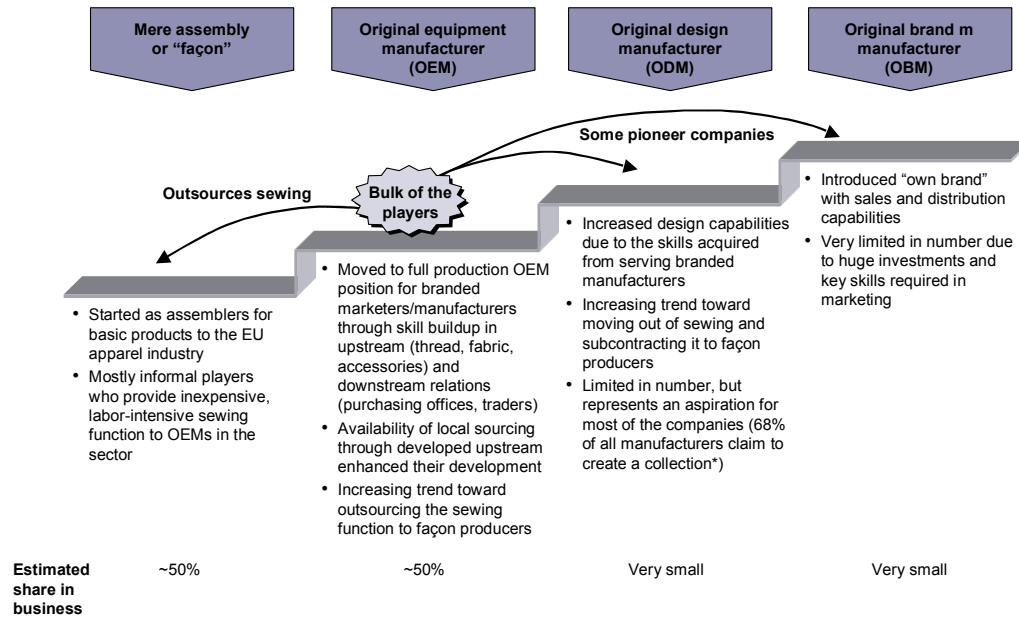
The Turkish apparel sector is currently dominated by OEMs linked to global buyers, and by façon producers, to whom the OEMs outsource assembly. Historically, the Turkish industry started by providing assembly services to the nearby European markets. However, OEMs developed rapidly through upstream skill buildup. Growing out of the OEM position, with skills acquired by serving branded manufacturers, there are also pioneer ODMs and OBMs in Turkey. Though limited in number, these pioneers represent a vision for others to follow (Exhibit 9).

PRODUCTIVITY PERFORMANCE

In the apparel sector, we have identified productivity as *value added that is created per hour worked*. Value added is defined as sales price to buyer minus cost of raw materials (fabric, accessories and thread). We did not make a purchasing power parity (PPP) adjustment, because of the global nature of the sector with majority of production being exported.

Exhibit 9

DEVELOPMENT OF TURKEY'S APPAREL SECTOR



* State Planning Organization survey
 Source: Interviews; State Planning Organization; MGI analysis

The relationship between value added created and physical productivity (time required to manufacture a unit of apparel) is important to understanding overall productivity in the sector. For example, drawing on the information in the previous section, a women’s jacket may retail for as much as US \$800 (ignoring haute couture) or for as little as US \$30 in a developed market: a difference as great as 25 times. However, even the least efficient ODM or OBM would not take nearly 25 times as long to produce an \$800 finished jacket as an OEM/façon would take to produce a \$30 jacket. Therefore, the greater the brand value that can be built into the jacket, the greater the productivity will be, almost regardless of the number of hours required.

Benchmarking productivity in this sector poses several challenges not found in other sectors:

- ¶ Productivity has to be measured on individual products since sector-wide productivity is not possible to aggregate, given the huge variety and differences among products. Our study benchmarks a fast-moving type of trouser because of the importance of that product to Turkish exports, and the relative sophistication required in the production.
- ¶ As most of the companies produce different types of products in a single manufacturing unit, production is usually organized in terms of order lots in this sector, rather than continuous monthly production plans. And, in terms of benchmarking duration, in most cases a representative order lot is measured.

