

Chapter 2

Conceptual Approaches

Abstract The theoretical framework of this study draws on the global value chain (GVC) perspective that is complemented by considerations of informality, subcontracting and middlemen to explore and to uncover the informal dynamics in inter-firm linkages at the lowest end of the leather value chain. Strategies to overcome development constraints are drawn from the debate on economic upgrading in GVCs and embedded in the institutional context to achieve sustained competitiveness. Given its limited practicability, the global production networks (GPN) approach is deemed inappropriate for the extent of this study, although its notion of power, being negotiated in social interaction regardless of the firm's position in the chain, has been integrated. In the end of this section four research questions are outlined to analyse the complexities of inter-firm relationships in Bangladesh's leather industry, their informal dynamics and potential strategies to overcome structural constraints and to reposition themselves within GVC governance.

The theoretical approaches synthesised in Table 2.1 constitute this study's analytical framework to understand the complexity of value chains. Considerations of informality, subcontracting and middlemen are added to the GVC perspective to explore and uncover the informal dynamics in inter-firm linkages at the lowest end of the leather value chain. Strategies to overcome potential constraints are drawn from the debate on upgrading in GVCs and embedded in the institutional context to achieve sustained competitiveness.

2.1 Global Commodity Chains, Global Value Chains and Global Production Networks

Since the 1980s, global division of labour has been facilitating outsourcing of manufacturing and services from the global North to low-cost areas in developing countries. Different theoretical perspectives have emerged to provide a conceptual framework to analyse the governance of globally dispersed but functionally integrated economic activities. The vast body of literature on value chains and

Table 2.1 Framework of analysis

Theoretical strand	Analytical category	Dimension	Object of investigation
GVC	Coordination	Complexity of transaction	Middlemen versus producers; producers versus producers; local lead firms versus suppliers; multi-tiered supply relationships
		Codifiability of information	
		Capabilities in the supply base	
GCC, GPN, NIE	Institutions	Formal institutions	Associations; export policy; environmental regulation; international trade regulation (e.g. GSP)
		Informal institutions	Traditions, cultural norms, conventions, practices
GCC, GPN	Power	Resource-based; negotiated in social interaction	Firms, institutions
Upgrading in GVCs	Upgrading	Process, product, functional, inter-sectoral upgrading	Producers, lead firms, development organisations

Source Own composition

production networks originates in the seminal works of Porter's (1985) value chain analysis of the competitiveness of organisations and of Hopkins and Wallerstein (1986) on cross-border commodity chains regulated by the state. Gereffi et al. (1994) revisit the *Global Commodity Chain (GCC)* concept from a development perspective, placing emphasis on the strategies and actions of firms. GCC analysis pays attention to spatial inequalities in market access and the distribution of resources. Gereffi (1994) unfolds a binary view of producer- and buyer-driven commodity chains, with the position of the lead firm in the chain based on the distribution of power and the ability to govern all economic activities from the raw material to the final product. Producer-driven value chains are typically found in capital- and technology-intensive industries (e.g. automobile industry, personal computers), where lead firms control up- and down-stream activities, including the production system and retail. Profits are realised by scale, volume and technology (Fernandez-Stark et al. 2011, p. 11). In buyer-driven value chains usually few non-manufacturing firms (e.g. brands, retailers) face a large number of suppliers of labour-intensive, highly standardised consumer goods (e.g. garments, footwear). Here, value and thus profit accrue at stages that are prior to or after assembly (e.g. R&D, design, marketing). Gereffi's framework within which multinational firms act as "conduits for the transfer of capabilities from developed to developing countries" (Sturgeon 2009, p. 115) has been widely received in development studies and development cooperation. Focusing the analysis of upgrading and development on powerful firms instead of on the state allows for a broader set of interventions.

Despite valuable contributions towards analysing the relationship between production and trade, the GCC concept has been criticised for its static view of chain governance, which ignores multi-faceted inter-firm linkages to change over time (Sturgeon 2009). It conceptualises governance as “drivenness” (Bair 2009, p. 26), focusing only on lead firms that use their power to steer production, whereas more complex inter-firm relationships are overlooked.

