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EMPOWER PRIVATE SECTOR ACTIVITY

THE KOSOVO APPAREL EXPORT SECTOR: PRODUCT CAPACITIES & MARKET POTENTIAL

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EMPOWER Private Sector Activity

THE KOSOVO APPAREL EXPORT SECTOR: PRODUCT CAPACITIES & MARKET POTENTIAL

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1. Introduction and Summary

The Kosovo EMPOWER Private Sector project's primary objective is job creation, in order to increase household incomes and promote overall economic growth. The project works closely with firms from selected growth-ready sectors – including apparel – to help them identify and connect to market opportunities, increase productivity, upgrade management and workforce skills, and expand access to finance. Through its activities and interventions, EMPOWER Private Sector seeks to expand Kosovo's underdeveloped export and import-competing sectors.

This assessment of Kosovo's apparel sector production and sales capacities was conducted by Robert Alexandriysky, an Apparel Sector Marketing Expert with Cardno Emerging Markets, USA, through a two-week technical assignment in April 2015. He visited 20 companies, representing the spectrum of apparel producers across Kosovo. During the trip, he also held formal and informal meetings with other relevant industry stakeholders – an academic organization (Academia Evolucion), two local business associations (SHZAP and ESNAF), the Prizren Economic and Tourism department, and the Municipality of Giakov. Ms. Arta Istrefi of the EMPOWER project accompanied Mr. Alexandriysky on all meetings.

The apparel sector is one of the industries reborn in Kosovo in the last few years. Following the traditions in the region where production of clothing and shoes was established and thousands of jobs created in the period of 1975-1990, new companies emerged to cover the market needs and wants of the Kosovo consumers. Entrepreneurs have refurbished existing facilities and expanded into new premises and purchased new production equipment.

With about 3000 people employed, the Kosovo's apparel industry is in early stage of development. While foreign investors have focused on exports, local entrepreneurs have mainly pursued opportunities in the domestic and regional markets at this early stage.

The major findings of this assessment as to the growth potential of this industry, and recommendations for supporting it, are as follows:

- Given its location and low labor costs, a substantial market opportunity exists for Kosovo to join the Euro-Mediterranean apparel production outsourcing zone for European labels, as its neighbors Albania and Macedonia have done, adding over 10,0,000 over the past 10-15.
- A number of Kosovo producers are already able, or are close to being able, to cope with competition from imports on the domestic market, and build successful brands. Several others are looking to export development, and have the capability to enter regional and EU markets, if buyer connections can be established.
- In general, Kosovo companies need to improve their quality and productivity (quantities) to be able to compete with companies from elsewhere in the region for both "full package" and cut-make-trim (CMT) contracting with major foreign brands.
- Other than one exceptional jeans contractor, the most attractive near-term opportunities for export contracting are in workwear / uniforms and light separates, building on successful domestic / import substituting business foundations.
- There is little cooperation among companies in the Kosovo apparel sector, in production or marketing. Joint trade show attendance and the sharing of sales agents

should be pursued. The Kosovo Apparel Marketing Association (KAMA) can become a powerful tool to improve cooperation and competitiveness and drive exports and job creation.

- Support will be most valuable in market connections, expansion finance, process certification, productivity / quality consulting, and marketing / promotion.

It is estimated that with targeted support, the Kosovo apparel sector can add over 3,000 new jobs over the coming 5 years.

2. Companies

The sector is highly fragmented which is a result of the way Kosovo businesses are organized. Majority of the Kosovo companies are family organized. A typical small apparel company will be managed by husband and wife and may employee few workers. Operations start because someone from the family has acquired skills in sewing or cutting in the past. Most of the entrepreneurs are in their 40s' and a new generation (their children) is coming to take responsibilities in different operations like finance and marketing. Women are taking power in the apparel business by assuming lead designers or production positions and creating new business projects.