- ¶ The benchmarks from Italy have to be created, as there are no readily available data as defined in the two points above. The importance of choosing Italy as the benchmark country reflects the importance of value added in overall productivity calculations. Italy enjoys unsurpassed leadership in value-added creation, especially within the context of fast-moving products.

As Exhibit 10 demonstrates, on a like-for-like basis Turkey benchmarks fairly well versus its Italian counterparts. The productivity of Turkish OEMs indexes at 70 percent of Italian OEMs, while the productivity of Turkish ODMs indexes at 75 percent of their Italian counterparts.

As important, however, is how a Turkish OEM benchmarks against an Italian ODM. Since both types of players participate to about the same extent in the physical production of an apparel product, the difference in productivity will be attributable not just to differences in physical productivity, but also to differences in the way an ODM is able to command additional value added.

The OEM-ODM comparisons are instructive of this difference in value added: Turkish OEMs index only at about 60 percent of Italian ODM levels (Exhibit 11).

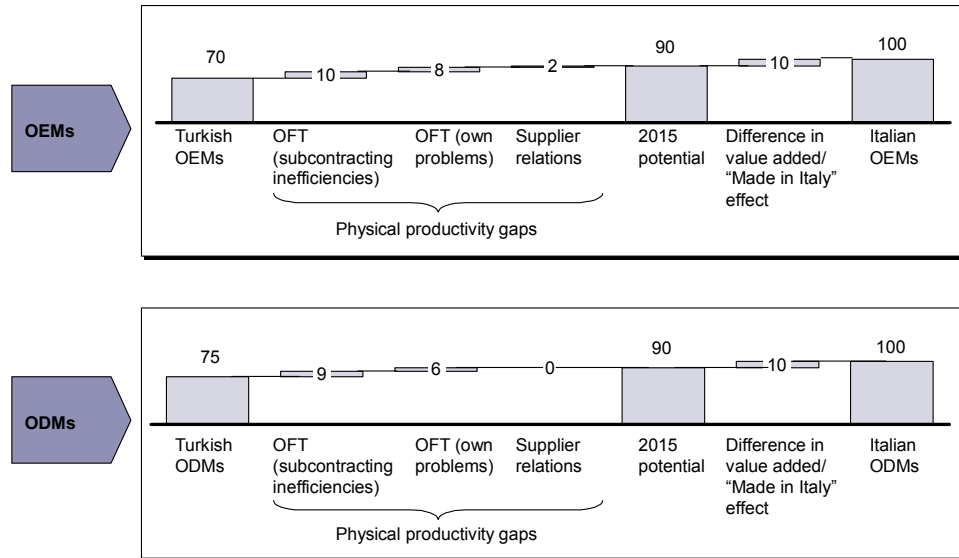
OPERATIONAL REASONS FOR PRODUCTIVITY GAP

To better delineate the operational factors causing the productivity gaps, we have divided the gaps into two categories: segment-to-segment productivity gaps and cross-segment productivity gaps. The first category focuses on operational reasons for productivity differences between OEMs/ODMs in Turkey and OEMs/ODMs in Italy; the second category focuses on operational reasons for differences between OEMs in Turkey and ODMs in Italy.

Segment-to-segment

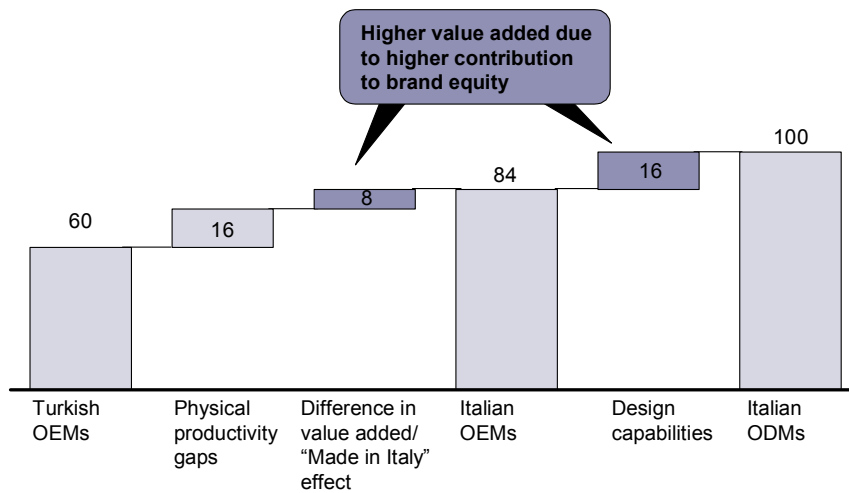
In a like-for-like comparison of productivity for both OEMs and ODMs, two major reasons for the productivity gap stand out: physical productivity shortfalls and gaps attributable to “Made in Italy” brand equity. The sector has the potential to close physical productivity gaps; however the closure of the value-added gaps is substantially more demanding and may require an effective combination of private sector and state initiatives.

