

COMPETITIVE ADVANTAGES OF THE CROATIAN WOOD INDUSTRY

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Abstract

This research will look into competitive advantages of the Croatian wood industry. The paper provides an explanation of potential sources of competitive advantages as well as positive and negative aspects of the selected generic strategies, followed by examples of companies using these strategies. The subject of the research encompasses characteristics, the area and the impact of competitive advantages on the company's market position and business success.

The aim of the paper is to define the term competitive advantage and to bring it into correlation with the wood industry.

The methods used in the research include description, compilation and classification, and use of comparative and genetic method to interpret the phenomenon in its origin, i.e. in this case, a competitive advantage in its source, namely in costs or differentiation.

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1. On competitive advantages in general

When organisms belong to different species, they can both survive, as they fight over resources in different ways. However, when they belong to the same species, one of them disappears. In other words, the species that take up the same ecological niche cannot coexist in a stable equilibrium (Popov, 2010:10).

Accordingly, the natural law that the stronger ones will survive can be perceived. For this reason in the field of economy and business operations there is competition between companies fighting to achieve competitive advantages by means of which they would avoid competitors' threats and succeed in achieving their set goals, expressed in profit, market share or something else.

Competitiveness can also be defined as productivity by which a company utilizes its human resources, capital and natural resources. Higher productivity leads to higher competitive advantage.

Staying competitive and being always aware of consumer needs requires cooperation among different business functions. Operational function is not isolated. Actually, none of the business functions can survive isolated from others. Work can be done optimally only if interdependence of various business functions is accepted and exploited in an optimal way (Barković, 2011:27).

Competitive advantage is *punctum saliens* of the strategic activity of a company, and presence or absence of a competitive advantage is what makes a difference between successful and unsuccessful companies. It is achieved by having or building a specific quality that is required and accepted by buyers and which makes a company different from their competitors (Tipurić, 1999:3).

A company achieves a competitive advantage in the situation when it offers a product or service that is considered superior by buyers and does so at a lower cost than its competitors, making it possible to sell a product at a lower or equal price, whereby the company generates higher profit. Simply said, competitive advantage is a characteristic of a product that makes it different from the competitor's product. According to Porter, competitive advantage arises in the first place from the value that the company offers to its buyers, and which exceeds the very costs of achieving that same value (Pekanov Starčević, 2012:12).

There are two key sources of competitive advantages – lower costs and differentiation. Competitive advantage is achieved and maintained by either supplying identical value to buyers at a lower cost than competition in the industry (cost advantage) or by supplying higher value to buyers at an average cost in the industry (differentiation advantage).

1.1. Cost leadership

Although competitive advantage is established and maintained through all business activities and their operativity, a company may achieve a competitive advan-

tage by orienting itself primarily towards low costs, which implies focus on relatively standardized products and services.

Through this strategic orientation, based on the experience curve, efficient use of resources and economies of scale, and with strict cost control, a company seeks to reduce the price of its products (costs), thus achieving competitive advantage. Based on low production costs, a cost leader is able to impose low sale prices that are lower than competitors' prices. A cost leader chooses the lowest level of production differentiation, as differentiation makes production more expensive and it can lead to the situation where the strategic business unit directly jeopardizes the foundation upon which its strategy is built. Furthermore, a cost leader ignores the differences among market segments and directs the positioning of its products towards an average buyer. The reason for such an attitude of the leader is that adjusting the product to the different market segments is costly, i.e. it increases production costs.

Besanko, Dranove and Shanley also state the following favourable conditions for building a competitive advantage based on low costs:

- When the industry is characterized by economies of scale and economies of experience, but none of the companies in the market has begun to exploit them seriously
- When the possibilities for improving the perceived benefit of an industrial product are limited by the nature of the product itself
- When buyers are relatively price sensitive and they are not willing to pay a premium price for additional improvements of quality, design or image of the product
- When an industrial product has features of a product whose objective quality attributes buyers are able to estimate at the time of buying (for example, office furniture or computers). In such cases possibilities of differentiation can be found in improving the visible product features, which multiplies the risks of imitating differentiation and directs strategic attention to cost advantages (Tipurić, 1999:15).

It should be mentioned that cost advantage arises from more efficient performance of activities in the value chain compared to industrial competitors. In addition, "low cost culture" should be implemented in the core of the company's activities, thus successfully monitoring and managing costs, which is not an easy task at all. Exactly for this reason, a company may not succeed in achieving competitive

advantage through orientation on low costs. The logic behind this strategy is to be the leader in the industry, and not one of several followers. Rivalry of several competitors over the position of the industry leader is extremely dangerous, because, as long as one of the companies does not become a leader and eliminates others from the market, consequences for the company may be catastrophic. However, high risk is also followed by a high yield, so that focusing on costs may achieve a significant competitive advantage.

