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The background of the slide features a close-up of a wood cut on the left and a chainsaw chain running horizontally across the middle. The text is centered within a white, rounded rectangular area that is part of the chainsaw chain's path.

# Market analysis of the wood Industry in Pcinja and Jablanica District

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# 1. Introduction:

## 1.1 Project Overview

Project "**Private Sector Development in the South Serbia**"- inception phase, started in February 2010 and will last until September 2011. Project is funded by SDC, implementing agency is RDA "VEEDA", the total value of the project is 350,000 CHF (259,000 EUR). The project covered Pcinja and Jablanica region (municipalities of Presevo, Bujanovac, Trgoviste and cities: Vranje and Leskovac).

The project aims at improving employment and income opportunities in the Pcinja and Jablanica region of South Serbia by stimulating and facilitating systemic change in key sectors that leads to economic growth and improved access to markets and services. In doing so, the project uses a market development approach<sup>1</sup> as its project rationale, focusing on sustainable change in supporting functions and rules that constitute the wider system around markets. Three sectors are selected for interventions during the inception phase, all three which play a significant role as generator of income and employment in the region.

The project is in its inception phase<sup>2</sup> in which market analysis will be conducted to generate an understanding of the root causes that prevent a more inclusive growth in the three sectors. Based on this understanding, the M4P approach will then be used as guidance to facilitate systemic change such as improving access to business services, enhancing value-added production, facilitating cooperation amongst businesses or public-private dialogue. M4P is an approach to developing market systems so that they function more effectively, sustainably and beneficially for poor people, building their capacities and offering them the opportunity to enhance their lives. Applicable to development and other agencies working in both economic and social fields and who pursue public goals, it is an approach defined by a number of important characteristics.

<sup>1</sup> 'Making Markets Work for the Poor (M4P) approach. For further reading please refer to the key documents published by SDC and DFID: a Synthesis, Operational Guide and Perspectives' – all available from [www.springfieldcentre.com](http://www.springfieldcentre.com)"

<sup>2</sup> The inception phase started 01.04.2010 and end 30.09. 2011. After this, the project will enter into a 3 years implementation phase.



## 1.2 Market Approach

The *PSD project uses a market development approach* (known as the “Making Markets Work for the Poor (M4P)” approach), which is gaining increasing recognition among development agencies worldwide. As such, this PSD project is among an increasing number of projects worldwide that stress the importance of creating long-term, sustainable systemic change in markets that are essential to a large number of people as a source of income and employment. PSD is one of two SDC funded projects in Serbia that are pioneering this approach

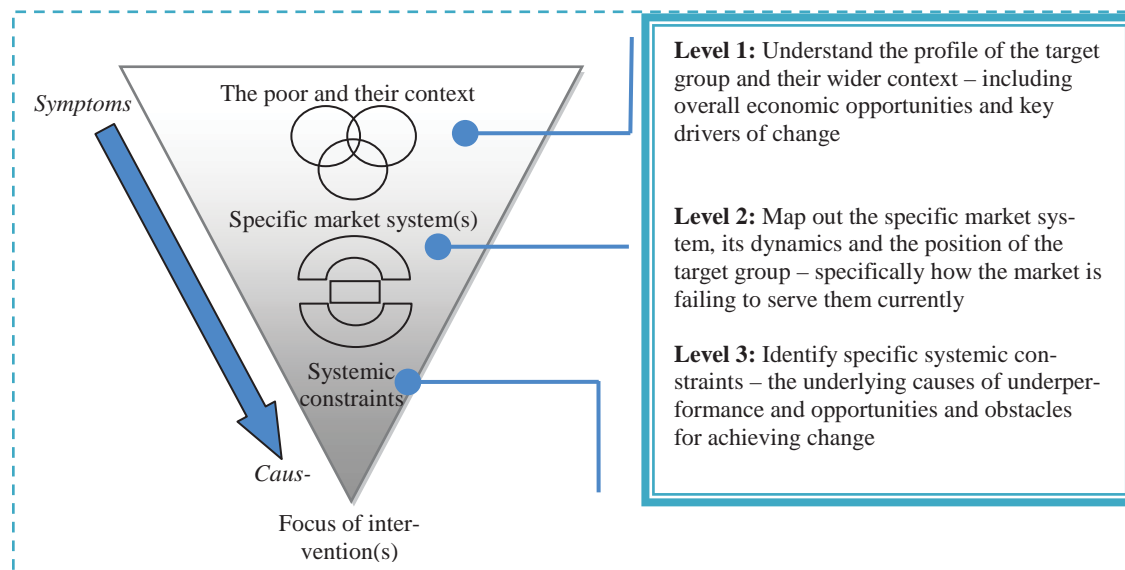
M4P is an analytical and action-oriented approach guiding development agencies and governments toward sustainably improving the terms by which people participate in market systems. Though varied and non-prescriptive in application, M4P programmes are all consistent in their adherence to **a set of common principles**, defined below:

1. **Inclusive growth (and access):** Creating an environment in which people (especially the poor, SMEs, youth and women) are able to access and take advantage of sources of growth and opportunities to improve their economic (and social) circumstances.
2. **Systemic action:** Understanding the disadvantaged position of the target groups to be the result of critical failings in how (market) systems function, and acting to correct such failings. This requires the project to develop an understanding of functions and players within market systems and how these can be strengthened in order to better serve the needs of the poor.
3. **Sustainability:** Ensuring that the market players needed to supply relevant goods and services on a recurrent basis have the incentives and capacities to do so. The focus on systemic change also means that interventions address the underlying causes of underperformance rather than merely their symptoms – hence achieving greater sustainability.
4. **Impact at scale:** Aiming to affect change relevant to large numbers of people, for example, across a whole sector, rather than across just one village or a few individual enterprises. The project therefore pursues an active strategy of crowding-in market players, ensuring that change goes beyond immediate intervention partners.
5. **Facilitation:** Determining a temporary, catalytic role for the PSD project which stimulates market players themselves to adopt and perform functions necessary for the continued, successful operation of their market system, rather than become a market player oneself.

The complete intervention process of the PSD project in the wood processing industry is illustrated in *Figure 1 below*. According to this, the project started with a “context analysis” in April 2010, which was aimed at developing a better understanding of the target group (unemployed/poor, youth, women, and SMEs) and their socio-economic context. As a result of this, ***the project selected three markets for further intervention: wood processing, forest plants and tourism.***

Subsequently, the project conducted an ***in-depth value chain analysis of the wood processing industry*** (level 2 in the figure 1), to understand the structure and dynamics of the industry, as well as the constraints that undermine its overall competitiveness and more intensive and inclusive growth in income and employment. As a result, the project identified ***some key intervention areas*** (see *Chapter 5*) that will form the project’s main focus over the coming three years.

Figure 1<sup>3</sup>: M4P – a process that seeks to distinguish symptoms of underperformance from causes in the wider system

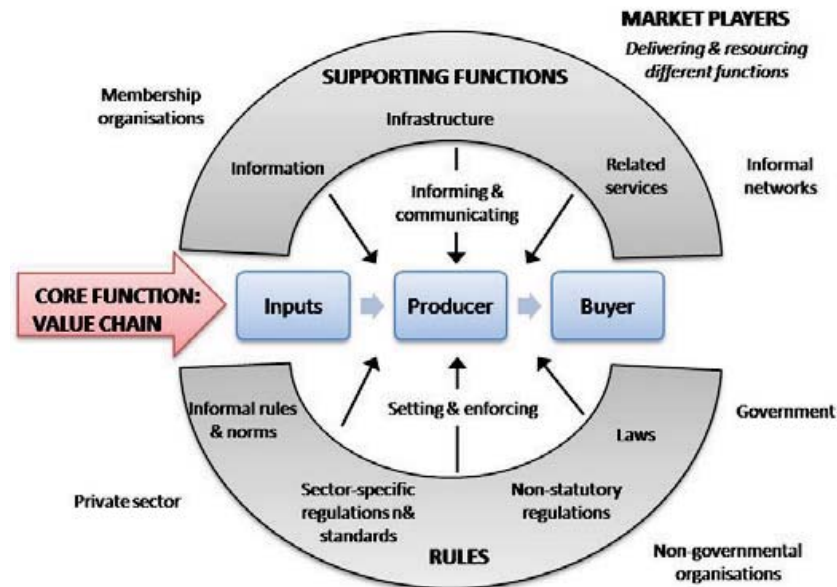


<sup>3</sup> Source: *The operational guide for the M4P approach*

**Market system focus:** its focus is on developing market systems, assessed with respect to different market functions and players, public and private, formal and informal. This systemic character of M4P defines many of its most important features. Its view of a market system.(Figure 2) emphasizes their multi-function, multi-player nature – in particular the three main sets of functions that make up the market system:

- The **core function** between provider and consumer (or the series of players in the flow of value-added in a value chain),
- The **formal and informal rules** impinging shaping behavior and
- The **information, services and other functions** supporting exchange.