Exhibit 10
APPAREL LABOR PRODUCTIVITY AND OPERATIONAL GAPS – SEGMENT-TO-SEGMENT
 Indexed, Italy (2002) = 100



Source: Interviews; Incon; MGI analysis

Exhibit 11
APPAREL LABOR PRODUCTIVITY AND OPERATIONAL GAPS – TURKISH OEMs VS. ITALIAN ODMs
 Indexed, Italy (2002) = 100



Source: Interviews; Incon; MGI analysis

Exhibit 12

INCREASING PHYSICAL PRODUCTIVITY – OFT

● Very developed
○ Undeveloped

Area	Best-in-class features	Italian OEMs	Turkish OEMs	Turkish faon
Production planning (workflow)	<ul style="list-style-type: none"> Fluent flow of production Bottleneck management Adjustment of the production plan every 2 hours for irregularities Control of all regular non-production times (e.g., time spent in restrooms, smoking, breaks) Tracking of productivity by activity timekeeping 			
Workspace design	<ul style="list-style-type: none"> Single-layer working environment Design allowing a perfect transmission of completed parts between operators No non-productive staff in production layer e.g., "ortaci" 			
Production planning (organization of upstream)	<ul style="list-style-type: none"> Effective material purchasing planning ensuring no stopover Understanding and planning around supplier lead times Consistent on-time deliveries 			n/a*
Employee training and continuity	<ul style="list-style-type: none"> Attain highly-qualified employees through dedicated training and build skills through continuity Cross-training of employees for multi-tasking to avoid idle time 			
Performance tracking and supervision	<ul style="list-style-type: none"> Continuous tracking of performance vs. targets Compensation management based on production performance 			

* Not relevant as OEM manages the upstream for faon producers

Source: Interviews; site visits

Physical productivity gaps

Overwhelmingly, the organization of functions and tasks (OFT) is the greatest source of physical productivity shortfalls in Turkey versus Italy. Notably, OFT issues take two forms: OFT issues that faon producers transmit to OEMs as subcontracting inefficiencies and OFT issues at the OEM/ODM itself. However, the causes and implications are similar for each.

Apparel production is a very labor-intensive sector, in which operators are closely linked to each other so that each individual operator directly influences the total productivity of the team as a whole. As a result, the organization of the operator network is as critical as individual operator productivity. All Turkish producers tend to have similar deficiencies as they provide the same function in terms of physical productivity, but ODMs perform slightly better and faon producers relatively worse. There are several sources of Turkey's relative weakness, as summarized below and in Exhibit 12.

- ¶ **Production planning at work flow.** Fluent, dynamic, and proactive production planning with standard timings for each operation is not a typical factory working arrangement in Turkey. Rather, an irregular flow with varying operator speeds and resulting bottlenecks is common. This irregularity creates productivity losses, as some operators have to wait for the bottleneck to be solved or synchronize at the lower speed.