The *Global Production Networks (GPN)* approach develops the dichotomous GCC concept towards a more holistic understanding of the dynamics of globally-organised production activities that are linked to distant markets (e.g. Coe et al. 2004, 2008; Henderson et al. 2002). In a regional development perspective, the GPN approach sees firms embedded within a local and regional institutional environment which is decisive for creating, enhancing, and capturing value (see Coe et al. 2004). They respond to the GCC concept’s weakness by adopting an explicitly networked approach, going beyond the quintessential buyer-supplier relation. It examines the inter-linkages and tensions between commercial (firms, agents) and societal actors (workers, civic organisations, consumers) intermingling in networks (Barrientos 2013). Here, power is negotiated in social interaction irrespective of economic resources.

Alongside Global Production Networks, a large body of literature on the *Global Value Chain (GVC)* analysis has emerged. The GVC framework portrays the way global firms govern spatially disperse market activities. Gereffi et al. (2005) identified five forms of governance at the interface between lead firms and suppliers (see Fig. 2.1):

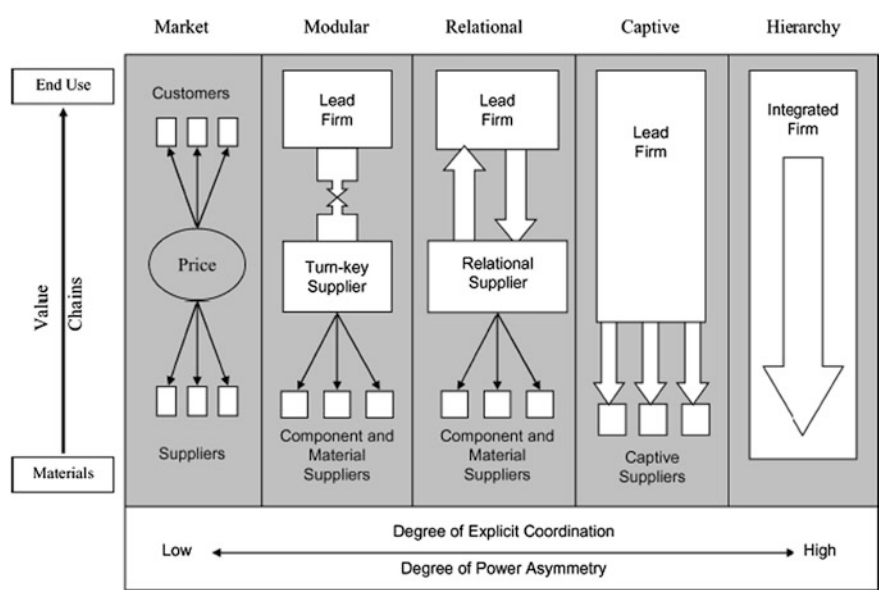


Fig. 2.1 Types of global value chains. Source Gereffi et al. (2005, p. 89)

- *Arm's-length or market based relationships*: Competent suppliers make mostly standard products with little explicit coordination by buyers, that is, there is little exchange of information (white block arrows in Fig. 2.1). Product specifications are simple so transactions can be codified easily. Switching costs are accordingly low thanks to the wide range of potential buyers. The linkage is mainly governed by price (black thin arrows in Fig. 2.1).
- *Modular relationships*: Highly competent suppliers are capable of codifying complex transactions (for instance, by technical standards) and of supplying a variety of customers. Conversely, buyers can source from different potential suppliers without needing to invest substantially in the coordination of their supplies. Suppliers in modular value chains often provide turn-key services, covering activities that go beyond mere assembly.
- *Relational relationships*: Product specifications and transactions are complex but cannot be codified adequately. Producers of high technological capabilities and customers in relational value chains need to exchange tacit knowledge to overcome the low codifiability of their products. The mutual dependence created by highly specific assets (Meyer 2011, p. 54) is regulated by trust, reputation, social and spatial proximity, and personal ties. Because relational value chains develop over a long time they require intense inter-actions between buyers and suppliers. Then even spatial distance can be overcome (Sturgeon and Gereffi 2008). Consequently, the costs of finding new business partners are very high.
- *Captive relationships*: A few lead firms control many suppliers with low technological competences competing with each other. Buyers distrust suppliers, perceiving them as unreliable (Humphrey and Schmitz 2000), and minimise risk by tight supplier management. Detailed product specifications as well as tight monitoring and control ensure reliable supplies. The captive value chain mostly applies to standard or labour-intensive consumer goods (e.g. agricultural products, textile and clothing, etc.) produced in low-cost regions. Switching costs are particularly high as low-skilled suppliers depend on dominant lead firms.
- *Hierarchy*: Lead firms organise production in-house because products are complex and cannot be codified, nor can capable suppliers be found without incurring major transaction costs.