Specialization and Value Added

Kosovo apparel industry has regional product specialization:

1) The area of Peje – Giakova - Prizren is specialized in production of casual products, including jeans, t-shirts, uniforms;
2) Gjilan is specialized in wedding dresses requiring hand-made operations. Due to the nature of this business, requiring fit sessions this business has expanded to other areas.
3) The South Region of Suha Reka – Prizren is hub of shoes production.
4) Pristina is a center of trade, and besides the major producer and exporter Kosovatex (Jeanswear) is a home of several designers and academic organizations.
5) Yarns for hand knitting production in Gjilan

This research found that the companies in the area of Peje-Giakova-Prizren follow more the principles of a "connections economy"[i] instead of an "industrial economy", and each one of them produce several products (workwear and uniforms, knitted items) to meet the local market demands, especially tenders and is not specializing in production of one specific item only.

While this approach works for Kosovo market, it does not create competitive advantage and does not create further organic growth opportunities. If considering exports, it will be impossible for companies to attract large buying European organizations with production lines of average10 – 15 people.

Another reason why Kosovo apparel companies should consider specialization is to avoid the wasteful duplication of tools, which is the case of the above-mentioned producers, who use limited capacity of some of their expensive machines like printing, embroidery and others.

In general, most value in the apparel sector is added at the planning and retail ends, associated with the control of key functions such as branding, designing, and marketing, which are highly knowledge intensive (Goto, 2012; Kaplinsky, 2005). In the apparel industry, firms from developing countries usually find their ways into global value chains through labor intensive functions of relatively low knowledge intensity; cutting, making (sewing), and trimming (CMT).[ii]

Kosovo producers add various degrees of value, depending on the product:

1) *Wedding dresses and evening gowns*. These products are made with imported materials from China, Turkey, Italy and Czech Republic, adding value through design and workmanship, very often labor intensive, with hand-made operations.
2) *Jeans* made by one large manufacturer add value through finishing operations including special washes and destroying, which allow them to sell CMT services at a higher value than other local retail operators are selling their products. In addition, this company offers other services to their customers including pattern development and grading.
3) Other companies are producing *basic products* to meet the local demand – underwear, t-shirts, knitted pajamas, jeans (enzyme washes only), work wear, and other uniforms. One company also produces car covers for exports in the same category. Most of these products reach the market flat packed and these make them vulnerable to imports that arrive from the Far East sometimes vacuumed to reduce transport charges. New production companies are also looking for establishing production in basic products like shirts.

Wedding dresses and gowns will remain a solid mostly local product. Other jeans producers may be able to move toward private label and CMT markets. Producers of products should target transforming their production to other higher value-added products like jackets and dresses for CMT, requiring handling with more care and hanger delivery.

Supply Chain Position

The supply chain has been defined as the network of organizations that are involved, through upstream and downstream linkages, in the different processes and activities that produce value in the form of products and services in the hands of the ultimate customers (Christopher, 1992). Supply chain management is seen as a critical factor in managing contemporary fashion businesses, as a means of improving productivity, as operation management and the associated lowering of inventories and finally as a means of meeting customer demand (Hines, 2007). Today the global apparel business is competing not company vs. company but supply chain vs. supply chain.

Kosovo apparel producers are in the middle of the supply chain. With few exceptions, they do not have retail operations. Their upstream linkages are b2b, while their downstream linkages lead to suppliers outside Kosovo. There are no local supplies or just a few providers of products and services that make the supply chain: yarns, fabrics, accessories, trims, design and/or pattern making services, marketing services, etc. This fact makes Kosovo supply chain not very flexible.

Each company builds its supply chain, based on its market knowledge. There is little or no cooperation among the companies in the local market. Subcontracting is not developed and should be encouraged to create opportunities for small businesses with average number of employees of five people and more who struggle to survive doing alterations or other services.