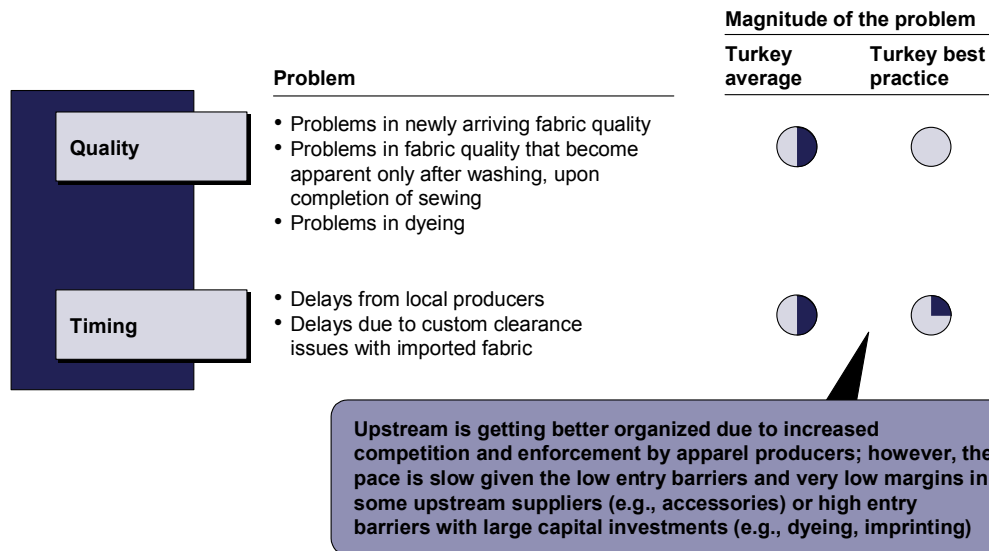
- ¶ **Workspace design.** One of the most important factors in ensuring fluent production flow is optimal workspace design. Optimal workspace design minimizes unproductive time (e.g., bending and taking the piece for sewing or transmitting the product to the next operator) throughout the production line. But optimal workspace design is not the case in Turkey. To overcome its deficiencies in physical arrangement, the industry uses a system, called “ortacı,” in which a cadre is employed only to carry products between operators. The workplaces themselves, especially for *façon* producers, further complicate the design issues, since they usually are located in the basements of apartments in multi-layered formats.
- ¶ **Production planning in terms of organizing the upstream.** Effective planning of the upstream for continuous production enables efficient production planning for apparel producers on a weekly/monthly basis. In Turkey, however, because they are so concerned not to lose an order due to delivery time, apparel producers often commit to deadlines that are not realistic from an upstream point of view. This inevitably creates delays not only in the start of production but also in delivery to the buyer. As a result, Turkish exporters have developed a reputation for delays in delivery. Similar problems are also observed in Italy, because of the characteristics of the fast-moving segment.
- ¶ **Employee training/motivation and continuity.** Attaining highly qualified employees through dedicated training, and achieving skill buildup through continuity are the two key enhancers of operator productivity. In Turkey, employee continuity is especially a problem for *façon* producers, who experience high turnover and absenteeism among their workers. In Italy, these problems are usually cured through multi-tasking and cross-training (indeed, almost everywhere in the world apparel workers are generalists). In Turkey, however, they are classified with specific skills like “overlokçu²” or “reçmeci³” On one hand, this classification process increases skills specialization, but on the other it creates inflexibility for total production.
- ¶ **Performance tracking and supervision.** Performance tracking and supervision to ensure high operator productivity is developing in Turkey. This is true especially among OEMs, where compensation is largely tied to output and performance is closely measured accordingly. Rigid labor laws and unions in Italy do not allow tying compensation to output, creating an advantage for Turkish players.

² Workers who stitch the finished pieces such as lapels and arms to main body

³ Workers who do the hemming

Exhibit 13
**PROBLEMS IN UPSTREAM SUPPLIERS
 IN TURKISH APPAREL SECTOR**

- Stops production
- ◐ Productivity decreases
- Does not affect production

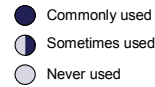


Source: Interviews

Weaknesses and issues in the upstream sectors contribute the balance of the physical productivity gap. As discussed, some of the upstream problems are attributable to misplanning by OEMs. However, some of the delays in upstream delivery are also attributable to quality problems in the upstream itself. Problems in fabric quality, dyeing, and imprinting, or delays in delivery all distort production scheduling for apparel manufacturers. It should be noted that the magnitude of these problems is significantly smaller among ODMs in Turkey, as upstream suppliers cannot afford to jeopardize their relationships with these best practice players (Exhibit 13).

Interestingly, the effective application of technology is not a problem in the Turkish apparel sector. Advanced technology is readily apparent. The machines are relatively new (old Turkish machines are transferred to Balkan countries or Central Asia after being dismantled in Turkey) and specialized technology such as automatic pocket assemblers and finishing robotics is used (Exhibit 14). Even the technology at façon producers is sufficient, as these producers are often supported by the OEMs for which they work.