In this typology the degree of explicit coordination rises with verticalisation of the chain. While information is exchanged between lead firms and first-tier suppliers in relational and modular value chains, buyers in captive and hierarchical governance forms need to provide detailed specifications to receive satisfying results. Gereffi et al.'s (2005) merit is to have shown that even without direct ownership of their suppliers global buyers are able to control and coordinate spatially dispersed (manufacturing) activities. In addition to explicit coordination, the degree of power asymmetry varies from market to hierarchical relationships, where power is either levelled or fully concentrated with the lead firm, shaping network relationships in between. With the three distinct types of network governance

(modular, relational, captive) Gereffi et al. (2005) added complexity to the GCC approach they had been building on (see Fig. 2.1).

This typology is based on three key factors that are derived from transaction cost economics (Gereffi et al. 2005):

- *The complexity of transactions*: Information and knowledge is exchanged to specify products and processes. The more complex transactions are the more coordination (or interaction) is needed.
- *The codifiability of transactions*: Complex information can be reduced by codification, for instance, through contracts or standards. Suppliers capable of handling codified information provided by their buyers are likely to operate in modular value chains (Sturgeon and Gereffi 2008). Suppliers lacking the competences to act on codification require more coordination (captive).
- *The capabilities in the supply base*: Refers to the producer's ability to deal with complex and codified information. Missing supplier competences (e.g. knowledge, financial, technological, management) lead buyers to monitor and control suppliers tightly (captive) or even organise production activities in-house (hierarchy).

As delineated, the combination of these variables defines the form of governance.¹ The three key determinants take into account that the coordination rises with the increasing asset specificity of a particular transaction, that is, transaction-specific investments are of limited use for actors outside this relationship (Gereffi et al. 2005). This means that transaction costs increase with rising product complexity, so that, for instance, standard products quintessentially used in market relationships are easier to produce and it is easier to find customers for them than for highly specified products. In general, the complexity of transactions determines the transactions costs and thus the coordination of the value chain.

The GVC analysis has been criticised for the simplifying “chain metaphor” (Bair 2009, p. 4) and its highly idealised typology (e.g. Nadvi 2008; Coe et al. 2008) that lacked empirical evidence. It confines inter-firm linkages to global flagship firms governing the entire chain. Multi-tiered and horizontal supply relationships are neglected or assigned to specific forms of governance (e.g. modular, relational). Talbot (2009) and Sturgeon (2009) suggest that complex commodity chains may fork into different strands or threads, entailing multiple forms of governance. Gibbon et al. (2008, p. 323) re-define governance as the coordination of inter-firm relations at specific nodes of the chain. Gereffi and Lee (2012) acknowledge that governance schemes may vary along a value chain. Evidence from this study indicates that there may be more than just one way to coordinate even a specific inter-firm linkage. GPN advocates object to the narrow focus on inter-firm transactions, which ignores other actors (e.g. consumers, state, NGOs) and relationships (Coe et al. 2008). The “Manchester School of global production networks” (Bathelt

¹Of eight possible combinations three are excluded for being unlikely. See for a detailed discussion Gereffi et al. (2005, p. 87/88).

2006) argues for a multidimensional, multi-scalar, networked approach, stressing global connectivities and interdependencies within production networks (see Coe et al. 2004, 2008; Henderson et al. 2002; Dicken et al. 2001). How this myriad of analytical categories relates to each other remains unanswered. In stressing the relevance of social relations, the GPN approach adds a more dynamic and holistic view of the global economy. But even Coe et al. (2008, p. 290) admit that to understand the organisational complexity of GPNs, their multi-scalarity, and their multi-actor network requires a multinational research team. Notwithstanding the analytical value of the GPN approach, its practicability is highly questioned and thus not appropriate for the extent of this study.