Operations

Physical observation at some of the visited Kosovo apparel companies with retail operations shows that they are overstocked with goods which leads to shortage of cash. The reasons to have excess stocks is that these makers are more production and less market driven. These companies decide to produce certain products to keep their production lines and people busy, expecting future sales will decrease the stocks. This may however not happen soon and can create debts or cash shortage if these practices continue. Decisions to produce new product based on historical data and in-store testing only is a reason for inaccurate inventory. Companies need to improve the inventory accuracy by being proactive in market research and improving the visibility of products.

Factories need to improve their inventory turnover rates. This turn rate might be even less than 1.0 for some companies while it should be certainly positive with rates between 2.5-4.0 for men's clothing and 3.0-4.5 for women's clothing.

Exports can improve inventory management; production can balance between exports and domestic market, increasing the turnover rate, instead of producing overstocks.

Workforce

Workforce is available in Kosovo but requires training. Companies generally complain of the lack of skillful technical staff and operators. Middle management staff for the visited 20 companies was recruited mainly from family circles or companies that were closed in the 1990s. This staff still needs additional training and knowledge exchange to keep up with production trends.

Companies should take advantage of the availability of young people and recruit staff that will be able to match customers' experience with professionalism and dynamism. Most of the management of the apparel companies need training in marketing, sales and b2b communication.

3. Markets and Marketing

Potential markets for Kosovo apparel products are Kosovo retail market, regional market, the European Union market.

Kosovo Domestic Market

The domestic market could play larger roles when it comes to functional upgrading (higher skills and knowledge intensity) for textiles and apparel firms in developing countries (Goto, 2012). Producers in developing countries are finding that they can even generate bigger margins in their domestic markets than in their export markets, where they face intense pressure from buyers to cut prices. In emerging and developing countries, demand for apparel products is increasing at an even higher rate than economic growth.[iii] These findings are valid for the Kosovo market too.

The retail leaders are hypermarkets and supermarkets like ETC with 17 stores around Kosovo, Viva Fresh Store with 7 hyper stores (above 3000 m2) and 15 supermarkets (800-3000 m2). We estimate their apparel business to over 50 million euro per year. These stores offer mainly basic apparel items, and some products with shorter life cycle (fashion) products. Pristina is center of the retail trade with Grand Store (32000m2), Minimax and Newborn shopping centers. A new shopping mall Dardha has opened in Pristina in May, 2015. Important market players are also Albi Group and LC Waikiki, the latter probably the only foreign fashion company operating with their own subsidiary store on Kosovo retail market. Other small stores function on the survival edge in the main cities importing selected goods from Turkey, China or Europe, most of them selling at the lowest end market prices.

Most of Kosovo manufacturers of casual products (jeans, t-shirts, polo shirts, sweatshirts) have positioned at the lowest market end. Most of the producers have not established strong brands. Only a few of them consider new labels in upscale level. Few designers have established in the premium segment. There is little consistency in product quality, labeling, and communication. Their retail operations, if available, are not different from those of the majority of the shops: overstocked, not impressive store windows, and unsufficient assortment. Brand identity elements are not developed or visible and communication with consumers is poor. Often retailers and wholesalers buy goods from local manufacturers without any labels or with their private labels.

Big box players have demonstrated interest to buy basic merchandise categories from Kosovo apparel manufacturers for the private labels of the store. The reason behind this decision is that retailer needs fast replenishment of the stocks. When shoppers look through racks and shelves, they are likely to abandon the purchase if they do not find their specific size, fit, or finish[iv]. Having a reliable supplier next door to deliver goods at short lead times will help the store to sell higher volumes. Currently these stores buy underwear and other circular knitted items from local manufacturers. but local purchases are much smaller than the needs and the opportunities.

Reasons for the limited scope of cooperation between the manufacturers and the retailers could be described as follows:

a. Manufacturers do not understand final consumers' behavior and the retailers' needs.
b. Manufacturers are not flexible in delivering the right model, color or size due to lack of domestic inputs, bringing them from Turkey, which extends their lead-time.
c. Manufacturers' lack of cash to support the business under the general conditions established by these retail operators.