Exhibit 14
**COMPARISON OF USE OF TECHNOLOGY IN THE
 TURKISH AND ITALIAN APPAREL SECTORS**



Purpose	Description	Turkey OEMs	Italy OEMs
Marking	• Computers determine optimum arrangement of pattern pieces	●	●
Spreading	• Automatic spreading of fabric for cutting	●	●
Cutting	• Electronic copies of layouts are sent to computer-controlled cutting machines	◐	◐
Specialized sewing	• Automatic pocket assembler • Loop setter	●	●
Automatic body press	• Presses garment in one step	◐	◐
Stain removal	• System of compressed air, steam, and solvents	●	●
Quality control	• Needle detection machine	◐	n/a*

* Mostly relevant for UK customers (especially Marks&Spencer)
 Source: Interviews; site visits

Productivity gap attributable to “Made in Italy” brand equity

A significant portion of the segment-to-segment productivity differences between Turkey and Italy is due to the effect of branding. As discussed above, brand equity includes the combination values (often intangible or emotional) that become attached to a physical product. In this context, the fact that the garments are produced in Italy attaches a generic “Made in Italy” attribute to them, which consumers find valuable and worth paying a premium for. As a result, the generic “Made in Italy” branding for all Italian products creates a value-added premium that is not enjoyed by equivalent products made elsewhere. Although it is difficult to quantify this effect, we estimate that 10 percent of the productivity gap between the Turkish and the Italian apparel industries is due to “Made in Italy” branding. In fact, interviews in Italy confirmed that 10 percent is about the average price premium that buyers are willing to pay for “Made in Italy.”

Across segments

Segment-to-segment comparisons do not highlight the full effect that the creation of high brand equity has on value added and, therefore, on overall productivity. To more fully understand this effect, we also benchmarked the Turkish OEMs to Italian ODMs (Exhibit 11). We determined that Turkish OEMs have lower productivity by 40 points, with more than 60 percent of the difference due to lower brand equity in Turkey, and the remainder caused by lack of design capabilities.

Exhibit 15

STAGES OF DESIGN CAPABILITIES DEVELOPMENT

	Description	Key additional qualifications required	Benefits
Basic	<ul style="list-style-type: none"> Replicating an existing model and developing the size set of the model 	<ul style="list-style-type: none"> Basic pattern making skills 	<ul style="list-style-type: none"> Entry barrier to be able to provide OEM service
Developing	<ul style="list-style-type: none"> Adapting basic or existing models with a variety of trendy fabrics, colors, and accessories 	<ul style="list-style-type: none"> + Understand the upstream industries + Following the textile sector trends in the world + High level of search-and-reapply skills with a moderate understanding of design 	<ul style="list-style-type: none"> Increased value added Increased sales opportunity because of the flexibility to respond to orders very quickly
Advanced	<ul style="list-style-type: none"> Developing a collection of different model designs 	<ul style="list-style-type: none"> + Understanding the fashion trends in the world + Well-developed, in-house design skills with advanced target-consumer understanding 	
Best-in-class	<ul style="list-style-type: none"> Developing a collection of original designs with a concept (e.g., working woman of the 21st century) 	<ul style="list-style-type: none"> + Highly developed target-consumer understanding with advanced marketing and design skills 	<ul style="list-style-type: none"> Significant increase in value added because of the full service provided to retailers Increased sales opportunity as different pieces in the collection complement each other

In addition to requiring new skills, capital requirements (i.e., up-front spending and fixed costs) increase significantly at each higher stage

Source: Interviews

¶ **No “Made in Italy” equivalent.** The lack of generic “Made in Turkey” branding that connotes value equivalent to “Made in Italy” explains a major part of the gap between Turkish OEMs and Italian ODMs, as it did in the OEM-to-OEM comparison.

¶ **Lack of design capabilities.** Although the Turkish apparel sector has developed some design skills, they are not as developed as in Italy. Creating design capabilities takes place in several stages, starting with basic pattern making and ending with the ability to offer a coherent, original collection. All Turkish OEMs have the basic skills and the majority of them have moved beyond this stage. However, the coherent and original collection stage that enables the manufacturers to serve retailers directly is lacking in most Turkish OEMs (Exhibit 15).

Our study does not attempt to quantify the effect that developing stronger individual brand names would have since the premiums attached to branding are usually in the marketing/retailing part of the business, not in the manufacturing part. However, superior individual brand development also contributes to the gap between the Turkish OEMs and Italian ODMs as a potential source of increased value added.