Figure 2: Stylized view of the market system



Source: Springfield centre

### 1.3 Project focus

**The PSD project focuses on five municipalities:** Presevo, Bjanovac, Trgoviste, Vranje and Leskovac (Vranje and Leskovac are recently categorised as cities), are representative for the economic structure of South Serbia. The reason for SDC to start a new project in South Serbia is related to the poor economic performance (the region's GDP averaged only 63% of the republic and grew only by 4 percent between 2005 and 2010), low income levels (average salaries in Pcinja district and Jablanica district are approximately 27% below republic) And high unemployment rates (Jablanica district 23,6% and Pcinja district 18,71% in July 2010<sup>4</sup>. Most of the unemployed in the region are women in Jablanica district 48,79% and in Pcinja district 50,46% and young people in Jablanica district 39,63% and in Pcinja district 36,91%<sup>5</sup>.

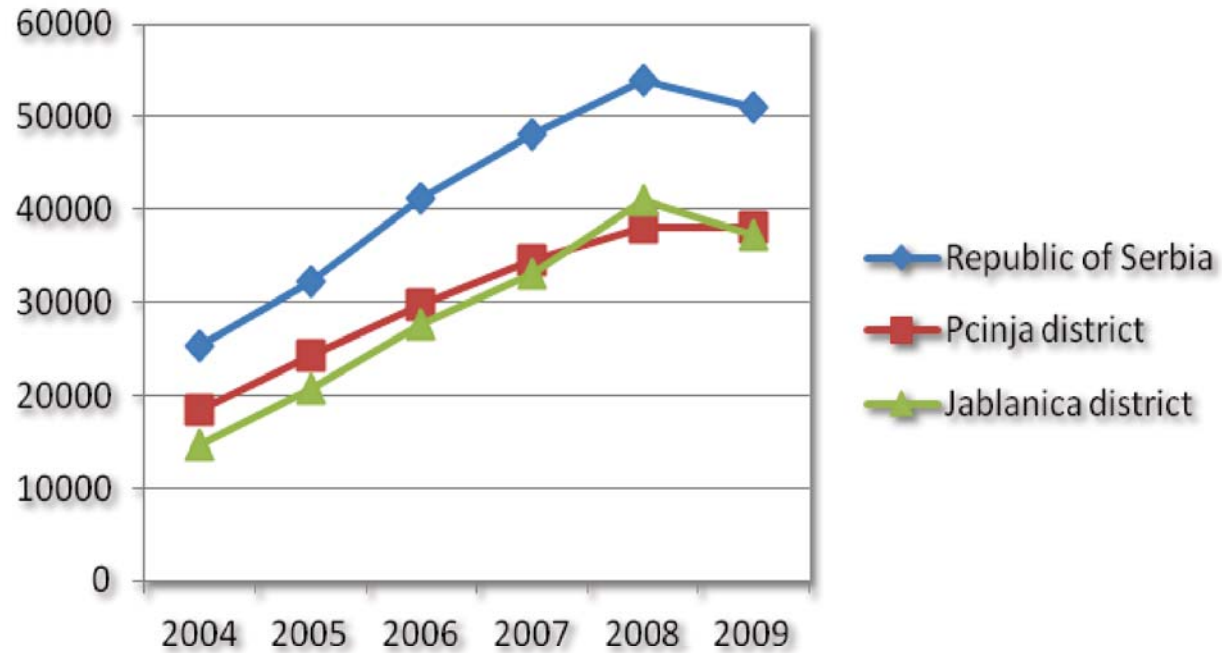
*Although the PSD project focuses mainly on the above mentioned five municipalities, the market development approach that underlies the project rationale puts a strong emphasis on achieving impact beyond direct partners and beneficiaries – ie pursues an active strategy of crowding-in other players. Furthermore, intervention partners might include lead firms or other regional/national public and private players that are not only important change agents for the five municipalities, but whose influence goes beyond district boundaries. The project outreach is therefore expected to go beyond the five municipalities.*

<sup>4</sup> Unemployment rate=(active population/ unemployed)\*100

<sup>5</sup> National Employment Service



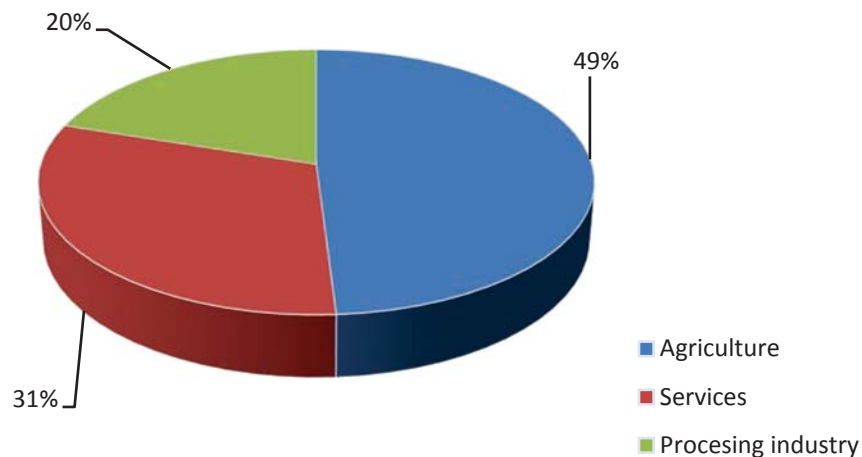
Chart 1 -: Compared average salaries in Republic of Serbia, Pcinja district and Jablanica district in 2004-2010



Source: Stistical office of the Republic of Serbia,  
Salaries and wages per employee 2004,2005,2006,2007,2008,2009

**Processing industry** (20%) (especially the one based on wood, forest plants and herbs), **agriculture** (49%) and **services** (31%) now has the biggest contribution in national income.<sup>6</sup>

Chart 2 - Registered and operational activities by type



Source: HELP - Hilfe zur Selbsthilfe e.V. - Republic of Serbia Mission

The most important sectors in Pcinja and Jablanica district include wood processing ( number of employees approximately 10000-12000), leather industry ( number of employees approximately 800), milk and meat production ( number of employees approximately 10000), textile industry (number of employees approximately 3500), and forest plants (number of employees approximately 5000). Tourism (number of employees approximately 3000) is seen to be a service sector with good growth potential: natural environment, hot water springs, cultural and historic sites, as well as the fact that the two districts are located along the main transit route to Macedonia and Southern Balkan countries provide good preconditions for tourism.

<sup>6</sup> Source HELP - Hilfe zur Selbsthilfe e.V. - Republic of Serbia Mission

The wood processing industry has been chosen by the PSD project as the immediate focus for development interventions for the following reasons:

- **large number of different wood processing enterprises** - because it have significant absorption ability for our target groups and wider influence on interconnected markets.
- **possibility to increased production and export** – through interviews with entrepreneurs they strongly point us that there are a number of inquiries from Western markets to which they are unable to respond due to low production capacity, lack of standards and quality.
- **good ground for raw material** – Raw materials in 90% of the purchase of neighbor private cutters and the products are sold at local markets. In addition to small shops in the market operates several enterprises engaged in primary processing of wood and which sell their products on the local market but to individuals and larger companies. These are companies that have great flexibility as well as production facilities that make it possible to meet the Demand of large companies. The main products in the primary industries are lumber and supplies for building and lumber for a secondary processing. As already stated, these products are not exported but is sold at local markets.
- **good geographic position** – It's located on the South of Serbia, close to border with Bulgaria and Macedonia. There are very important international communication routes: highway E-75 connecting this region with Macedonia and also central Europe with Balkan, railway Budapest-Belgrade-Skopje-Athens.

## 1) Relevance

Wood industry in Pcinja and Jablanica district is consist of few big companies like SIMPO, which is employing 5000 employees, also there is 100 SME-s with 20-50 employees and 200 small enterprises with 5 employees. Average total number of involved in this sector is 10000-12000.