Wall-Mart and Southwest Airlines have won strong market positions by using low-cost advantage over their competitors and by consistently having lower prices than their competitors (Thompson & Strickland & Gamble, 2008:7). Other successful global cost leaders include Texas Instruments in consumer electronics, Hyundai in the automobile industry, Black & Decker in the power tools industry, etc.

In the wood industry, the Swedish company IKEA is known worldwide for its low prices, as their business strategy is based on low prices only.

1.2. Differentiation

By means of differentiation in the process of market exchange, a company is trying to achieve the desired level of differentiation between its product and similar products of its competitors. The content of differentiation relies on the knowledge about consumer needs, wants and preferences. Efforts and investments in this area belong to the category of improving placement of the products that are already present in the market. When it comes to new product development, the producer is trying in advance to embed certain elements in the product through design, which will help the product to stand out among similar competitors' products.

In the Croatian wood industry, there is an example of Kvadra Design, a company that differentiated itself from other companies in the industry through its innovation and finalisation of their own designer products. With emphasis on the Croatian design furniture, they were the first to start with the above business concept and have chosen a business strategy that in the long run produces only top results. The concept and model they apply in their production can be compared to Italy, a country that is known for production of design furniture.

By applying this generic strategy, barriers to entrance of other companies are established by building customer loyalty, which discourages potential new players. Buyers also feel connected to products or services with unique attributes, which

reduces the threat of a substitute, and brand loyalty provides safety to the company against rival threats.

Brand is a name, term, sign or a symbol, i.e. a system of fundamental, visual, verbal and written characteristics, aimed at identification and differentiation of one supplier's product from those of others (Medić & Pancić, 2009:88).

The term brand refers to a specific product that will be accepted by consumers, that will remain familiar to them based on differentiated features and promises they have to ascertain. Consumers also have to be convinced of its superiority or appropriateness for their lifestyle, status, purchasing power. In this way, brands are transformed into beliefs, ideas, and the world that consumers can identify with (Pavlek, 2008:121).

Brand is the basic reason why buyers are willing to pay more (although they could buy an identical or similar product for less). Brand is the strongest weapon in the fight against competition and a company's most valuable asset (Medić & Pancić, 2009:95).

Consequently, differentiation makes it possible for a company to:

- Set the price with additional profit
- Sell larger quantity of the product at a given price
- Acquire equally valuable benefits (higher customer loyalty during cyclic or seasonal falls) (Jović, 2010:51).

The process of differentiation of the existing products in the market is actually neutralisation of causes and differences that cause the product to fall behind others in the market. By applying adequate measures, for example, product "metamorphosis" in the production and technological sense, the company is trying to improve the product, under condition that it is profitable (considering the costs). Sometimes it is not about eliminating physical flaws, but about the need for changes in the marketing mix. The problem lies within the fact that buyers often cannot know the value a product has for them. Sometimes they overestimate a product, and in other cases, they underestimate it. Buyers often do not know what is beneficial for them. Therefore, the strategy should be based on use and signal values. A buyer ought to recognise the product as unique; thus, the forms of differentiation that are difficult to imitate have the best chances for success. Some of the examples of such successful differentiation are overall value of McDonalds, prestigious Rolex watches, Federal Express delivery, Daimler Chrysler engineering, etc.

Examples of companies successful at applying differentiation in the Croatian wood industry include Spin Valis d.d., with high quality solid wood furniture sets and eco-friendly furniture – chest of drawers, show cases, tables and chairs. Spačva is known for its high quality floors and doors, whereas Kvadra Design is known for its original furniture designed by Croatian designers.

In addition to the two extremes of competitive advantages, there is also another generic strategy – focus strategy, which is based on the choice of targeted market segment. Focused cost leadership includes cost control in a narrow field. Similar to focused cost leadership, focused differentiation also offers a unique product in a narrow field. Cost leadership strategy and differentiation strategy are trying to find competitive advantages in a wide range of industrial segments, whereas focus strategies are focused on cost advantages (Cost Focus) or differentiation (Differentiation Focus) within a narrow segment (Pekanov Starčević, 2012:27).

2. Analysis of the wood industry in Croatia

Forests¹ cover about 47% of the Croatian land area, and total area of forests and forest land amounts to 2 688 687 ha.

Wood processing and furniture production in the Republic of Croatia has developed based on high quality raw material. Development of these industries is based on utilisation of this raw material, long-term tradition of wood processing and good human resources (Pirc et. al., 2010:230). Wood processing industry accounts for a significant segment of the Croatian economy.

As shown in Table 1, the total number of people in Croatia employed in the activity C16 – wood processing and wood products in 2012 amounted to 11 072, whereas the total number of people employed in the activity C31 – furniture production was 8 887 in the same year. Therefore, the total number of people employed in these activities in the Republic of Croatia in 2012 amounted to 19 959.