INDUSTRY DYNAMICS AND EXTERNAL FACTORS AFFECTING PRODUCTIVITY

To date, Turkey's apparel sector has been a real success story: export volumes have grown rapidly; Turkey has become one of the major global players, particularly with respect to EU markets; and Turkish players have made good progress in moving up in the value chain. Looking ahead, the challenges facing Turkey need to be viewed through the same two lenses used throughout this case: barriers to improving physical productivity and barriers to improving value added.

Barriers to improving physical productivity

Unlike in most sectors in the Turkish economy, in apparel there are no significant barriers to improving physical productivity. Access to technology, labor, skills, and capital poses no real challenges.

However, informality⁴ exists in the sector to a significant extent: almost half of the employment is in *façon* producers, where informal workers are a ubiquitous phenomenon. But unlike in other sectors, informality in apparel does not present a non-level playing field within the industry, as almost all Turkish players utilize informality equally through outsourcing to smaller *façon* producers. And informality is not limited to Turkey; informality is a major part of the industry across all geographies – in developed countries as well as in developing and underdeveloped.

It is true that informality may have contributed to some of the weaknesses in the organization and alignment of the business system of *façon* producers that we see in productivity comparisons of *façon* producers versus OEMs. However, a much more significant force has been dramatic growth opportunities that have attracted the attention of owners and managers. Simply put, it has been more important to seize new export volume than to wring out full productivity through alignment of *façon* producers. Once OEMs face the pressure for increased productivity, they will reflect this pressure onto subcontractor *façon* producers, increasing their productivity accordingly.

Barriers to increased value added

Again, there are no barriers per se to increased value added. Interviews show that retailers who are already doing business in Turkey are anxious to see increased value added from Turkish producers, since that would take more of the burden from their shoulders. In this context, we have not identified any barriers to increased value added.

⁴ Evasion of legal tax and/or labor obligations due to lack of enforcement

However, to say this does not exclude the possibility of kick-starting a virtuous cycle to increase value added a la “Made in Italy.” We have not attempted to design “industrial policy” for any of the sectors in this study; nevertheless, the case of the apparel sector also sheds some light on how private industry and government initiatives are coming together in some countries to shape their apparel sectors to capture increased value added.

In Italy, the creation of “Made in Italy” has been a result of the natural evolution of market forces. A unique combination of the consumer, supporting/related industries, design capabilities, and entrepreneurial manufacturers has created the so-called “Made in Italy” image, not only for apparel, but also for other design-driven industries like ceramics, jewelry, footwear, and interior home furniture and accessories. Efficient, specialized, and competitive upstream industries along with sophisticated retailers and strong consumer demand have fueled innovation in the highly competitive apparel market. This innovation reinforced existing design capabilities, creating the world-famous Italian fashion brands (Exhibit 16).

But there are also at least two examples of countries that have kick-started their national branding efforts without leaving it to natural evolution:

- ¶ **Portugal Quality Shoes.** Led by the footwear industry itself, together with its supporting industries, an institutional marketing campaign was developed and managed to support the branding of “Portugal Quality Shoes.” The campaign was able to convert the local Portuguese footwear fashion show into the premier footwear fashion show in the world, and provided the impetus for arranging similar shows in select cities elsewhere in the world. The private sector’s efforts were supported by the government as well as design schools and training centers. The result of this organized effort can be quantified in export figures. Since the “Portugal Quality Shoes” campaign started in 1999, exports have increased 2.9 percent in volume but 11.9 percent in value, meaning that value created per unit increased significantly (for 2000 to 2001; see Exhibit 17).
- ¶ **Hong Kong, World Boutique.** Different from the shoe branding effort in Portugal, in Hong Kong the government took the leading role in raising the profile of its apparel industry, as it has done in other export sectors through the Trade Development Council (TDC). Its activities have focused on “fashion” and “boutique” concepts to help the industry move beyond the OEM manufacturing role. Activities range from fashion shows and design schools to develop local talent, to direct marketing to the large retailers of the world (Exhibit 18).