Even though criticism is justified, the GVC approach has sufficient explanatory power to shed light on complex interactions within and beyond the firm-level. The three key variables proved particularly useful in analysing logistically complex value chains shaped by low skilled producers and middlemen in developing countries (see Dannenberg and Nduru 2012). They are also critical to the analysis of this study. Going beyond ‘global lead firm-local supplier’ linkages, this study incorporates upstream (traders) and downstream (buying houses) actors in the chain analysis as they are assumed to have a profound impact on the coordination. Horizontal relationships (e.g. suppliers of intermediate products, services) support the production network to a large degree, though verticality of material flows and processes is an essential feature of cross-border producer-customer relations. This study therefore uses the terms production network and value chain interchangeably. Taking into account the multi-scalarity of production networks, it is believed that “GVC governance theory operates equally well at any and all of these spatial scales” (Sturgeon 2009, p. 123), which means processes on the local/national level go well with the GVC perspective. Sturgeon (2009), one of the authors of the seminal article on ‘The governance of global value chains’ (Gereffi et al. 2005), argues that verticality inherent in the chain metaphor should not obstruct the analysis of multi-scalar and organisational complexity as it is rather a “heuristic tool” (p. 127). Instead, he suggests adding power and institutions to the inter-firm linkages in GVC analysis, thereby reviving constitutive elements of the GCC concept.

Power is the essential agency in social relations (Fox 1974) and thus innate to economic transactions. GVC analysis defines power as the availability of resources and capabilities, presuming a concentration of power with large multinational firms. With the degree of power asymmetry rising from market to hierarchical relationships, power determines governance structures. In captive value chains in particular, lead firms command material and immaterial resources. They set prices, place orders and direct the production; in a nutshell, they “wield purchasing power” (Sturgeon 2009, p. 129), whereas suppliers are outclassed in coordination abilities, technological competence, financial resources, and design and marketing skills. In modular chains power among buyers and suppliers is more or less even as both are able to switch partners. Highly skilled suppliers in relational linkages have “competence power” (ibid.) that, if knowledge is tacit, may give them leverage in negotiations with lead firms. This study is amenable to the GPN view that power is negotiated in social interaction regardless of considerable structural differences in

resource availability and the firm's position in the value chain (Coe et al. 2008). Qualitative research methods are expected to explore the nature of power in the leather production network and how it materialises in practice.

Institutions defined as a set of rules that regulate social relations and thus economic transactions (North 1990) matter in the analysis of global value chains. The institutional context within which industries have developed is decisive for the way firms adapt to these institutional constraints. As will be set out below, formal and informal institutions may shed light on the intrinsic complexity of business relations at the lower end of the value chain, where the GVC framework remains deficient. For instance, reactions of multinational companies to recent disasters in the garment industry in Bangladesh (Savar/Dhaka, April 2013) and worldwide (e.g. Karachi/Pakistan 2012) indicate that lead firms do not control local suppliers (Silva 2013). Instead, middlemen forward orders to producers with no linkages to their real customers. Multi-tiered supplies disguise competences and responsibilities. Often, producers and middlemen in developing countries resort to informal and even illicit practices to take advantage of dysfunctional institutions or to deal with power asymmetries (e.g. self-organisation, trust, informal employment, tax evasion). Yet GVC analysis lacks conceptual clarity about informality in governance. This study seeks to shed light on where informal practices and strategies are positioned within the value chain, the role they play for market integration and to what extent they modify power relations.

2.2 The Role of Middlemen/Intermediaries in Global Value Chains

Globalisation and trade liberalisation allowed manufacturers in developing countries to become functionally more integrated in global markets, although low capabilities (e.g. product quality, compliance with environmental regulation, logistics, language) in the supply base limit their opportunities for international market entry. The literature has widely acknowledged the importance of middlemen in linking low-skilled producers in developing countries to distant international markets (Dannenberg 2012; Ogouma et al. 2010; Ponte 2009). While product specification and requirements for farmers in agricultural value chains are relatively low, the complexity of transactions rises with the increasing processing degree in manufacturing industries. Asymmetries in knowledge and information keep suppliers dependent on middlemen (Dannenberg 2012; Ogouma et al. 2010; Reeves 2002). In manufacturing industries middlemen or buying agents have been mostly discussed within the framework of multinational corporations organising sourcing on a global level.² The key responsibilities of such international purchasing offices

²For a detailed discussion on international purchasing offices see Jia et al. (2013), Sartor et al. (2014).