There are significant number of people regarded us our target group waiting for work in wood processing industry. The data from NES shows that youth participate in total with 34.21% in Pcinja district and with 43.28% in Jablanica district. Women participate in total with 35,95% in Pcinja district and with 19.02% in Jablanica district. ( Table 1)

- There is permanent lack of high educated people in this sector.
- Attractive for young people and w omen especially considering salaries and "soft" operational processes needed ' woman hand'.
- Women participate in total employment in wood industry with 20%. In primary industry, the majority workers are men. Women mostly work in managerial and administrative jobs. A higher percentage of women employed in the sector of final processing or part of product design.
- Equally distributed in both districts





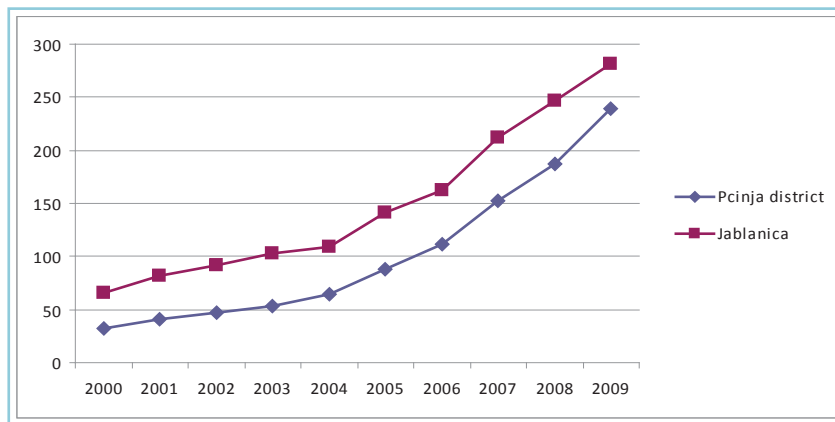
Table 1: Unemployed people at the end of July 2010 in Pcinja and Jablanica district

District	Total		15-34		35-54		54+	
	Total	Women	Total	Women	Total	Women	Total	Women
<b>Pcinja District</b>	687	247	235	83	379	154	73	10
<b>Jablanica District</b>	573	109	248	82	238	26	87	1

Source: National Employment Service

At the end of 2009 in Pcinja district was 239 companies registered in wood industry and 281 in Jablanica district. The number of registered companies increase from year to year, especially since 2005, ( Chart 3) thanks to state measures that stimulate the creation of new businesses and thus new jobs (over National Employment service grants, start up loans, the various programs of the National Agency for Regional Development...)

Chart 3 - The movement of companies in wood industry in Pcinja and Jablanica district in the period 2000-2009



Source: Chamber of commerce

Considered observations from the field in the preparatory stage of this document the large number of SME emphasizes the possibility of expansion of its activity.

## 2) Growth potential

The number of enterprises and implicitly employment in this sector has consistently increased from year to year. Thus especially after 2006, when the average year growth is 20 enterprises per district. The market represented the ability to for competitiveness in export (see chapter 2.1). Very competitive sector for a wide spectrum of activities which includes different compatible activities in finished products, available raw materials, and environmental factor is present in this sector, the possibility of renewal of raw materials by re-planting of new trees.

This sector is a potential "reservoir" for the absorption of re-qualified workers from the other similar sector.

We can notice that, as a consequence of global economic crises, total production of wood industry on republic level, in 2009, is lower than in 2008 and amounts up to 77.6 index points for the products in primary processing, packaging and carpentry of wood, and 92.2 index points for the furniture

It is not easy to start this job but also a low risk of failure in this sector, because the equipment for this industry is usually more expensive and require more technical and educational precondition than in other sectors in this area ( for example cattle breeding). This high barrier decreasing the potential competition in start.

### 3) Intervention potential

There are great opportunities for potential interventions in this sector and due to the lack of qualified labor force for primary production, lack of work force in the area of standardization of products and product designs, innovative new products, expanding markets, information on export opportunities, the introduction of new materials and improving the use of wood waste. In addition, developing of wood industry is one of priorities in local strategy.

This branch has a large potential for further development primarily because of available raw materials, the number of registered enterprises in this sector and the number of employed are growing from year to year, it's attractive for the youth and it has absorption capacity in terms of employment.

The positive side of developing this sector is primary reflecting in primary processing. The large number of unskilled workers can be hired.

## 2. End markets for the wood processing industry, trends and requirements

### 2.1 Main products and destination markets

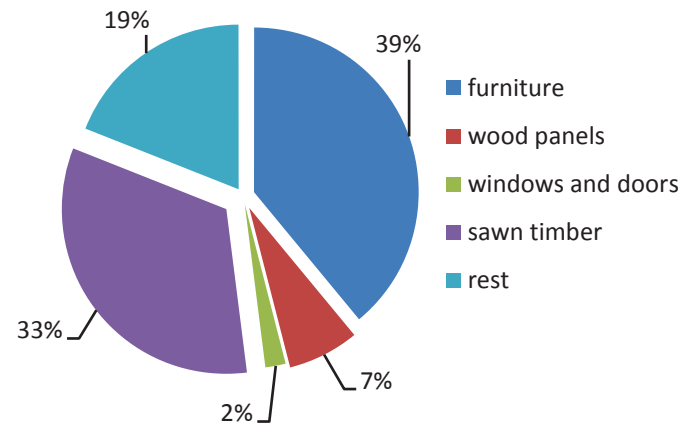
Large companies are mostly oriented towards the export of their products. A sale of furniture in the domestic market is oriented toward the larger towns and cities and developed areas in Serbia. Also, interesting towns are those whose citizens are working abroad. Companies from Southern Serbia produce almost all categories of furniture: household furniture, catering facilities, hospital facilities, schools, etc. Bedrooms takes important part in furniture industry in South Serbia. This category of furniture occupies a leading position due to high demand of hotels in Serbia, Montenegro and Russia.

Also, in the production of high position occupied by furniture: chairs, sofas, dining room and kitchens.. Foreign trade exchange between Serbia in 2009. for the wood products industry, forestry, pulp and paper industry is generally achieved expected level.

Mostly exported wood products from Pcinja and Jablanica district are shown on Chart 4.

Most important exporting markets for those wood product are: Russia – 24%, Bosnia and Montenegro – 23%, Italia – 16%, Croatia – 13%.<sup>7</sup>

Chart 4 - export share in wood industry from Pcinja and Jablanica district



Source: SIEPA

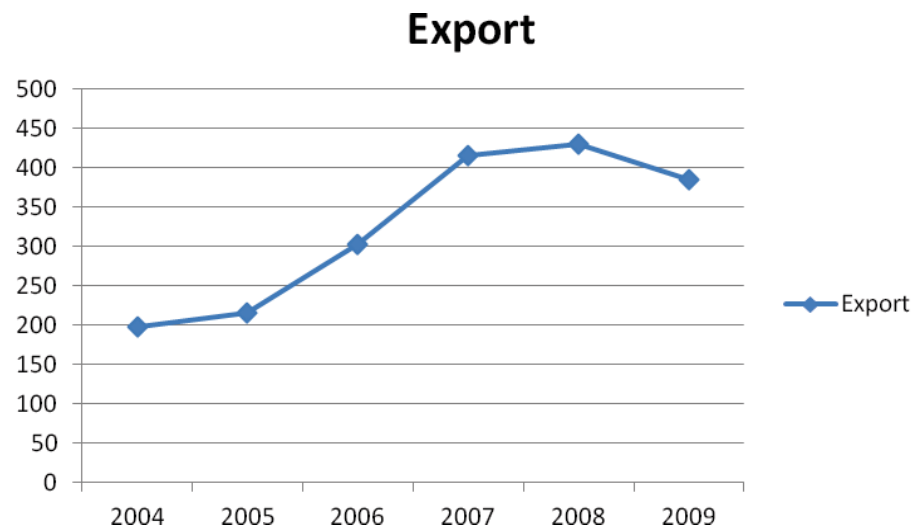
<sup>7</sup> Chambers of Commerce



## 2.2 Export trends

Export of wood products increase in period 2004-2009 while in the period 2008-2009 decreased (Chart 5). Causes of export decrease are: lower foreign demand as the effect of global economic crisis and the fall in prices of products on World market. In export structure of wood industry there are growing number of value added products - the final product, while the number of products of primary processing decreases.

Chart 5 - Export trend from Serbia 2004 - 2009



Source Statistical Office of the Republic of Serbia

### 2.3 Competition and comparative advantage

In Pcinja and Jablanica district are total 117.527 hectare under the forest land, with total timber volume of 15.336.037 m<sup>3</sup>, and total annual timber yield 229.204 m<sup>3</sup>.

Imports of wood products for the first time in the last five years is less than the previous year (table 2). Cause of the decline in imports is weakening manufacturing activities and industrial production fall of 12.1%. This decline in industrial production led to a decrease in imports and raw materials and equipment. Also, weakening household demand for finished products as a consequence of their purchasing power brought about a decrease in imports. Another reason that led to the reduction of imports is the fact that the launch of production of the only manufacturers of our plywood panels SPIK FC, met part of the market especially with raw panels.

Table 2: Import

Subsector	USD 2008/6	USD 2009
Forestry	28.587.925,00	14.239.599,00
Wood production	167.958.124,00	96.961.436,00
Other wood products	318.055.203,00	243.128.321,00

Source: Chamber of commerce

### 2.4 Market requirements and demand conditions

There is a market requirements for constant quality level of products and need for standardised products. It is necessary to carry out testing of product quality and also the adaptation of product design for specific markets, also it is necessary to bring products to the level where the buyer can participate in making furniture, by the system "do it yourself".

