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# Study on the Transform and Upgrade Strategy of Chinese Textile Processing Enterprises

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## Abstract

Contracting with transnational corporations and their investing enterprises in China is one of the main methods of Chinese textile enterprises to participate in international production division. With many transnational corporations' subcontracting activities entering China, more and more Chinese textile enterprises actively participate in the global production division system, which not only promotes the increase of Chinese export trade and economy, helps the employment and introduces advanced technology and management experience, but also provides a rare opportunity for the transition of textile industrial value chain as well as the growth and upgrade of domestic textile industry. Considering the factors influencing the sustainable development of Chinese textile processing enterprises, Chinese textile enterprises have much to do in improving their international competitiveness and achieving the transition of the value chain.

**Index Terms:** Textile Processing Enterprise; Dynamic Ability; Organizational Study; Industrial Upgrade; International Competition Advantage

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## 1. Introduction

The subcontracting production mode, also referred to as processing, is a rapidly developed production mode in recent years. It is actually a commissioned production and processing relationship, i.e. the contractors make use of their advantages in core technology, innovative design, sales channels, etc, and entrust the subcontractors to manufacture, after which they sell the products in the market with their own brand. The subcontractors are called the processing party, i.e. the processing enterprises. From a worldwide view, subcontracting has become the important carrier of international division and the dominating mode of transnational corporation's international production. With the acceleration of the economic globalization, the subcontracting has developed from the developed countries to the developing countries; and from traditional light industries such as garment, shoes, and toys to heavy industries such as home appliances, transportation equipment manufacture, etc. The subcontracting is becoming the important method of the developed countries' traditional manufacturing enterprises to get rid of difficult situation and get back the competitive advantages. In our country, the low land cost, labor cost and good policy environment naturally attract the manufacture

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enterprises of the developed countries which pursue efficiency, lowering production cost and strengthening core business ability. China is gradually becoming the centre of the world manufacture industry.

## **2. It Is Imperative for Chinese Processing Enterprises Including the Textile Processing Enterprises to Establish and Improve the Ability System to Adapt the Dynamic, Complex and Changing Market**

Since the 1990s, Chinese economy dominated by the manufacture industry has developed greatly, and China has become the world second largest manufacture country which is only next to America. According to the Chinese Economy Investigation Report (2010) issued by OECD on 2 February 2010, in 5 to 7 years, China will surpass America and become the world largest manufacture country. China plays an important role in the global manufacture subcontracting, and is called most competitive “world processing factory” and “global manufacture subcontracting service platform”. It is proved by some scholars’ research that the OEM model in the processing enterprises can be used in certain period, and processing does not necessarily mean “meager profit”, to which Guo Taiming’s Hong Hai Model is a good testament. On basis of the analysis of the four strategies, i.e. the leader, the challenger, the follower and the supplementary, Kotler and Keller (2008) consider that the follower strategy is an effective strategy which can be adopted by the manufacture processing enterprises of the rising market countries in certain period. In reality, many Chinese enterprises use the processing model (which does not have its own brand) and only process products for various manufactures in the world. Therefore, processing has become the main operation mode of Chinese enterprises, and is the important method for Chinese enterprises to integrate into the international production system and participate in the global competition division. This processing operation mode inevitably causes a problem to Chinese enterprises: the Chinese enterprises which accept the subcontracting only have the ability to process low technology products, but lack the product design, research and develop advantage, or the technology innovation ability and famous brands with independent intellectual property right. They greatly depend on the overseas suppliers and importers in respect of information sources and sale channels. With the forthcoming of the “super-competition” era, the market and industrial environment become more and more complex, dynamic and uncertain, and the competition among Chinese processing enterprises also becomes fiercer and fiercer. Their advantages built in stable environment are constantly eroded, and the static balance formed in the original market is broken. In the meantime, for Chinese local processing enterprises, the direct investment from international manufacture industry may upgrade local industry structure, enlarge industrial scale; in addition, if local processing enterprises can match up the pillar enterprises, they may not only develop in short period, but also gain dynamic innovation ability and long term competitive advantage. However, the reality is that the international manufacture capital is only interested in such corresponding facilities as materials rather than improving the ability of local processing enterprises to adapt the environment.

Influenced by the regional economic developing pattern which depends on low labor cost, the extensive GDP increase competition mechanism, and the lack of local market demand caused by unequal income, the international buyers of developed countries and transnational corporations as the contracting and dominating parties in the global processing system, constantly restrict and control Chinese local processing in upgrading ability. In this background, the competition among many Chinese local processing enterprises is fiercer and fiercer, and the surviving conditions are worse and worse. Especially, the financial storm started in the USA has brought austere challenges to the global economy, and Chinese local processing enterprises also face great survival pressure. Taking the textile industry for example, as the beneficiary of China’s entry of WTO, especially after that the global textile products quota system was cancelled in 2005, the export of Chinese textile products has developed rapidly, and the processing center position in the global industry value chain is strengthened. However, from the perspective of international competitiveness, although Chinese textile industry is competitive in quantity and scale, the advantages in quality and level are not strong. Chinese textile industry integrates the global value chain through “brand pasting” and develops rapidly, but it is still in the low value added manufacture link in whole. The income shrinks. As such, it is urgent to transfer from OEM to ODM, OBM. From the textile industry example, we can see that how can Chinese processing enterprises adapt

the dynamically changing environment, survive, gain profit and develop, how can they upgrade from OEM to OBM with independent brands is an issue in which the theory and practice are interested.