¹ Find more details on forests in Croatia at: <http://portal.hrsume.hr/> (February 5, 2014)

Table 1. THE NUMBER OF EMPLOYEES IN LEGAL ENTITIES ACCORDING TO THE 2007 NATIONAL CLASSIFICATION OF ACTIVITIES (annual average)

	ACTIVITY	2009	2010	2011	2012	Shares 2012	Indices 12/11
A	Agriculture, forestry and fishing	25,766	24,710	24,891	25,391	2.2	102
02	- forestry and wood cutting	8,659	8,224	8,495	8,478	0.7	100
C	Processing industry	232,751	219,976	214,302	207,298	18.0	97
16	Wood processing and wood products	11,501	11,050	10,839	11,072	1.0	102
31	Furniture production	9,637	9,676	9,357	8,887	0.8	95
	Total wood processing and furniture production	21,138	20,726	20,196	19,959	1.7	99
	TOTAL CROATIA	1,211,085	1,168,179	1,159,657	1,153,497	100.0	99

Source: State Bureau of Statistics, Communication 9.2.6.

Wood processing industry in Croatia is among rare industries that have recorded exports higher than imports. Exports in this industry in 2012 accounted for 7% of the total exports of the Republic of Croatia, and it amounted to USD 902 million. The value of exported wood and wood products was USD 578 million, whereas the value of exported furniture amounted to USD 324 million. The value of imported products in the same year was USD 498 million (Table 2).

Table 2. FOREIGN TRADE OF WOOD PRODUCTS AND FURNITURE

	EXPORT mil. USD	IMPORT mil. USD	BALANCE mil. USD	Export -import ratio (%)
2008	977	905	72	108
2009	755	655	100	115
2010	814	535	279	152
Index 2011/2010	118	110	135	
2011	964	587	377	164
Wood and wood products	612	239	373	256
Furniture	352	349	4	101

2012	902	498	405	181
Wood and wood products	578	194	384	298
Furniture	324	304	20	107
Index 2012/ 2011	94	85	107	
Wood and wood products	95	81	103	
Furniture	92	87	573	

Source: State Bureau of Statistics

The greatest problem is that the structure of export products is very unfavourable. It is dominated by export of raw materials and semi-finished goods that generate the lowest added value. As the most important segment of forest-based industry that should represent the highest added value, furniture industry is in a very difficult position. Although global recession has significantly reduced demand for furniture, the problems for this industry actually started 20 years ago. At the beginning of the 1990s, within only a couple of years, Croatian furniture industry was almost halved and brought to the verge of catastrophe, partially due to the war, and later due to the largely unsuccessful privatization and economic policy that failed to provide adequate incentives. As annual yield has increased, companies now have wood raw material, but they lack processing capacities to increase the added value (Vlahinić-Dizdarević & Uršić, 2010:66).

Due to the situation in the industry outlined above, imported products dominate the furniture market.

To change the structure in the wood processing industry, the Ministry of Agriculture has developed the Operative Programme for the Development of Wood Processing and Furniture Production with the goal to increase the value of wood raw material multiple times through products of high finalization level, quality, design and recognisability.

The long-term goal is to achieve wood processing and furniture production as economically successful, profitable activities with well-balanced, competitive and sustainable development, following the global development trends.

This goal is based on the prerequisite of increased economic efficiency, and increased level of competitiveness will be the key point for continuous economic achievements.

The long-term goal will be achieved through realization of short-term goals:

- Change in the existing structure, with higher proportion of final production;
- Increased share of final products on the market;
- Increased competitiveness of final products on the market;
- Increased employment and maintaining the population in rural areas;
- Encouraging the development of, and protecting the national wood processing and furniture production, without compromising its openness.²

Thus, the entire economy as well as wood industry in the Republic of Croatia needs to face strong and large competition, in both the home and foreign markets, and look for solutions for its survival and future development in such competitive conditions.

One of the strengths of the forest-based industries is superb yet available raw material. Products made of Slavonian oak and other types of wood have been traditionally exported to the European and world markets. Croatia has a long tradition and experience in production of wood products. One of the strengths is also the forestry policy with elements of sustainable development. According to *Hrvatske šume* (a public enterprise for forest and woodland management in the Republic of Croatia)³, the wood mass in the Republic of Croatia amounts to 398 million m³, with annual yield growth of 10.5 million m³, thus ensuring the future of sustainable management, as annual consumption of wood mass is lower than the yield.

However, the above stated facts are only comparative advantages that should be developed into competitive ones and become opportunities for the development of this sector. One of the possibilities refers to encouraging the development of clusters, which would make it possible for Croatian companies to specialize in a particular phase of furniture production and improve production flexibility. This type of business organisation has already proved itself very successful, for example in Austria (Vlahinić-Dizdarević & Uršić, 2010:71).