### 2.5 Conclusion: Key determinants of competitiveness for the industry

The main goal of the wood industry is to strive for constant quality and standard of products, also to invest in design capacity that are close to the demands of consumer markets as well as taking into account the manner of utilization of forest resources.

### 3. The wood industry in Pcinja and Jablanica district: structure, performance and key challenges

This chapter will look in more detail at the current structure of the wood industry in Pcinja and Jablanica districts, as well as assess its overall performance with regard to meeting market requirements and remaining competitive on the international market. The chapter concludes with key challenges the industry faces and that undermine growth and which creation of income and employment opportunities in the region.

The furniture industry in South Serbia employs over 10000 employees in over 200 companies and approximately 300 workshops, furniture made of wood. The largest number of private companies is ranked as a "small business" (91.7%). Medium-sized companies make up 7.1%, and large companies covering the remaining 1.3%. Some of the companies that are privately owned produce distinctive style furniture successfully exported to EU countries. Volume of foreign investments in local companies, for now is lower than expected. In previous period is invested only in the purchase of public companies, therefore the structure of investments is unfavorable. Cheaper labor, existing inter-state agreements ( selling products from Serbia without customs), favorable tax policies and government stimulus for employment are not enough for foreign investors. Bad infrastructure, legal insecurity, unnecessary administrative procedures have negative influence on level of investment. The largest concentration of small and medium-sized manufacturing company is in major towns and cities. This is understandable, since companies tend to be as close to its potential customers. Most often it is the owner and several other family members. They are characterized by low volume production, low level of invested capital.



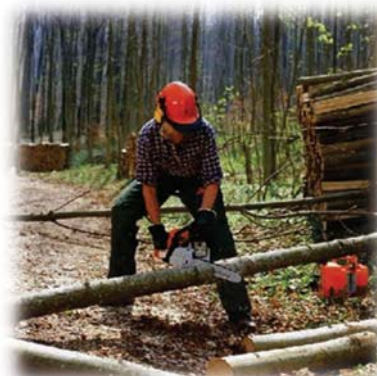
Large distributors have extensive sales network in the territory of Serbia, but part of the products exporting. This distribution chains represent a potential opportunity for SMEs primarily because of market size. But very few companies in this region sell products through them. The reason for the unfavorable terms offered by these retail chains: the price of the product, method and time of payment, place in the showroom. In addition, this system can lead local producers in a difficult position if the merchant decide to change operating conditions to the detriment of local producers, or decide not to work more with certain local producers. Small local producers cannot sell contracts with retail chains, because of lack of manufacturing capacity to fill orders. This producers sold their products in their saloons, in business partner saloons, on the fairs and through catalog, in one word they have an ad-hoc approach.

### 3.1 Basic value chain functions – structure of wood industry

Wood processing industry in south Serbia can be generally divided on four sectors:

- Primary processing

Primary production consists mostly from woodcutters and people who prepare the wood for production, producing planks and joinery. This tape of production mostly conduct in sawmill.





- Secondary processing

In the secondary processing of wood based products are dried wood flooring, finished parts for furniture, hardwood furniture piece, fences, poles and other products. These companies sell their products on local market, companies such as SIMPO, large retail chains such as IKEA and a part of the production is exported to foreign markets especially in the countries of former Yugoslavia, Bulgaria, Austria and Italy.

- Final products processing

Final production is part of wood industry where many parts joining together and giving the final product like: windows, doors, beds, chairs and kitchen. Practically in this stage of production the products are finalised and ready for market.



- Compatible industry

Compatible industry produce: staples, wooden pins, locks and other products which is very important for wood industry especially furniture production.



There is three main market channels

- local market with participation from woodcutters through large exporters
- neighborhood markets on witch participating medium companies and production centers, large companies and also a collecting centers.
- foreign market is made up of large companies and medium-sized companies with exporting capabilities.



The importance of different distribution channels for each producer is reflected in the fact that such woodcutters can occur at the local market through collecting centers and SMEs, primary producers may occur on the local market through the small producers, artisans and SMEs. The biggest potential have the channels to the neighborhood markets and foreign markets, because they have great potential for increasing production, better quality of products, adaptation of new technology and increasing the profit.

The number of people involved in the wood industry are represented in section relevance in chapter 1.3 Project focus.



### 3.3 Players and relationships along the value chain

Wood industry market consists of a large number of participants, he goes from woodcutters to large companies. Between these participants is very different and complex relationship as it shown on graphic 1, Here one can see that the woodcutters associated with the local market by SMEs, also can be seen that the primary, secondary production, designers, retailers, exporters are connected with large companies, medium and small producers, artisans, through which further connect with local, neighboring and foreign markets.

Existing horizontal and vertical connection enable some advantages to companies in this value chain: access to new markets, partner distributive network, use of individual and common experience, chipper raw material.

Possible lack of connection: information leakage, possible malversation with information, partner access to own markets, financial self-reliance.

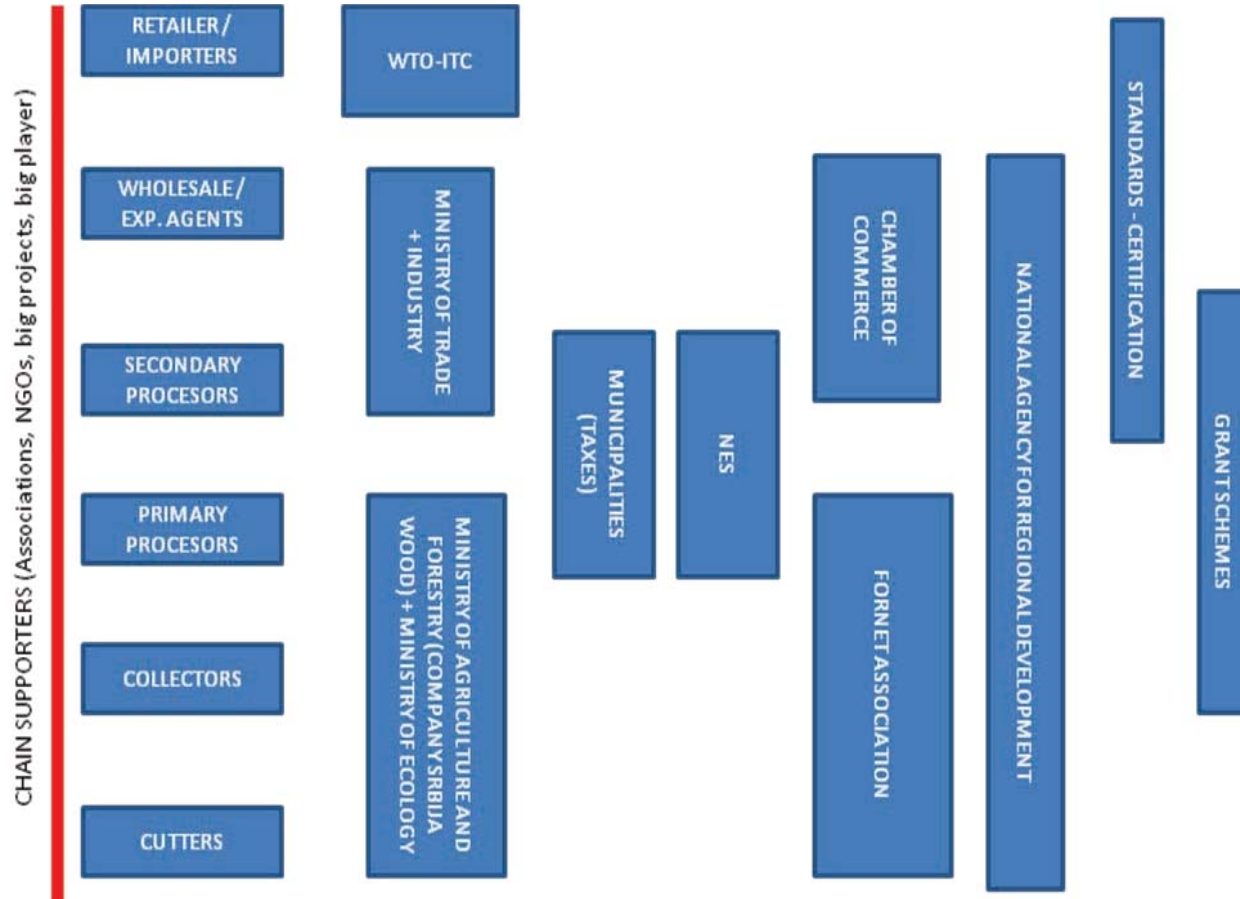




### 3.4 Value chain supporters and their performance

Next figure represent main relations between stakeholders in wood industry and processors.

Figure 4: relations between stakeholders in wood industry and processors.



Ministry of Agriculture, Forestry and Water Management (MAFWM) and the Ministry of Ecology provide support in the primary stage of wood processing. Directorate for Forests, as a part of MAFWM is responsible for professional activities related to forest policy, forest preservation, promotion and use of forests, the implementation of forest protection measures. Ministry of Trade and services to businesses operating in the secondary wood processing and exporters through legal regulations, encouraging and supporting local producers to go out to the international market, increase competitiveness and stimulate direct investment in the sector.