Exhibit 16

CREATION OF “MADE IN ITALY” BRAND EQUITY

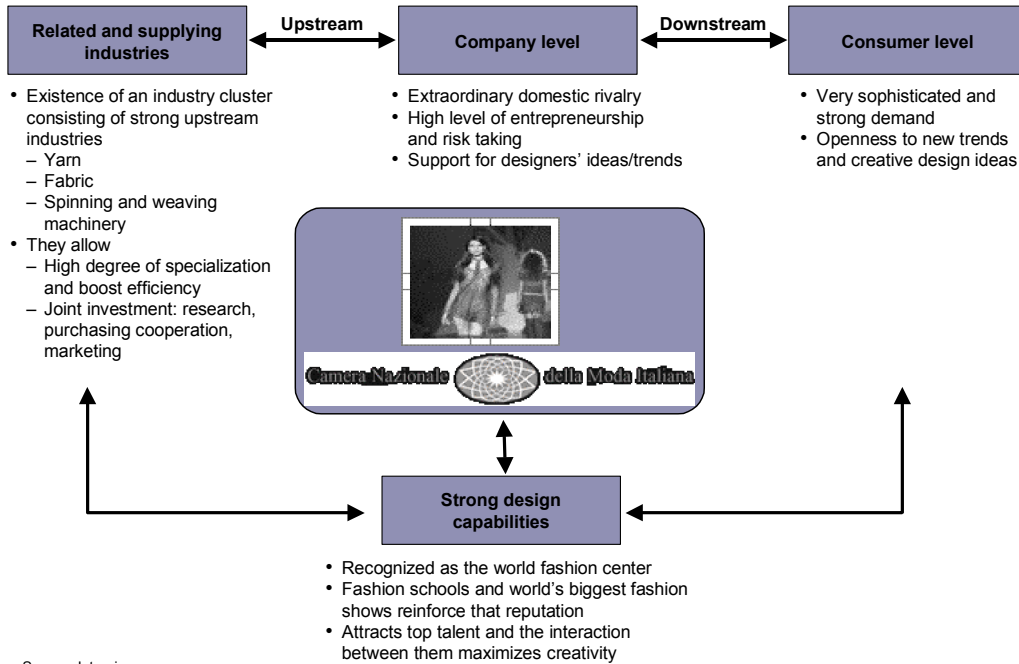


Exhibit 17

CREATION OF “PORTUGAL QUALITY SHOES”



- “Portuguese quality shoes” (red square with green bar and letters in white, inspired by Portuguese flag) is the trademark of the institutional marketing campaign for entering international markets
- Marketing campaign is run by 3 parties
 - APPICAPS (Portuguese footwear, components, Leather Goods Manufacturers' Association)
 - ICEP (Investment, trade, and tourism; autonomous government agency under Ministry of Economy)
 - PEDIPII (Strategic Portuguese Industry Development and Vitalization Plan)

- Organized and promoted by APICCAPS, MOCAP is one of the main footwear trade fairs in the world (22 years old) and it has fulfilled a fundamental role in the evolution of the Portuguese footwear industry, as the main catalyst of exports growth
- Fashion shows (e.g., Modalisboa and Portugal Fashion International in strategically chosen cities like Sao Paolo, New York, London) also promote footwear
- CFPIC, footwear professional training center (since 1965), specializes in footwear and 8 leading design schools also support footwear

Source: APPICAPS; ICEP; interviews

Exhibit 18

PROMOTION OF DESIGN SKILLS IN HONG KONG

- TDC (Trade Development Council) is the leading government agency promoting design in garment industry with policy objective of “developing Hong Kong into a ‘world design and fashion’ center”
- “Innovation and technology fund” provides assistance to institutions/companies to upgrade the overall standard of Hong Kong designs, as well as step up related educational and publicity activities

- Participation in and organizing fashion festivals and design exhibitions in Europe, the US, and Asia
- Introduction of Hong Kong’s brand names and designers to renowned merchandisers and traders
- Arranging visits by prominent Italian designers to Hong Kong to encourage cooperation/exposure between world’s top designers and local talent
- Arranging the new “World Boutique, Hong Kong” – a showcase (to boost Hong Kong’s role as a fashion center) that will bring established and up-and-coming fashion and design talent from around the globe
- 4 local design schools turning out 70-89 graduates every year
- Hong Kong fashion week (bi-annual)
- For the last 2 years, relaunching the “Made in Hong Kong” garment exhibition in Japan (started in 1985) under the “Total Fashion” concept
- CITA (Clothing Industry Training Authority) to provide technical training for the sector

