GLOBAL COMMODITIES FORUM

7-8 April 2014

GVC governance structures
and firm-level upgrading trajectories

Examples from modern sector exports

by

Ms. Jodie Keane
Research Fellow
International Economic Development Group
Overseas Development Institute, London

The views expressed are those of the author and do not necessarily reflect the views of UNCTAD.
GVC governance structures and firm-level upgrading trajectories

Examples from modern sector exports

Jodie Keane - Research Fellow
International Economic Development Group
Overseas Development Institute, London
7 April 2014
Overview

• GVC Governance Structures
  – Producer/Buyer (Gereffi, 1999)
  – Horizontal aspects (Humphrey and Schmitz, 2002)
  – Spectrum, from market to hierarchical (Gereffi et al., 2005)

• Upgrading Trajectories
  – Humphrey and Schmitz (2004)
  – Structure of rewards (Gibbon 2005)
  – “Capturing the Gains” (Milberg, Barrientos)

• Case- Studies: GVC governance and firm-level upgrading
  – Garments: Cambodia/Bangladesh
  – Cut flowers: Kenya/Ethiopia
GVC Governance Structures

- **Producer/Buyer Driven (Gereffi, 1999)**
  - Governance = control as production fragments.
    - **Buyer driven**: power results from control over marketing and retailing nodes.
    - **Producer driven**: proprietary knowledge or technology at node of production

- **Clusters/value chains (Humphreys, 2002)**
  - Horizontal/vertical aspects
  - Institutions, role of producer associations.

- **Refinement (Gereffi et al., 2005)**
  - Informed by case studies, nature of technology
  - Dynamic, as producer capabilities change
<table>
<thead>
<tr>
<th>Clusters</th>
<th>Value chains</th>
</tr>
</thead>
<tbody>
<tr>
<td>Governance within the locality</td>
<td>Strong local governance characterized by close inter-firm cooperation and active private and public institutions</td>
</tr>
<tr>
<td>Relations with the external world</td>
<td>External relations not theorized, or assumed to be based on arm’s length market transactions</td>
</tr>
<tr>
<td>Upgrading</td>
<td>Emphasis on incremental upgrading (learning by doing) and the spread of innovations through interactions within the cluster; for major upgrading initiatives, local innovation centres play an important role</td>
</tr>
<tr>
<td>Key competitive challenge</td>
<td>Promoting collective efficiency through interactions within the cluster</td>
</tr>
<tr>
<td></td>
<td>Not discussed; local inter-firm co-operation and government policy largely ignored</td>
</tr>
<tr>
<td></td>
<td>Strong governance within the chain; international trade increasingly managed through inter-firm networks</td>
</tr>
<tr>
<td></td>
<td>Incremental upgrading made possible through learning by doing and the allocation of new tasks by the chain’s lead firm; discontinuous upgrading made possible by ‘organizational succession’ allowing entry into more complex value chains</td>
</tr>
<tr>
<td></td>
<td>Gaining access to chains and developing linkages with major customers</td>
</tr>
</tbody>
</table>

Source: Humphrey and Schmitz (2002)
## GVC Governance Typologies

<table>
<thead>
<tr>
<th>Governance structure</th>
<th>Complexity</th>
<th>Codification</th>
<th>Capabilities</th>
<th>Degree of explicit coordination, power asymmetry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market</td>
<td>Low</td>
<td>High</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>Modular</td>
<td>High</td>
<td>High</td>
<td>High</td>
<td></td>
</tr>
<tr>
<td>Relational</td>
<td>High</td>
<td>Low</td>
<td>High</td>
<td></td>
</tr>
<tr>
<td>Captive</td>
<td>High</td>
<td>High</td>
<td>Low</td>
<td></td>
</tr>
<tr>
<td>Hierarchy</td>
<td>High</td>
<td>Low</td>
<td>Low</td>
<td>High</td>
</tr>
</tbody>
</table>

Source: Adapted from Gereffi et al. (2005)
Governance Structures and Upgrading Trajectory

• Influence of GVC governance on upgrading opportunities
  – Humphrey and Schmitz (2004)
    • E.g. Product, Process, Function, Inter-Sectoral upgrading
    • Informed by experiences of East Asian NICs.