Municipalities operate on producers in the primary and secondary wood processing through various exemptions in the payment of tax and utility taxes, simplifying procedures for obtaining building and other permits, creating favorable conditions for foreign investors. National Employment Service as well as the municipality looks at the vendors in the primary and secondary wood processing through various exemptions in the employment of workers (the first chance, Severance to job).

NES provide training and retraining of unemployed persons in order to create profiles of workers that are ne-

cessary to meet the immediate needs of enterprises in the primary and secondary wood processing. Chamber of Commerce provides support to producers in the secondary wood processing and exporters through various programs and projects linking businesses in the region and abroad by organizing fairs, business meetings, training.

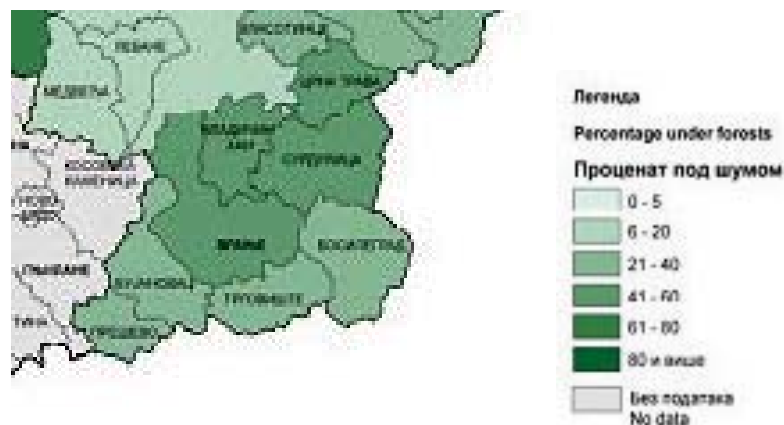
Formal associations operating in the primary manufacturers of wood processing. Common market created favorable conditions for the procurement of raw materials, selling the product and increase their competitiveness. National Agency for Regional Development works to producers of primary and secondary wood processing and exporters implementation of programs and projects to encourage the innovation and competitiveness (grants, projects), the organization of trade fairs at home and abroad, business connecting entrepreneurs in the country and abroad, authorizes funds for introduction of standards, implementation of credit lines to the Development Fund for the purchase of equipment and construction of working space, services, mentoring and education organization.

### 3.5 Rules and regulations

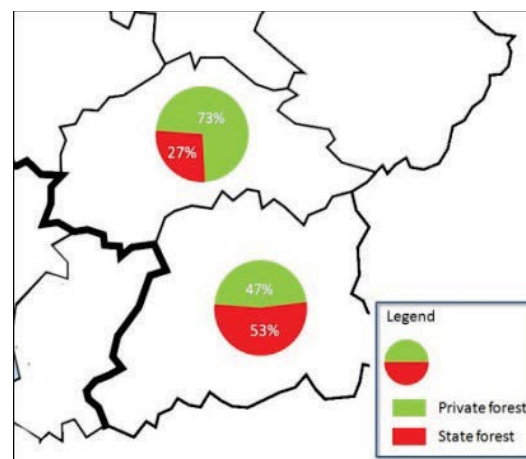
- Primary processing:

Resources :Forest stock in Pcinja and Jablanica is in state forests 117,527 ha, the total volume 15,336,037 m<sup>3</sup>, the annual yield of 229,204 m<sup>3</sup>, estimated felling volume 138,375 m<sup>3</sup>, while professional and technical jobs in private forests regional directories Leskovac and Vranje to cover 146,514 ha . On state forest 60.1% and private 40.9% of total covered area and forest area per capita is about 0.24 ha.

Percentage under forest

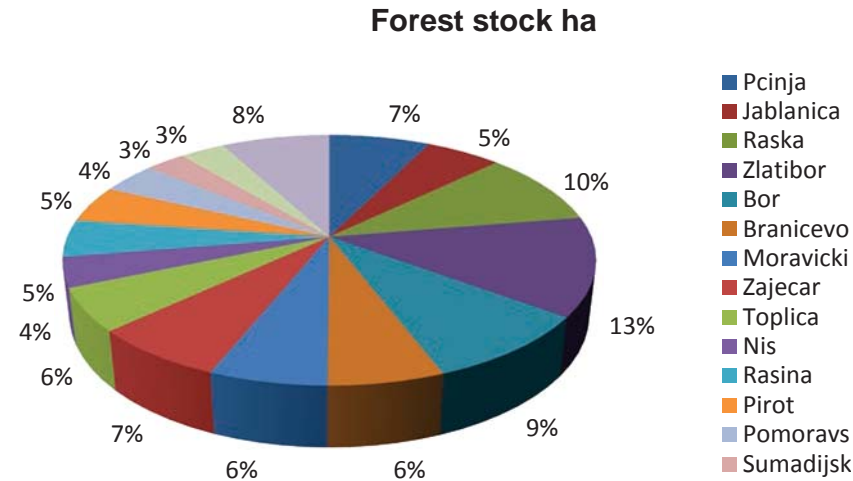


Forest area in the total area of municipalities



Source: "Srbija Sume"

Chart 6 - Forest stock in Serbia by regions



Source: Statistical Office of the Republic of Serbia

Serbia has a great potential for reforestation. According to the Spatial Plan of the Republic of Serbia from 1996 area under the forest needs to be increased until the 2010 to the 31,5%. Unfortunately because the economic crises in the last decade this goal has not been achieved. Next goal according to the Spatial Plan is to achieve that until 2050 the 41% of territory of Republic of Serbia is covered by forest. This value was estimated as the optimal. To achieve this goal, the forest area should increase each year for 29 000 ha. During periods of intense reforestation in the eighties the reforestation was about 20 000 h a per year.

Reforestation conducted in the Serbia in the last few years (2006-2010) show us that the intensity of reforestation is a lower than it should and is only 5300 ha per year. The increase of 5300 ha of forests needs to provide proportionally greater volume of woodcutting to about 6900 m<sup>3</sup>. Reforestation has positive influence on eco-system and also provide chipper and quality raw materi-

al for wood industry. Beside those lateral benefits reforestation is "sine qua non" in sustainability of the sector

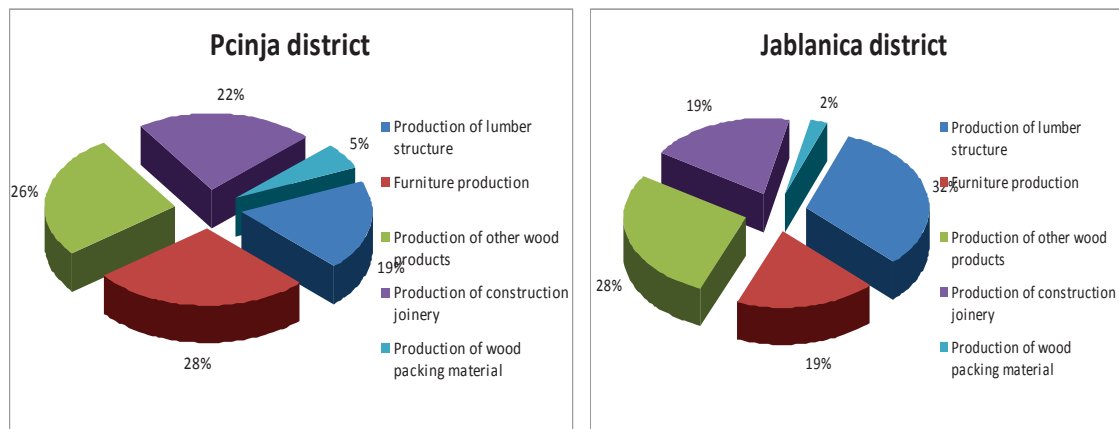
Processing: In Southern Serbia, there are about 510 companies engaged in wood processing and furniture. Most of these companies (430) are in the wood processing sector, producing timber, wood panels, veneer, joinery, and the remaining 80 companies are engaged in manufacturing furniture. There are no available data in domestic statistic regarding the GDP per branches. We off course can assume, relying on number of enterprises and employed that GDP in wood sector is at least 20% from total. As for the size of wood processing enterprises, the largest share of small businesses are doing about 90% of enterprises of this industry.

Industrial production in Pcinja and Jablanica in 2009. compared to 2008. decreased by 7.2%. Observed by sectors of industrial production, furniture production and the production of lumber for the first time declining production. Manufacture of wood and cork products except furniture during this period decreased by 33.2%, while the production of furniture and related products decreased by 21.5%. Fall in industrial production was due to lower demand as a result of the global economic crisis.