Source: Trade Development Council; interviews

POLICY RECOMMENDATIONS AND IMPLICATIONS

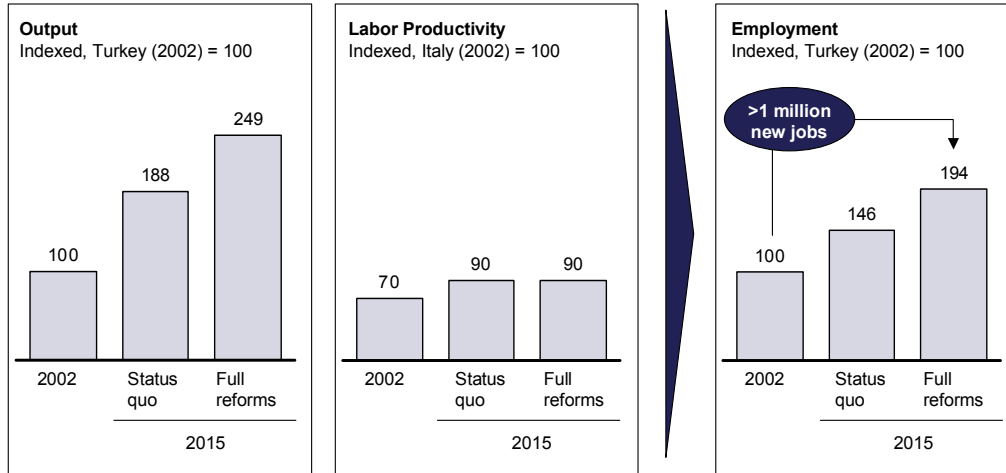
As we have discussed, if we put aside informality there are no specific barriers to increased sector productivity. The physical productivity gaps will be closed as the labor costs increase and as competition intensifies, and the closure of the value-added productivity gaps will depend on industry programs, possibly supported by government initiatives; these are outside the scope of our study.

We can, though, point out that the challenge of increasing the Turkish apparel sector’s ability to contribute to the total brand equity/value added attached to a physical product is not completely new. In almost every industry discussion, the theme of creating Turkish brand names is hotly debated, as the industry as a whole has nearly achieved the productivity frontier of its OEM status, which is now threatened by increasing labor costs. And to stay competitive, Turkish apparel players are trying to up their game.

There have been several fragmented efforts: “Turquality – from Turkey,” Istanbul International Fashion Days, attendance at international fashion fairs, and young designer awards are some of the activities. The Turkish Clothing Manufacturers’ Association (TGSD), the Istanbul Apparel and Confectionery Exporters’ Association (İHKİB), the Istanbul Textile and Confectionery Exporters’ Association (İTKİB), and the Assembly of Turkish Exporters (TİM) are among the organizations contributing to the effort of increasing brand equity.

Exhibit 19

IMPLICATIONS OF POLICY RECOMMENDATIONS



Source: MGI analysis

It is possible that there is a role for the state in assisting these efforts. However, the only reasonable starting point would have to be a thorough and comprehensive effort to align objectives. By this we mean a clear debate – with a resolution – within the industry and between industry and government of such issues as how to prioritize among increasing the design capabilities in Turkey; increasing the number of Turkish private brand names sold outside Turkey or increasing the brand equity of “Made in Turkey”; the definition of roles and responsibilities – who will be involved in the program and how interactions among different parties will work; what tools will be employed; and the like.

Implications of the policy recommendations

Looking to the future, we can say with confidence that the apparel industry is one of the sectors with the highest potential to generate employment in Turkey. The industry is already operating at a relatively high rate of physical productivity, suggesting that any increase in output will require new employment.

We expect growth in total apparel sales from both domestic sales and exports; we have assumed that export sales will continue to grow at a 5 percent cumulative annual average growth rate, and domestic sales will grow in line with the GDP growth rate.

If all the reforms in the economy are made (enabling a high growth rate in the domestic market) and increased value added is realized, based on the above assumptions, the sector will increase its employment at an annual rate of 4.5 percent. Depending on the current real employment levels in the sector (i.e., reflecting only the broad estimated range currently available), this employment growth rate could lead to more than 1 million new jobs (Exhibit 19).