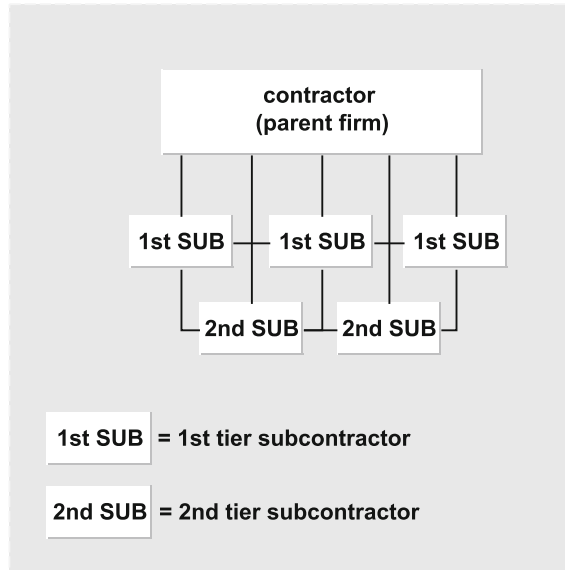
include supplier management, transfer of knowledge, negotiation between buyers and suppliers, marketing support and logistics management (Sartor et al. 2014). Humphrey (2004) observes that global sourcing companies have entered the garment supply chain, assuming competences in logistics, sourcing of materials and translating designs into product specifications. The concentration of capabilities on such strategic intermediary level allows for very flexible sourcing, obstructing upgrading of low-skilled producers. Contrary to the global sourcing strategy, Bangladesh's buying houses have emerged from within the industry, taking on the role of facilitators of buyer-supplier relationships. Interviews with local agents suggest that international traders often encourage them to set up buying offices and establish an exclusive trade relationship. To the author's knowledge, the character of Bangladesh's leather-industry-related buying houses is still that of an intermediary and has not yet evolved to an outsourced office of a global company. Buying houses resolve disputes between producers and customers, manage supplies either locally or by imports and diminish contractual uncertainty (Woodruff 1998, p. 984). They provide assistance in bridging knowledge and cultural gaps between low-skilled manufacturers and powerful multi-national corporations governing the supply chain. Briefly, buying houses mediate an asymmetric relationship (buyer/principal vs. supplier/agent). It is therefore necessary to examine the buying houses' role in terms of power asymmetries towards suppliers and the way the latter adapt to those.

2.3 Subcontracting in Global Value Chains

Subcontracting has increasingly been referred to as a competitive strategy to organise production in vertically disintegrated supply chains (Holl 2008; Van Mieghem 1999; Webster et al. 1997). As it has turned out to be a dominant feature of Bangladesh's leather industry, it is included in this study's conceptual considerations.

The term is often used interchangeably with outsourcing. Either strategy relates to a firm (subcontractor or supplier) providing a service or good for another company, i.e. the contractor, buyer or manufacturer (Van Mieghem 1999, p. 954). This study follows Pratim Sahu (2010) and Webster et al. (1997) in their view of subcontracting, in which the contracting unit (principal or parent firm) hires out the production of parts, components, subassemblies or assemblies of a final product to one or more enterprises (subcontractor or agent) (see Fig. 2.2). Webster et al.'s (1997, p. 830) distinction between industrial and commercial subcontracting in the electronics manufacturing industry is also conducive for this study. Industrial subcontractors feed intermediate products into the parent firm's highly complex manufacturing process. In commercial subcontracting trading companies hire enterprises to produce entire products and market them on their own. The lower the complexity of the product and labour costs the greater the incidence of multi-tiered subcontracting (Pratim Sahu 2010).

Fig. 2.2 Subcontracting production. *Source* Own illustration



Three reasons for subcontracting relate to production cost factors (Holl 2008; Deavers 1997; Webster et al. 1997):

- Limited capacity and fluctuating production volumes lead to capacity subcontract to meet exceptional surges in demand.
- Getting access to specialised capabilities (e.g. knowledge, economies of scale, labour-intensive activities) which are not available at the contractor's plant.
- Labour-intensive productive activities are subcontracted to low-wage firms.