*- Secondary processing:*

Impetus to the development of southern Serbia just gave an installed capacity of this branch, we should point out Simpo, PEGASUS, "Unity", "Lagado", "LESKODRVO", "Drvopromet", "Randjelovic," product "Pecenjevce," Drvoprodukt " "Inter product "and SZR" Mita "," Nikolic "," Furnier "from Leskovac, which occupy more important place in the production of final products(primarily room furniture cabinets, tables, chairs, beds), "Morava-interior" Vranje and others. It should be noted that in the industry and have strategic partners in the presence of "Gesim industry" Vranjska Spa, where 67.9% of the Italian capital.

Chart 7 - Wood industry production in Pcinja and Jablanica district



Source: Chamber of commerce

*Marketing and distribution:*

Market activities are focused mainly on fairs. In most cases wood producers themselves distribute raw material from woodcutters to their production. In the local market big and small companies distribute themselves the final products, while for export big companies use their own distribution capacity and large export companies.



### 3.6 Key challenges of the wood industry (symptoms of underperformance)

In a series of interviews and workshops with key stakeholders in the wood industry, we identified a number of problems. Almost all the problems related to difficulties in accessing markets. Sublimation of all problems through the SWOT analysis of all problems can be classified in several categories

Symptoms are:

- **poor quality**
- **low productivity and volume of production**
- **Costs of raw materials and threat of supply shortage**
- **Costs of production**

<b>Strengths</b>	<b>Weakness</b>
<ul style="list-style-type: none"> <li>- raw material</li> <li>- heritage of wood processing</li> <li>- existing skills / capacities</li> <li>- cluster industry</li> <li>- geographic position</li> <li>- costs / price?</li> </ul>	<ul style="list-style-type: none"> <li>- low production capacities</li> <li>- slow / late payment</li> <li>- outdated technology</li> <li>- illegal cutting</li> <li>- application of standards</li> <li>- knowledge about market regulation</li> <li>- supply larger quantities</li> <li>- lack of cooperation</li> <li>- lack of design innovation</li> <li>- copy-cat industry - do not have innovation</li> <li>- "do all myself" attitude</li> </ul>
<b>Opportunities / potential</b>	<b>Treats</b>
<ul style="list-style-type: none"> <li>- capacity strategies</li> <li>- market opportunities</li> <li>- improve quality (new design)</li> <li>- productivity of cutting / manufacturing</li> <li>- cooperation / labor division</li> <li>- services providers</li> <li>- education</li> <li>- new tree varieties - better wood</li> <li>- use wood waste / recycle of waste</li> </ul>	<ul style="list-style-type: none"> <li>- deforestation (no regulation)</li> <li>- lose market with high requirements in quantity / quality</li> <li>- competition?</li> </ul>

## 4. Underlying causes for poor performance

The *previous chapter* mapped out the structure and analysed the performance of the wood industry. The chapter concluded with key challenges that undermine the industry's long-term competitiveness and the creation of income and employment opportunities in the region. These constraints were mainly related to the industry's ability to meet international market requirements and demand conditions.

*This chapter* looks at some of these challenges more closely, and attempts to understand the reasons that lead to the poor performance of wood industry in Pcinja and Jablanica districts. It thus seeks to distinguish mere symptoms of under-performance from their root causes in the wider market system.

### 4.1 Local design capacities – in this section we meet with following weaknesses:

- **Lack of new design** - buyers are turning increasingly to producers that are able to provide modern/contemporary designs, if producers do not improve design, then market access to higher value markets will be difficult. Due to the lack of application by the manufacturer and an insufficient number of trained designers in the field. There are a number of architects working in this field but do not follow trends and market information from the wood industry. One of the reason is that there is no protection for new products.
- **Lack of appropriate knowledge and skills** - the result of inadequate educational system that does not follow the needs and trends in wood industry, especially for the design sector, also the lack of adequate training centers, especially for design in wood industry.
- **Lack of good research** – it appears from different connected reasons the lack of joint action of the producer, the lack of information, the modest role of chambers of commerce and non existing of training centers and service providers, lack of understanding of the industry needs, the lack of a constructive approach.
- **Comfortable safe zone** - Manufacturers are generally satisfied with their current situation and dont have plans for further progress and new investments. The reason is that there is a real possibility that someone else copy their products. This fear is justified because there is no law to protect new products.

## 4.2 Specialisation and joint ventures to improve quantity and quality - in this section we meet with following weaknesses:

- **Old technology** - the production processes are represented very outdated machines which have limited productivity and reduced accuracy of work. Introduction of new machines is limited mostly because of high costs of machines, especially if every producer want to have separate machine and insufficient training to work on new machines.
- **The organization of the production process** - poor organization of the production process is closely associated with specialization of the production process, rather than producers do just what they are specialized and have sufficient experience they are doing all kinds of jobs, it occurs due to a lack of confidence and preventing competitors to take market and also due to lack of cooperation between manufacturer in the field and leaving one part of a business to its competitors in order to achieve greater profits. There is a problem around the conduct of business and therefore the production process because it mainly comes down to a manager who has limited managerial capacity, because a one man is unable to hold all the strings in his hands and also is not possible even if he is equally good in all areas of business.
- **Standardization of wood products** – non standardized production processes and final products themselves. Our manufacturers must be aware of all the standards necessary for the improvement of production such as standards for wood quality and the environment, also there is a lack of good practice and reforestation of new orchards regulations themselves for this reason manufacturers from these region often provide suppliers with no requirements for these standards, there is also a problem in the absence of consultants who are interested in this area or has no right solution or not interested in.
- **Disconnect between R+D and wood industry** - There is a lack of cooperation between the producers and also a lack of interest in the common market in order to achieve better performance and more serious, with the possibility of meeting the growing needs of a specific market.

#### 4.3 Skills - in this section we meet with following weaknesses:

- **Waste at work** - this type of cost occurs due to improper handling of raw materials in storage
- **Lack of certain skills** - due to the lack of practical work and vocational training for specific skills, unprofessional handling of raw materials.
- **Price of raw materials and the risk of supply** - a problem with supply is linked to limited opportunities for woodcutters to supply the market with sufficient quantities of timber. In addition there are government limitation of cuts, which can be insufficient. The problem is that this is a seasonal business, and in winter there is the possibility of reduced supply in the market and increase prices of wood.

#### 4.4 Forest management and certification - in this section we meet with following weaknesses:

- **Reforestation** - must be coordinated between the wood industry and “Srbija sume” with the help of the Faculty of Forestry, Forestry Institute for determining planting of certain tree species, also appears related to a lack of organization in reforestation

#### 4.5 Waste management and recycling - in this section we meet with following weaknesses:

- **Costs** – Insufficient exploitation of raw material creates a high production costs. Better production management can contribute to saving material.

#### 4.6 Administration - in this section we meet with following weaknesses:

- **Large administrative requirements** -\_A large number of required permissions which produce more costs for carrying out any work is the basic problem, also the procedure to get the permissions represents the one of the problem which leads to lack of transparency and application problems. There is too many subcontracts to woodcutters which they cannot meet.

## 5. Intervention areas and strategies

The above chapter has outlined some of the underlying systemic constraints that prevent the wood industry to become more competitive and provide more accelerated and inclusive growth of income and employment opportunities key intervention areas are identified:

This chapter begins by outlining the overall vision and logic for development intervention in the wood industry, and then continues to describe specific intervention strategies for the areas mentioned above.

### 5.1 Overall vision and rationale for intervention

In the eyes of the average connoisseur of economic opportunities in southern Serbian Wood processing industry, would look very successful. The justification for this perception could found in the fact, that it is only one "major" industry in the region, who survived the collapse of former economic system. Specifically in this industry, there have been no drastic changes, but it went in one process, which is still ongoing, "the gradual melting of ice" from the old state structure, into private flows. From this industry, a significant number of people living in the region, the number of newly established enterprises constantly growing. Yet it seems that the wood market in some kind of phase saturation. Facing with new "real" markets, and competitors, wood industry should from "factor of social peace", focused on maintaining the "status quo", grow into a development force, able to absorb higher number of employees and generate higher revenues. Given that the poor region of southern Serbia should use all chances to improve the general welfare,

the need for interventions that would allow the system continue to work and grow is evident

There is a belief that the definition of the problem is the first step in solving it. In addition, that in every problem is half of its solution. PSD team by working with representatives of the wood industry convinced that they are aware of the problems that surrounds them but often does not understand their causes. The essence of the approach used by the PSD team is just acting on the causes, not symptoms. Just so, it is possible to systematically improve the situation in the wood processing industry.

PSD team is aware that it must concrete respond to the demands of wood industry, means to act on those areas that can lead to systemic changes in real time of the project. Considering the needs of wood industry, sources of the project and methodology and rules, the PSD team made a list of priorities in the areas of intervention.