### **3. Analysis of the Factors Influencing Chinese Textile Processing Enterprises to Upgrade Dynamic Ability**

The internal characteristics of Chinese textile processing enterprises determine that they can not be for long. There are the following factors influencing their sustainable development.

#### *3.1. Profit*

By way of processing, the developing countries with low labor cost rapidly become the important production country and exporting country of low technology products even middle and high technology finished products. In this respect, China is no doubt the prominent one. Its textile processing enterprises can enter the complex middle and high technology production area from traditional low technology area in a relatively fast speed, and rapidly improve their productivity and market reaction ability. However, because of the strict control of transnational corporations and insufficient resources, it is difficult for Chinese textile processing enterprises to have independent technology and brands, causing them be “locked in” the low end of the global value chain. The entry barriers for manufacture are low, causing the over competition among the developing countries and more supply than demand, which in turn results in the rise of the price of the primary products while decrease of that of the finished products. The profit of Chinese textile processing enterprises continuously shrinks. Low profitability gives them little opportunity to deal with the market change, either reducing the price or rejecting the offer, the latter of which means the ending of the relationship with the contracting enterprise.

#### *3.2. Market Demand*

Market is the vane for the operation of enterprises. An enterprise ignoring the market will be kicked out by the market. After many years’ manufacture with “brand pasting”, Chinese textile processing enterprises have lost the acuity to the market. They just produce according to the requirement of the contracting enterprises while unable to grasp the market demand and cannot build effective sales network to use multi-mode marketing channels. Three critical links (sat, production, supply and selling) which determine the product profit are controlled by the contracting enterprises, and Chinese textile processing enterprises basically have no independent operation rights. Because of this, for those Chinese enterprises having no sales network, the purchase order and market are controlled by the contracting enterprises. If there are countries and regions where the cost is cheaper, Chinese textile processing enterprises will lose the advantages and may inevitably face risk of closing down.

#### *3.3. Production Advantage*

The motivation of transnational corporations is to improve efficiency, reduce production cost, enhance the core operation ability and strengthen the competitive advantage. The transnational corporations were once keenly interested in the cheap land cost, labor cost and preferential policies for foreign investments in China. However, with the lack of technological workers, appreciation of ren mi bi, rise of energy cost, adjustment of industrial structure as well as the stricter and stricter environmental policy, compared to other regions, especially Viet Nam, India, Bengal, Pakistan, Chinese textile processing enterprises have less cost advantages. Those countries become more attractive to transnational corporations, and many transnational corporations have reduced purchase orders in China. For example, the largest global retailer Wal-Mart has reduced purchase in China in recent years, but its purchase in India and Pakistan has risen continuously.

### *3.4. Independent Innovation Ability and Independent Brand*

Because the transnational corporations transfer only the labor intensive production activities to the developing countries rather than the innovation activities which are technology and research intensive, Chinese textile processing enterprises lacking independent innovation ability are the assembly workshop in transnational corporations' global production network which can be replaced at any time. On one hand, there is potential threat of new comers; on the other hand, the transnational corporations demand a low price. Therefore, Chinese textile processing enterprises without bargaining power or independent pricing ability can only transfer the cost pressure by low salary and environment prevention, while low salary will no doubt holdback the expansion of market demand causing larger dependence on international market of Chinese textile processing enterprises. In the meantime, because of technological progress and competition pressure, Chinese textile processing enterprises have to upgrade the equipment and invest in fixed assets to expand production scale and increase productivity. However, the redundant productivity can not be released in domestic market, and has to transfer to international market. Thus, local enterprises and national economy are dependent on both transnational corporations and international market, making Chinese textile processing enterprise become appendix to transnational corporations, and the extensive growth local economy can not improve national welfare in nature.

Comparing with processing, large amounts of capital has to be invested in the research and development of independent brands, and there are more technological risks and market risks. Facing these risks, on one hand, Chinese textile seldom create own brands because of their nature of pursuing gains and avoiding loss; on the other hand, Chinese textile processing enterprises are not allowed to have own brands. Otherwise, they would compete with the contracting enterprises. Firstly, the contracting enterprises are concerned that Chinese processing enterprises would copy their design; secondly, Chinese processing enterprises may fail to delivery on time if they have own brands and there is inefficient productivity. However, brand is the guarantee of market and high profit. Without brands, enterprises will depend on others, and can not bargain with transnational corporations. They are in the bottom of the industrial value chain and easily to be influenced by outside. Take Chinese textile clothing industry for example. Foreign enterprises have controlled the development in the upstream and the design in the downstream, forming a strong brand effect in the market. Without the support of international brands, the purchase order price of Chinese clothing enterprises shrinks significantly. In addition, in order to increase the transaction with the brand traders and improve the product level, Chinese textile processing enterprises usually focus on the demand of specific client and invest in certain specific products. Such investment is sunk cost. Once the cooperation relationship with the specific client ends, the investment will be left unused and Chinese textile processing enterprises might suffer losses.