The advantages for the contracting/parent firm are financial benefits stemming from smaller quantities, specialised production, fewer requirements for legal and environmental controls, and risk of production and quality problems being outsourced (Webster et al. 1997, p. 830). Subcontractors benefit from orders and indirect sales, which confine them, however, to very limited potential for growth, constituting the main disadvantage. Subcontractors have only indirect market access. The risk of being dependent on one single customer is high. Likewise, parent firms may be subject to opportunistic behaviour of the subcontractor (Webster et al. 1997, p. 831). Resources and capabilities between principals and agents are unevenly distributed, reflecting power asymmetries.

Building on Williamson's (1985, 1975) transaction cost approach, Holl (2008) sees the characteristics of the local economy determined by the costs of setting up and governing a bilateral subcontracting relationship. It is important to find a suitable partner who can be trusted and who is capable of realising asset-specific investments (Grossman and Helpman 2005). Costs for specification, monitoring and enforcement of transactions influence the decision to enter subcontracting relationships.

Globalisation and international trade have enabled globally operating firms to abandon non-core competences and strategically subcontract specific activities to cheaper companies. Supranational institutions such as the North American Free Trade Area (NAFTA) and the European Union (EU) facilitated cross-border sub-contracts and vertically disintegrated production systems. NAFTA boosted the duty- and quota-free export of US yarn and fabrics for assembly in the production plants (*maquiladoras*) of the neighbouring low-cost country Mexico and re-exports of the final garment (Bair and Dussel Peters 2006). This model of production sharing give producers from the South access to markets in the North, but has been criticised for keeping them trapped in labour-intensive, low-value added activities (ibid.).

Flexibilisation and downsizing have stimulated economic growth and international production networks, but also forwarded price pressure to the weakest in the supply chains. It is very common in the leather and garment industry for local suppliers to subcontract parts of or entire orders to independent workers manufacturing on a contract basis (for the Mexican garment industry, see Prügl and Tinker 1997). Chen (2004), Chen et al. (1999) contextualised self-employed home-based workers or unincorporated enterprises within the informality debate as an important source of (informal) employment. Knorrinda (1999) shows for the footwear cluster in Agra/India that producers in times of crisis increased the frequency of subcontracting at specific stages in the production process (e.g. upper). Lacking secure contracts and labour rights are quintessential traits of low-cost subcontracts that are prevalent in labour-intensive manufacturing industries in developing countries. While subcontracting in the leather and garment industry is often a survival strategy (e.g. Prügl and Tinker 1997; Webster et al. 1997), Sudhir Kumar and Bala Subrahmanya (2010) demonstrate for the automobile industry in India that SMEs subcontracted by transnational corporations are assisted in inducing technological innovations which lead to greater economic performance. Technical support and other forms of assistance with regard to learning from lead firms will be examined in Sect. 5.3.5.1.

In Bangladesh's leather industry subcontracting appears to be a common feature. Leather processors supply intermediate products to tanneries of a higher competence level, whereas leather goods and footwear subcontractors transform leather and accessories to leather commodities that are branded and marketed by their lead firm. Each mode of subcontracting (parts assembly, full-package production, self-employment) provides opportunities and displays asymmetries in resources, knowledge and capabilities. How subcontracting relationships are coordinated will be analysed in Sect. 5.3.3.

2.4 Reconceptualising Informality

The GVC approach analyses inter-firm linkages in vertically disintegrated production systems. As power varies with the firm's position in the chain (Gereffi et al. 2005) but is also negotiated in social interaction as GPN studies suggest (Coe et al.

2008), the aid of practices and adaptation strategies outside formal institutions is assumed. This section seeks to define informality, outline its dimensions and contextualise it within the GVC approach.

After pioneering studies in the 1970s (ILO 1972; Hart 1973), informality has been widely received in development studies, but has also been criticised for being a fuzzy concept (e.g. Kanbur 2009; Sindzingre 2006). This study follows the current debate on closing the “formal-informal divide” (Guha-Khasnobis et al. 2006, p. 2) by moving away from dualist (ILO 1972; Hart 1973), structuralist (Castells and Portes 1989) and legalist (De Soto 1989) approaches that are restricted to binary, mutually exclusive, static and juridical conceptualisations of informality.