## 5.2 Market access

Generally, the market access and finding new markets is a precondition for growth and development of the sector. Vantage is, that we are in talks with most of the wood industry representatives, ensured, that there are many chances of doing business with EU companies. However, in order to meet those requirements, it is necessary to previously prepare the wood industry to address specific market requirements. In the first line, we should work on the **quality** and all components which define it. Wood industry also needs support in terms of **quantity**, because the existing limited and fragmented capacities impossible to enter into serious business. The basis for the functional improvement of wood processing market system is improvement of **skills** at different levels. At the end, the project through the facilitation and dissemination should ensure a positive **business environment**, the cohesion between the supporting functions, (institutions and organizations responsible for support of development), private sector and the formal and informal rules that define it, because that is the only way to ensure the **systemic changes**.

The above priority list is created, as a result of responses to the logical questions that producers and buyers put in the negotiation of a potential job.



### 5.3 Quality

*What kind of product do you/we need?*

The first step in entering the new market is to define the final product. Not offer the same product in the Middle East, where for instance insists on the gentle and rounded lines, or the German market that prefers a pragmatic solution. Because of this to define **design** is the first thing that must be solved. The current situation in the wood industry in the south of Serbia is that the design pays little attention. In fact the existing markets, local and foreign, have very modest requirements in terms of design, because the spending power is weak. Activities related to this issue are solved mainly by the principle of "copy paste". Design services are almost non-existent. Also, staff for these tasks are not adequate and the entire main down to improvisation. The need for design is evident in all the major manufacturers and they are willing to pay for it, but apparently that is not rational that they each established their own department for design. Establishment of the function of design and its development, however, is conditioned by the analysis of target markets and trends that dominate them.

After defining the design is necessary to execute its application in production process. This leads to the materials and technology used, which brings us up to standards. **Standards** are also a prerequisite for export of goods. In fact, all materials and technological procedures in the production process must be standardized. The current situation in our Wood processing industry is that some manufacturers have some basic standards, but most do not possess. The reason is the lack of services in the region. The existing supply is mainly from Belgrade and amounts to "buying the fog." In the standard special attention should be paid to "**good management practice**" in handling raw wood, for the western market is increasingly insists. One of the most important issues related to design and standards is **protection of copyright**, which is a prerequisite for the elimination of unfair competition



## 5.4 Quantity specialization, cooperation and joint business ventures

What quantity of products we can offer?

It is clear that the orientation of small and ad hoc supply does not void into a long-term, stable operation and does not allow expansion and hiring new workers and increase incomes. On the other hand, all reliable buyers insist on longer term contracts and large quantities. Wood industry of southern Serbia facing the problem of productivity in any attempt to turn on the external market. The reason lies in the fact that there is almost no cooperation and linkages between the main players. Large did not cooperate with the small, public sector does not cooperate with the private sector, and institutions in charge for development leads activities regardless of economy. In companies the general rule that "everyone does everything," a partnership occurs on the external market are rare and of short duration. It is therefore essential to encourage cooperation. First, we should encourage **specialization** in production. This is possible through improvements to managers and workers for specific jobs. In this way it can affect producer costs and losses due to **waste materials**. Project in accordance with the methodology at this point can act to reduce costs in production through the improvement of skills. But recycling of waste materials would require more investment - grants are inconsistent with the methodology. Namely, in order to let the market function established or improved must be a willingness among the market players to participate in the financing. It is estimated that at this level of activity wood processing industry there is no critical mass of waste material, most of this material is internally used the cover for heating. Therefore, still there is no willingness of the private sector to invest in this business. Perhaps with the development and an increased amount of waste material in the future this will be interesting work

## 5.5 Improving the training system for better skills

*Are we able to form an offer?*

When we define the market quality and quantity, the next question that must be answered is what our capacities in terms of inputs are. There is a good raw material base, is also funding the basic functions of the market as possible. What about human resources?

There is an initial mass of knowledge that is mainly derived from the previous system of business. In the beginning it was the force that pulls the sector forward, but if we want Wood processing industry involved in global competition, it is necessary to improve a wide range of human resources and training system.

In this regard it is necessary to promote a broad range of knowledge and skills ranging from managerial, skills related to standards, research and development, specialization for certain manufacturing processes, knowledge, communication etc. Also it is necessary to upgrade the capacity of institutions such as the NES in terms of cooperation with the private sector and target groups. Namely, it is necessary to define the real requirements of the economy compared with the existing supply of personnel. We also require a closer cooperation with target groups and determine their intentions and capabilities. For now, working with target groups mostly boiled down to finding a way to get people off the record, and maker and temporary, with no real chances to find a lasting and sustainable solution for them. Therefore, we recommend the formation of interactive and inclusive systems to improve skills in all fields of intervention.



## 5.6 Improvement of business environment

Is it possible to work together?

PSD team is led by the idea that we should support those functions that are a prerequisite for expanding markets and creating new jobs and generate bigger incomes. In addition to these, functions is necessary to be sustainable, that is, someone for them to pay. But above this concept still standing "sword of Damocles" of distrust and possible placement of individual players in the privileged, the monopoly position. PSD team therefore proposes a fair solution that all players put in an equal position. First, insist that the overall cooperation based on market principles, that is, to the center of the relationship of market players is an economic interest. Just so we can expect them to cooperate permanently. The solution we see in the "**system caused by, interdependent functions**". This means that the dispersion of market functions that will support the project should be such that every player has a "key" role in the system. This can be achieved by, for example, as a participant for the function of design or application design and the others pay for such services, others working on the function of the joint space warehouses etc.

Another aspect that should also fit into the market, the Private Public Partnership. We believe that this is a prerequisite for creating a favorable business environment. Namely, local and even national institutions and other stakeholders, which are at present often passive in relation to the private sector, can contribute much to the success of our interventions. Also the project aims to produce systemic change. It is virtually impossible without the participation of the public sector. For some functions, such as, for example, Reforestation and changes in the rules of application, the project may affect only the facilitation of local and national level. It has been established for example that the Reforestation and good forest management alkaline condition for sustainability of wood processing industry. Otherwise, in the near future we can be in a position to literally "cutting the tree on which we sit." We therefore hold that the dissemination and spreading of knowledge about the approach that uses a PSD such a good to move closer the public sector to private. It would create a good basis for **inclusive development**. Benefits of adopting the methodology of the public stakeholders and its implementation in the strategy of supporting the private sector would be multiple, long term and not just in the Wood industry sector, but also in other sectors covered by the project.



## 5.7 Gender equality and inclusion

Facilitation on the regional and national levels should provide a better climate for the involvement of most excluded target groups defined in PSD project: **women and youth**.

**We must not forget the fact, that the main objective of the project is: “Increasing employment and income for target groups that are outside the system, but not by their own will.”**

A significant number of people are regarded as our target group, waiting for employment in the wood processing industry. The data from NES shows that youth participate in total with 34.21% in the Pcinja district and with 43.28% in the Jablanica district in the overall unemployment. Women participate in total unemployment with 35,95% in the Pcinja district and with 19.02% in the Jablanica district.

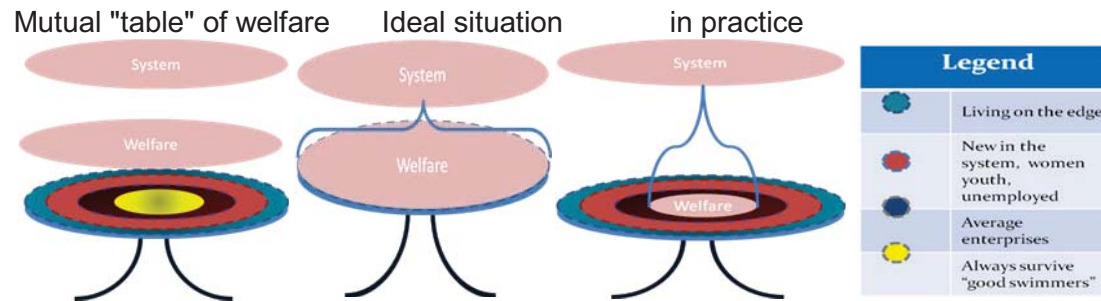
We have recognized that most excluded groups are youth and women. As an example, in November 2006, women were the owners of 20% of companies in Serbia. Among registered independent entrepreneurs 1/3 were women, in the status of a partner (partnership company) were 38% female, while the founders of the companies were in 25% women. However, although official figures show how many women entrepreneurs are in the formal status of ownership, they do not show how many women among the registered businesses really manage their businesses.

There are several **reasons** for the small number of women being included into the market: lack of initial capital, uncertainty of economic environment, credit disability (lack of ownership of real estate) and lack of knowledge, skills for entrepreneurship, confidence and lack of information.