• Given recent trends in global trade (↑ hierarchical)
  • Structure of rewards, how to release (Gibbon, 2005)
  • Terms of participation, rewards/risks (Bolwig et al, 2010)
    – Identify action points/political feasibility
  • “Capturing the Gains”: Economic and social upgrading
    – relationships between chain actors competitive and conflictual

• GVC literature – local embeddedness
  – Functional position and ownership of firms; case-study analysis
    • Firm-level heterogeneity
    • Backward/forward linkages
The Apparel Global Value Chain and Tiers of Suppliers in the RMG Industry

Source: Gereffi and Memedovic (2003)
<table>
<thead>
<tr>
<th>Functional Capabilities</th>
<th>Country Examples</th>
<th>Description of Activities</th>
<th>Firm Ownership and Size</th>
<th>Employed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cut, make, trim (CMT) (assembly) Supplier tier: Marginal supplier</td>
<td>Cambodia</td>
<td>Form of subcontracting: •Garment sewing plants are provided with imported inputs for assembly, most commonly in export processing zones (EPZs). •In general, companies operating on a CMT basis do not become involved in the design of the garment, just the manufacture.</td>
<td>FDI: 90%; Local: ~7%</td>
<td>352,000</td>
</tr>
<tr>
<td></td>
<td>Vietnam</td>
<td></td>
<td>FDI: 45%; State-owned enterprise (SOE): 10%</td>
<td>2 million</td>
</tr>
</tbody>
</table>
Firms Upgrading in Cambodia?

• Bernhardt (2013), part of Capturing the Gains project
  – Economic upgrading: Market share/Unit value - reflective of higher value products, and competitiveness
    • Increase in both over 2000-2010

• Social upgrading: employment/wages
  – Increase in employment 2000-2010
  – Similarly wages (av annual wage)
    • Still amongst lowest paid in the world; no decline though

• Brown et al. (2011) find that improvements in working conditions for firms participating in the ILO’s BFC programme
  – Also higher probability of plant survival; improved productivity and exports

• What about the industry and firm-level structure? Cambodian firms still sub-contracting, or upgrading their functional position?
Tiers of Suppliers in the RMG VC
Kenya

- Horticulture sector: quasi-hierarchical GVC governance
  - Dolan et al. (1999), Dolan and Humphrey (2000), Gereffi et al. (2005)
    - Cut flower VC, as a sub-sector, less attn.

- Direct sales to buyers (e.g. supermarkets), or to Auction house
  - Easier to access auctions via an intermediary, compared to accessing retailer led supply chains.
    - What about upgrading overtime?
  - Sales through direct relationships, not through auction houses, offer a stable demand with generally higher returns for firms.
    - But greater demands placed on producers.

- Tiers of suppliers identified; different roles, capabilities
Overview of Firms

[Diagram showing the flow from inputs to marketing with intermediary connections between firms 1, 2, and 3.]
Types of Firms Identified and Functions

• Different links to buyers; different products demanded
  • 65% of cut flowers in Kenya are destined for Dutch auction houses
    – Rest to retailers, mostly the UK; Diversification in flower product overtime

• Some firms moving towards a position of a full package supplier, with responsibility for sourcing inputs
  • Rapid growth from very low levels of more varied flowers, required to create bouquets and sprays.
  • Decorative flowers, and which are more likely to be supplied by Type 1, and Type 2 firms.

• Testing for choice of marketing structure (binary outcome)
  – Age of firm: proxy for LBD; knowledge accumulated
    • matters for direct retail route
Ethiopia

• Less than a decade, became the second largest exporter from Africa
  – Surpassing all other exporters except Kenya.
    • Demonstrates the power of GVCs?

• Trigger factors for the emergence of the flower industry include:
  – natural endowment and generous government incentives for all export activities
    • EU EBA regime for LDCs?

• Cut flower industry in Ethiopia is characterized by triple role of Dutch:
  – Investment/ trade/ donor
  – But also strong state management of the process
    • engaging with hierarchical GVCs; governance capabilities
Firm-level upgrading?

- Gebreeyesus and Sonobe (2011) tested the hypothesis of whether firms mainly engaged in direct sales are:
  - more likely to produce more varieties; be larger in size; more vertically integrated, and better human and logistical capabilities
  - found them to be true.

- But, not possible to disentangle:
  1. Whether the marked difference in the capabilities between the firms operating through the two marketing channels (direct sales, or those through an intermediary) were present upon entry (so came through FDI); or
  2. Occurred as a deliberate result of efforts to upgrade.

- Testing for choice of marketing structure (binary outcome)
  - Ownership matters for direct sales route
  - No significant influence on auction house
Concluding Remarks

• Newest trade literature and GVC lit share their focus on the firm
  – But GVC analysis emphasis on power, rents, control, BTEs
  • How influence contractual relations between firms to achieve
development outcomes
    – Social/economic upgrading
      » Productivity more generally
    – Functional upgrading
      » Attracting more VC functions
      » Upskilling over time (rather than more of same)
  – Drivers of VCs, action points and political feasibility
    • Some aspects outside of direct gov control
      – But not all - directive/facilitative approaches
        » VC development and trade and development strategy
        » Horizontal and vertical aspects of GVC participation
        » Domestic value added
ODI is the UK’s leading independent think tank on international development and humanitarian issues. We aim to inspire and inform policy and practice to reduce poverty by locking together high-quality applied research and practical policy advice.

The views presented here are those of the speaker, and do not necessarily represent the views of ODI or our partners.

Thanks! j.keane@odi.org.uk