## **4. Strategies for Chinese Textile Processing Enterprises to Upgrade Dynamic Ability and Achieve the Transfer**

### *4.1. Developing to the two ends of the industrial value chain*

The semi-finished product manufacture is the link with lower added value, large input expectation of transnational corporations and small supply flexibility of Chinese textile processing enterprises. As such, the transnational corporations can easily extrude Chinese textile processing enterprises, reduce cost and transfer risks to pursue maximum profit. Currently, the transnational corporations in the downstream of the industrial chain are strong while there are insufficient large enterprises in Chinese textile processing industry because of its short development time. Therefore, in the short run, it is necessary to interfere with industrial policies to integrate the resources of the textile processing enterprises in the upstream, and form the industrial structure of oligarch monopoly by mergers, acquisitions and restructure to make the textile processing enterprises irreplaceable and increase the bargain power with transnational corporations. From the long run, the

government may encourage and support some Chinese textile processing enterprises with certain power to improve the research and development level, create brands, improve the technological innovation and brand operation ability, and thus cultivate a group of equipment manufacture with independent intellectual property rights and core technology.

#### *4.2. Exploiting independent domestic and overseas markets*

One main reason why Chinese textile processing enterprises are controlled by transnational corporations is that they only process products and have no independent sales market. Therefore, the textile processing enterprises should be directed by the marketing conception rather than only pursuing operation efficiency or competing with rivals by such low end methods as simple imitation, price war, advertisement war, etc. Instead, they should research in domestic and foreign market, grasp current situation of marketing, track the demand and trend, and have differences in product quality, packing, color, pattern to provide customers with unique value. In the meantime, the government should accelerate the market reform, remove local protection to form national unified market and play a role in specialist cultivation.

#### *4.3. Attaching importance to improve the quality of production materials*

In the era of industry economy, countries dominating in international division mainly depend on large input of capital and machinery and equipment, while the advantages in labor, resources, land, climate conditions are not determining. However, in the knowledge economy era, having more knowledge and information means more domination in the international division system. With the development of Chinese economy, insufficient resources, environment constraint and trade fiction have become more and more obvious. Chinese textile processing enterprises have to improve the quality of the production materials, and transfer from dependence on resource input, cheap labor to capital advantage, technological progress and efficiency increase, either to develop specialized processing service or to create independent brands. Therefore, Chinese textile processing enterprises should increase the education and training investment and improve the labor quality to provide foundation for their independent research and development and brand cultivation. In addition, Chinese textile processing enterprises should upgrade the knowledge of the talents and cultivate specialized talents in the areas of knowledge management and innovation management; market analysis and product innovation; information science and e-commerce; brand operation and customer service; marketing channel development and logistics management, etc.

#### *4.4. Improving the studying ability and independent innovation ability, and focusing on the development of independent brands*

Chinese textile processing enterprises should regard technological innovation and differentiation as the main methods of competition. They can study while operating, adjust the organizational structure and improve the ability to catch up advanced enterprises, especially to study how can advanced enterprises satisfy the demand of the customer in respect of the price, quality, delivery period, after service, and study the methods to reduce the production and time cost to develop scale economy and speed economy. Specifically speaking, Chinese textile processing enterprises can build internal knowledge sharing, transfer and innovation mechanism by knowledge and information collection management department, make efforts to internalize the knowledge and skills of partners, and combine the internalized knowledge with original knowledge to enhance the innovation ability. In the meantime, Chinese textile processing enterprises should establish trust relationship with the contracting enterprises, strengthen the mutual trust, reduce the risk of the knowledge transfer of the contracting enterprises and provide more product added value.

It is necessary for Chinese textile processing enterprises to development independent brands. First, Chinese textile processing enterprises should clearly realize the differences between processing and brand operation,

including the differences in target customers, growth mode, product line, market input, operation manner, resource integration, etc, and incorporate that into the enterprise development strategy. Second, Chinese textile processing enterprises should focus on the brand power. They should not only create outstanding products, but also make deep analysis on the product name, product position, consumer category, core demand, and design and plan the product core value, product appearance, packing, price and price system, which is the key to create independent brands. Finally, Chinese textile processing enterprises should emphasize the construction of marketing team, construct the marketing organization and process according to the market goal, channels, etc, and build the team of their own with the enterprise culture and values.

## **5. Conclusion**

It is imperative for Chinese processing enterprises including the textile enterprises to establish relevant system to improve the ability to adapt the dynamic and changing market, and study and acquire technology and management knowledge from the contracting client by doing so, so that they could promote the improvement of enterprise performance. Current research has named this ability system as the dynamic ability, which is the ability of Chinese processing enterprises to integrate, construct and restructure the internal and external resources to modify the operation ability and thus adapt to the dynamic, complex and rapidly changing environment. It is especially important for Chinese processing enterprises including the textile enterprises to have good performance in the fierce “Red Sea” competition. We must deeply discuss and research how to build and improve such ability system.

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