During the last 10 and especially in the last 5 years, in Serbia different training programs for business and enterprises, were organized and implemented by various stakeholders: the National Agency for small and medium companies, business associations, the National Employment Service, Chambers of Commerce, etc. Educational programs supported by the state show that more trainings were attended by men than by women. For example, in 2007, in trainings organized by the National Employment Service, 8589 people attended training, out of which 3263, i.e. 38% were women.<sup>8</sup>

In defining the target groups, during the context analysis conducted by the PSD team, we have emphasized, that the development of the wood processing industry market system is unsustainable on the long run, without the commitment of "natural allies" at all levels.

Figure 5: Groups "uncovered" by the system (context analysis I, PSD team)

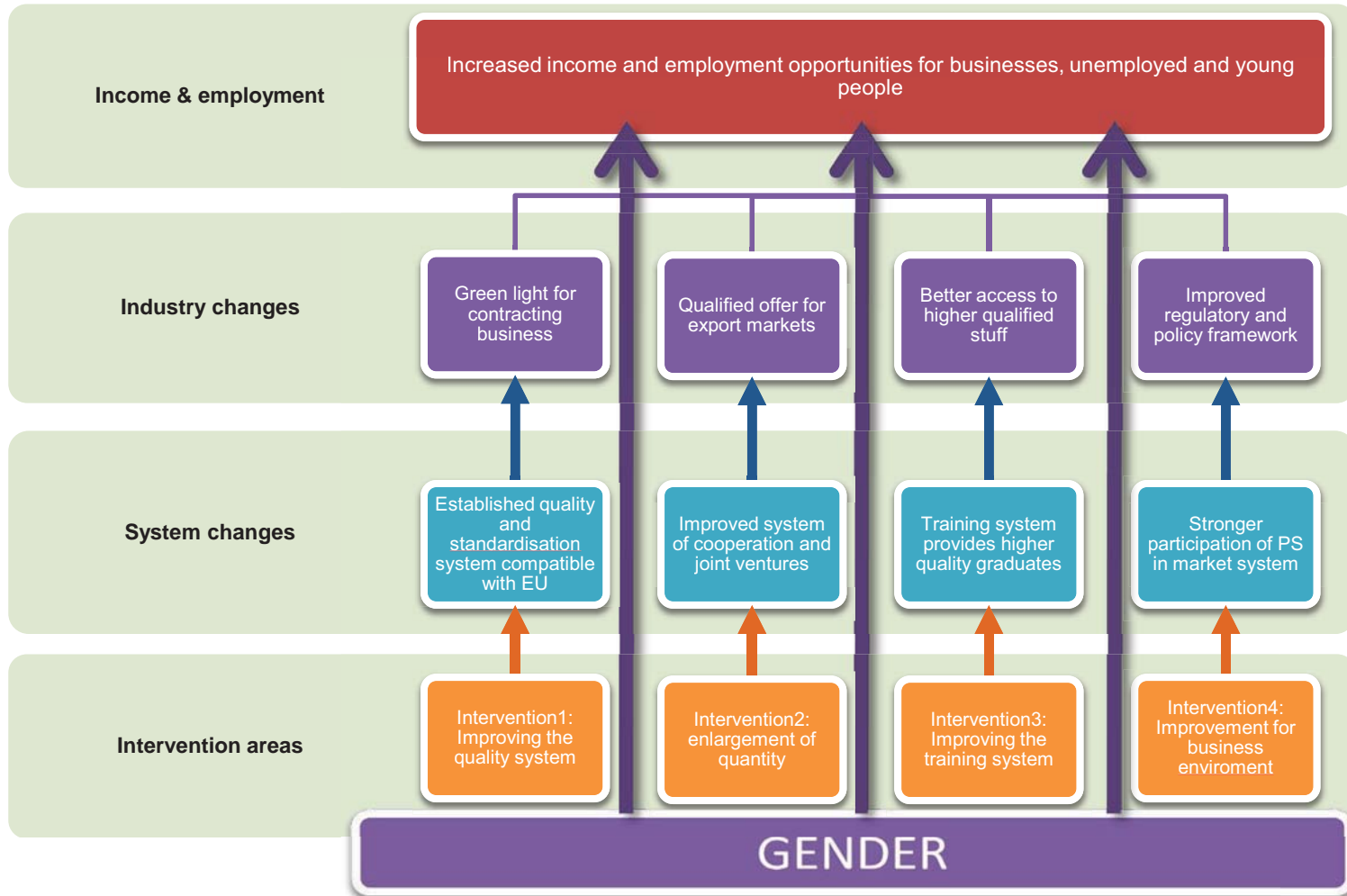


Considering all demands for the wood processing market improvement, interpreted in the intervention areas, we have found that the inclusion of women and youth is logically desirable and economically justified.

In the first line, improvement of the **quality** and all components, which define it: design, application of design, standards, protection of copyright, are exactly suitable for our target groups. In this area, ability to learn, ambition and good taste are prerequisite. Secondly, the enlargement of **quantity** from the other side is caused by the specialization and diversification of activities. It makes many operations physically easier, and lowering "entry barriers" for woman. Recycling of waste materials, for example expensive leather, demands handling with high technology machines and high sense for colors and texture. Thirdly, in area of **skills**, our target groups are just the right solution in many fields: management in foreign trade and banking, interior and sales space arrangement, communication skills, application of crafts etc.

We can freely say that the Gender issue is not a part of the problem, but rather a part of the solution. In order to support this process, the PSD team will moderate with all stakeholders. The intention is that the facilitation and M4P methodology meet the decision-makers at national level. In particular, it is necessary to include people who write the statutes and decide on the amount and manner of the distribution of subsidies. Inclusion of vulnerable groups in the market system is possible through the diversification of activities, and the expansion of general requirements for the application and development of action plans and sub strategies that are "friendly" to these groups. All of this requires a permanent and interactive cooperation between the PSD and the project authority.

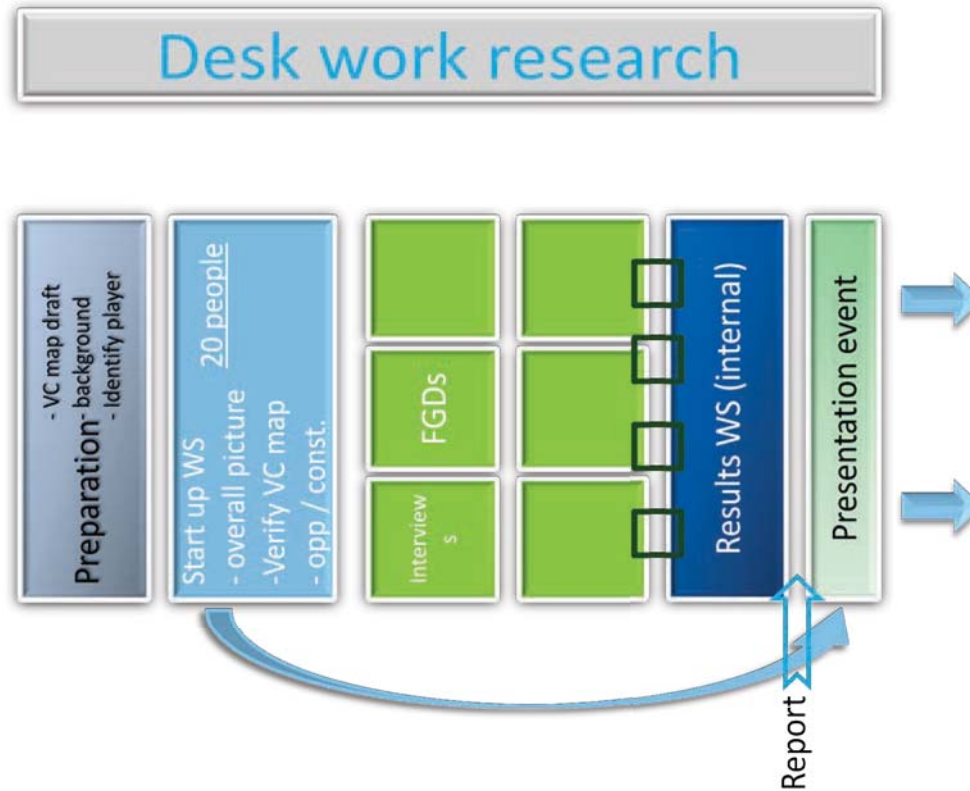
Overall logical model for interventions



## 6. Next steps

In previous chapter we mention intervention areas but they are still very broadly defined, but in the following weeks we will work out more detailed intervention plans for which we will conduct a number of presentations and work groups on specific topics with industry stakeholders.

Figure 6: Learning process of PSD in wood industry





Project is continuing to deep in understanding about the sector, and will increasingly also look at interconnected markets, such as the training system, standards and certification system, advocacy etc

The next planned activities are:

1. Organizing the presentations and briefings about the M4P approach and progress on project,
2. Finishing of Market analysis document and preparation of public report – Representatives of private sector in wood industry, local authorities and all other relevant stakeholders will be present, also representatives of SDC.
3. Defining the impact logic and drafting strategy for intervention in wood industry.
4. Starting with interventions sequent

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