Based on the above, several clusters were founded in Croatia and they are oriented towards problems of companies in the wood industry, trying to facilitate

² Operative Programme for the Development of Wood Processing and Furniture Production 2011-2014. Available at <http://www.mps.hr/default.aspx?id=8474> (January 19, 2014)

³ <http://portal.hrsume.hr/index.php/hr/ume/opcenito/sumeuhrv> (February 5, 2014)

placement of goods through joint presentations at trade fairs and on the market. Producers organised in a cluster can also obtain raw material under more favourable terms and many other benefits.

When it comes to branding of the Croatian wood industry, the cluster *Drvo je brand* ('Wood is a brand') stands out. Through its goals and activities, it promotes and educates companies about the need of the Croatian wood industry to aspire to the highest possible level of product finalisation. One of the most important tasks of the cluster *Drvo je brand* is to achieve a higher level of competitiveness of the Croatian wood products on the world market through its activities based on innovation, design and final products, with inevitable activities of marketing and promotion to create a higher additional value.

Change in the production structure to the benefit of final products opens opportunities for greater employment, but also for greater export. Opportunities also exist in tourism – involving of domestic furniture producers in supplying hotels and tourist facilities with furniture would result in sales growth and indirect promotion of the Croatian furniture (Vlahinić-Dizdarević & Uršić, 2010:71).

Unfortunately, there are more weaknesses than strengths. These refer to dominantly standardized mass production, which prevents comparative advantages of Croatia from being utilised. Mass production results in products of lower added value that have difficulties in finding the market due to increasing international competition within the observed market segment, where the product price is the most important factor of competitiveness. In the field of mass production, greatest competitiveness is achieved by countries with low labour costs with which Croatia cannot compete. Therefore, Croatian production should specialize in production of high quality furniture that is produced in small series (Vlahinić-Dizdarević & Uršić, 2010:71).

Poor product structure should also be emphasized, with dominance of primary products, which usually generate the lowest profit, compared to final products. Low productivity and low level as well as outdated technology are also some of the weaknesses of the forest-based industry. Significant weaknesses in furniture production include inadequate and unattractive design as well as a lack of brands.

Threats refer to poor utilization of wood raw material in the way that good raw material is turned into an uncompetitive final product. In terms of price competition, countries presenting threats include countries of Asia and Eastern Europe, which have lower labour costs.

2.1. Measures to stimulate competitiveness

The unacceptable existing programme and unsatisfying competitiveness require restructuring and diversification of the existing production toward products of higher added value and adjusting to the market conditions of the EU. This requires increased investment activity, embedding competitiveness factors in production and business, and sustainable production that increases the share of the analyzed activities in GDP structure.⁴

In order to increase competitiveness, in 2010 the Ministry of Regional Development, Forestry and Water Management presented the “Operative Programme for the Development of Wood Processing and Furniture Production 2011 – 2013”. This programme aimed to increase competitiveness in two ways⁵:

a) Through education and improvement of human resources

Raising the human capital value, acquiring knowledge, skills, attitudes and values that an individual needs to realise his or her working role, all of these are key factors of repositioning the economy in terms of competitiveness. Education should be perceived as an investment that enables integration of business plans and employees' skills in order to achieve goals in the field of economic growth, products and services. Education and improvement increases competitiveness by ensuring the necessary quality of human resources.

b) Through application of new technologies and technological processes

Today's production conditions imply wide application of automated technology in designing, engineering, and production process. Successful integration of this technology in the business process and keeping up with global trends requires systematic investment in technological development. Introduction of new technologies has numerous effects on business, such as increased production volumes, reduction of production costs, improvement of product quality and business processes, improved production flexibility and shorter delivery periods.

3. Conclusion

Recognising competitive advantages and disadvantages is the most important goal of any company. There are two key sources of competitive advantages – low

⁴ Amendments to the Operative Programme for the Development of Wood Processing and Furniture Production 2011 – 2014, available at <http://www.mps.hr/default.aspx?id=8474> (January 19, 2014)

⁵ Ibidem

costs and differentiation. Competitive advantage is achieved and maintained either by supplying identical value to buyers at a lower cost than the competition in the industry i.e. low cost advantage, or by supplying a higher value to buyers at an average cost in the industry, i.e. differentiation.

In 2012 in the Republic of Croatia there were 19 959 people employed in the wood processing industry. The crisis has had devastating effects on all segments in Croatia, including the wood industry. One of the most important strengths of the forest-based industries is high quality, easily available raw material. Another important strength is the experience in wood industry. Unfortunately, there are more weaknesses than strengths. These refer to predominantly standardized production in large series, which prevents Croatia's comparative advantages from being utilised.

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