When speaking to apparel manufacturers we hear very often that illegal imports (under-invoiced goods for customs purposes) are hampering their development. However, there are opportunities that could be taken by the manufacturers if they had improved their dynamics.

Target groups and products of interest:

1) *Young people aged from 20 to 30*, educated and working with various institutions and organizations, socially active and demanding consumers. Products – fashion separates that could be worn in office or after work hours. Existing outlets are trying to offer these products, but they do not have the required breadth and depth of the assortment

to satisfy the market needs and wants. These consumers are turning to online purchases to get what they are looking for.

2) *Women and men 31-45*, educated and working with various institutions and organizations. Contemporary clothing for various occasions and events. Same as above these consumers have to spend hours in shopping tours due to limited assortment or turn to local tailors for special occasions. The lack of time and more options will easy attract these consumers to ready-to-wear collections presented in convenient shopping atmosphere.

3) *Wedding* (ceremonial) dresses. As per Kosovo Agency of Statistics (KAS) 16 400 young women got married for a first time in 2011 and with an average decline of marriages of 5% per year, we expect that their number has fallen to about 13 000 in 2015.

   We estimate that this business runs about 30 million euro (including production and imports) per year at retail prices. Part of these products are imported and Kosovo producers are in a position to take over their market share, if they were more visible to consumers.

4) *Children* from newborn to 6 years – targeting young couples with incomes above average. All kind of clothing, especially for outdoors. About 27 000 newborns per year and parents demanding more than modesty for dressing their children should inspire entrepreneurship. This product group development can emerge naturally from young mothers with interests in design if they acquire additional skills, which is the case in many countries.

5) Various industries requiring standard or protective corporate clothing with the use of new materials and modern technology like seam taping or seamless operations.

Export Markets

In most industries exporters have to be successful in their domestic operations. Apparel industry does not make any difference. It is hard to believe that a foreign brand, retailer or consumer will buy a product, which does not have an acceptance on the domestic market and traditions in the business. Being successful in a changing market situation in Kosovo means that companies are taking the foremost of the opportunities and can be good at exports too.

<u>Regional markets</u>

The countries of Montenegro, FYROM, Bosnia and Herzegovina, the other ex-Yugoslavia countries and Albania are the destination Kosovo companies making ready-to-wear products need to explore. Few of the interviewed companies (wedding dresses, home textiles and work wear) mentioned that initial exports to these markets have been made already.

Understanding the language of the countries in the region gives Kosovo companies great advantage in collecting data when doing research for these markets. These opportunities have not been sufficiently exploited. Chances for entering these markets with ready-to-wear articles are good because many consumers have not established buying habits and they are susceptive to new brands – they have little loyalty to global brands yet, and opportunities are better for the first movers.

Products that could be exported to the neighboring countries are wedding and other ceremonial dresses, work wear, uniforms, quilted linen, and sportswear. This business require participation in b2b events like Tirana Textile fair or sales missions to promote the Kosovo companies and establish links with retailers in the region.

European Union

The European Union market is dominated by the best global brands, most of them sourcing products from two main production centers – Euro-Mediterranean and South-East Asia, each with its own characteristics:

The Euro-Mediterranean zone serves to supply the following needs:

- Fast fashion brands requiring short lead times;
- Other fashion goods that need to follow the markets needs and wants closely
- Hanger delivered goods like jackets, dresses, made of delicate fabrics;
- Protective clothing for various industries made of special fabrics, made in Europe that also require production in Euro-Med zone, due to the need of reliable suppliers and short lead times.

The South-East Asia zone serves to supply:

- Flat packed goods
- Products securing the season continuum that can be ordered several months before the season starts
- Brands positioned in the base of the fashion pyramid who need lower end prices.

The market needs practically define the global sourcing pattern of the brands, with Euro-Mediterranean zone taking increasing share of the orders due to its flexibility and proximity to the market. More accuracy on retailer's decisions is needed to decrease the stocks at the end of the season with some retailers selling about 40% of the stocks at reduced prices. This accuracy can be achieved when retailers place the orders in the Euro-Med zone with deliveries within maximum 3 months for the first orders and 30-45 days for repeat orders making impossible for most Far East suppliers to compete.

The Euro-Mediterranean zone is not made of countries with consistent development. While some countries like Romania, Bulgaria and Albania have more stable indicators for political and economic stability, others like Tunisia, Ukraine and Macedonia recently are not very predictable.

Political instability is considered as unacceptable risk for most buyers looking for new suppliers in developing countries or transition economies. One of the visited companies gave us an example when a potential customer arrived at the airport of Pristina but did not want to travel to visit the factory in Peje, considering tension in the country (in 2013/14). Recent tension in FYRoMacedonia is damaging the image of the region as a safe place for business.

While this factor is slightly less important for full package goods when the supplier holds responsibility for all stocks, in CMT business it is quite important when the property of the main materials remains that of the foreign customers. However, Kosovo has a good story to tell with the cooperation between Kosovatex and one of their German customers, which runs on CMT base.

Kosovo's apparel industry can have good prospects for development if serves as a bridge in the Balkans between the current productions centers in Albania and FYR of Macedonia. Due to the nature of the business when fashion brands are investing substantial amount of money in design and materials in the CMT business, they have to monitor and supervise the production process within a radius of few hours' drive between two or more suppliers. Therefore Kosovo producers can be a good choice for brands producing in Albania and FYR of Macedonia.

Market Communication

Quality information and contacts on Kosovo's apparel sector cannot be found online in English language, to cover basic information and to meet buyers' needs.

With practically no information about the sector from governmental or non-governmental sources, or from the companies themselves, it is hard to believe that Kosovo companies will find an inflow of many new buyers interested in the Kosovo apparel industry.

4. Current Exportable Apparel Capacities

A few Kosovo apparel products could be subject to exports (in short-term), but for many, quality upgrading is necessary to satisfy EU buyers. A review of the potential in various product categories currently produced in Kosovo follows:

1. *Full package goods* (producers design and offer finished products, and buy all or most of the materials). This is the form of business that can be applied immediately when buyers are interested to get the products ready-to-wear and are not looking into the process of production. In this category, Kosovo products with export potential are:
   a. Wedding and ceremonial dresses – we estimate that this business engages more than 600 employees nowadays, or 1/5th of all employees in the apparel sector, large part of them not registered as employed on the labor market. Most companies that we met showed stable results compared to last year and some are planning expansion. The contribution per worker engaged in this sub-sector can be estimated to 10 000 euro/per year (highest in Kosovo). This sector can add another 100 employees by using knowledge in design and skilled labor which will give them competitive advantage against main competitors from Albania and FYRoMacedonia. Further support is needed with promotional regional events.
   b. *Jeans*. One large company exports full package product to EU customers and can expand these operations. Possibly it can channel / lead overflow orders to smaller local jeans producers.
   c. *Work wear*. With about 200 employees engaged in five factories, the production capabilities could reach about 400,000 pcs per year and this number obviously exceeds the needs of Kosovo market. Within a year, exports of these products can exceed 500,000 euro and 50 new employees can be added to the workforce. Therefore we could expect that these products could be exported to EU markets, subject the companies improve their productivity and sourcing pattern.

d. *Home textiles*. There are two main producers, each employing around 60 people, selling locally and exporting to the region – Albania, Serbia and Montenegro. They are expanding their facilities and adding employees. Exports can grow further and 20-30 more persons can be employed in the near term.

2. *Cut-Make-Trim (CMT)* (producers offer production services; buyers supply the designs and fabrics)

   a. *Jeans.* There is one large exporter of jeans and slacks in Kosovo, with 300 employees and 20 undergoing trainee program; capacity of 2000 pcs per day, utilized about 65 - 70%, this company is looking for new buyers to expand sales beyond the target of 300,000 pairs for 2015. Another 500.000 euro in sales and 50 new jobs should be easily achieved in short-term.

   Another company in Dragash (40 workers) recently started a new line in jeans with 20 workers. If they keep this line busy and get expertise in this production, they should consider how to expand for exports. Because it does not have washing facilities, one option is to cooperate and work for the larger company. The company purchased second-hand jeans line and needs to refurbish many special machines. Another 50 workers can be added in this factory in a period of 1.5 year.

   Opportunities are alive for at least three other jeans producers, respectively with 40, 20, and 70 employees, with some improvements in the process and cooperation with other producers.

   This production group with about 500 employees can expand with 150 new jobs in short-term, exporting mainly to the EU market.

   b. *Work wear:* This product can attract strategic EU customers. Existing companies can make over 300,000 pcs, and another 500,000 euro in exports in short term. This business require investment of about 60,000 euro to buy some new special machines that will allow them to make protective clothing for various industries. These products are made with European fabrics and Kosovo can get a portion of this European business with quality and good price.

   c. *Light separates:* We estimate that about 600 people are employed in production in this category, which uses circular knitted fabrics to produce t-shirts, polo shirts, sweatshirts, track suits, and the like. There is strong international competition in this low-priced product group, so the main opportunities are in import substitution. However, on that production foundation, these factories have the potential to transform operations to include woven fabrics, producing such things as active sport, slacks, jackets, tops, dress shirts, etc., and these have contract export potential.

Summary of current and potential new jobs in the sector:

Product	Employment Mid-2015	Potential Job Growth 2016-17
Wedding dresses	600	100
Jeans	500	150
Light separates	600	100
Work wear, uniforms	300	50
Home textiles, car covers	150	60
Knitwear	15	0
Small workshops, designers	600	40
Yarn	40	0
Shoes	450	100
Total	**3,255**	**600**

Our expectations are to see conservative 20% increase in employment within about a year with a chance to reach 4000 jobs in Kosovo apparel sector by the end of 2017. This goal requires coordination among companies, KAMA, government, and donors.

5. Conclusion: Recommendations for Development of the Kosovo Apparel Industry

The following are recommendations for realizing the growth potential of this sector in Kosovo. They can be achieved with the collaboration of private companies, government (KIESA, MTI, MEST, MLSW), EMPOWER Private Sector, other donors, and KAMA.

1. Market linkages. Introduce Kosovo apparel industry on major European sourcing events. Support participation at the right international trade shows; organize exhibitions and B2B missions to attract new apparel buyers; establish agent networks.
2. Organize technical consulting to improve local firms' capacities to produce the quantities and qualities needed by the export market.
3. Facilitate and increase access to growth finance for Kosovo apparel companies with demonstrable market opportunities.
4. Develop communication tools using various publicity vehicles – web, print, media – targeting the industry stakeholders (customers, partner organizations, potential employees, suppliers, financial institutions, embassies, government institutions, donors, Kosovo diaspora and community) serving them with industry information;
5. Collaborate with government organizations to eliminate administrative barriers for exports, facilitating the inward processing regime.

6. Support the Kosovo vocational education and training system's practices and capacities to deliver the workforce skills needed for the apparel industry's growth.
7. Establish contacts and cooperation with the national apparel and textile associations of the EU countries. Introducing Kosovo apparel industry as a new member of Euro-Mediterranean apparel production zone at special seminars to members of their national associations.

The author believes that given the existing potential of the Kosovo apparel industry, and support that is being led by EMPOWER Private Sector and other donors and GoK institutions, the following goals can be achieved over the period 2016 – 2020

- Increase in sales to domestic market by a minimum of 10% per year
- Increase in export volumes by a minimum of 20 % annually.
- Increase in the industry employment by a minimum of 20% per year, or 3,000+ jobs in 5 years.

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