In the literature on global economic disparities and GVCs, informality has been mostly discussed in case studies on informal employment (e.g. Harris-White 2009; Mehrotra and Biggeri 2005; Barrientos et al. 2003; Maloney 1999), informal economic activity, that is, non-registered enterprises (e.g. Kulke and Staffeld 2009; Murphy 2007), often embedded within a discourse of social inequality (e.g. Sassen 1994), or trust (e.g. Meyer et al. 2012). Kaplinsky and Morris (2001) very instructively illustrate the potential of value chain analysis to reveal inter-linkages between formal and informal activities and their dynamic incorporation into global markets. However, a conceptual integration of informal institutions and practices in GVC analysis is lacking.

New institutional economics (NIE) conceptualise informality from an institutional perspective. According to North (1990), formal and informal institutions constitute a set of rules that delimitate opportunities in society and thus regulate economic transactions. Formal rules are understood as written codifications (e.g. constitutions, laws, market regulations) that, when externally enforced, provide security, but can be quickly modified. Formal institutions may also include (non-) governmental agencies, multi-lateral organisations or trade unions (Sturgeon 2009, p. 130). In contrast, informal institutional constraints comprising traditions, cultural norms and conventions, have evolved over time. They are self-enforced, thus more persistent and less prone to change (North 1990).

Recent studies on informality hinge on North’s (p. 46) understanding of a continuum of economic activities ranging from informal to formal (see e.g. Etzold et al. 2009; Kulke and Staffeld 2009; Li 2007; Chen 2004). Li (2007) drawing on research on *guanxi*, the Chinese way to structure social interactions informally, relates informality to social capital and captures five dimensions of formal-informal extremes (Table 2.2).

According to Li (2007), formal business transactions are written and thus highly codified as opposed to informal arrangements that are made orally and flexibly enforced based on social relations. Formal agreements imposed by abstract laws, regulations or external actors are enforced tightly, i.e. by the authorities, according to the terms and conditions stated. Depersonalised objective processes can be solved by vertical powers within a legal system, whereas peer pressure exerts power in horizontal relationships. Li (2007) further classifies each dimension into sub-groups, determining specific degrees of in-/formal transactions.

Table 2.2 Informal-formal paradigm

Dimensions	Formal 	Informal
Codification	Explicit (written)	Implicit (oral)
Formation	Exogenous	Endogenous
Enforcement of agreements	Tight	Loose
Power relations	Hierarchical	Horizontal
Personalisation	Depersonalised	Personalised

Source Adapted from Li (2007, p. 230). Own illustration

Although Li’s approach is useful in overcoming the binary view of informality and was well received in recent studies (e.g. Schiller 2012; Dannenberg 2012; Meyer 2011; Etzold et al. 2009), power has been oversimplified. Etzold et al. (2009) draw on Li (2007), amongst others, to set up a continuum of informal to formal practices and processes that are structured by institutions and dominant players (Table 2.3). Subscribing to Li’s perspective, they regard power asymmetries as constituent of vertical relations that are supposed to be prevalent in markets and need to be offset by codification. For instance, written contracts help level asymmetric relationships and ensure trust among unknown business partners. Following this conceptualisation, personal trust is confined to horizontal relationships in predominantly informal interactions. This view ignores the incidence of informal ties in asymmetric power relations as given in global value chains. It also erroneously implies that oral communication and personal trust-based relationships neutralise or are devoid of power asymmetries. Mistzal (2000) adds an instructive view to this study’s argumentation as “informality cannot be limited [...] to a local context where there is a relative absence of asymmetries of power” (Misztal 2000, p. 8). With formal and informal interactions coexisting in global trade and production networks, informal practices and processes are inextricably embedded within hierarchical power relations.³ Empirical evidence of this study is expected to shed light on relations between trust and power in global value chains.

In order to determine the informal nature of transactions in global value chains, four dimensions of informal interactions can be distinguished (Etzold et al. 2009; Alsayyad and Roy 2004; Misztal 2000):

Firstly, *informality is a strategy* to achieve individual goals. Actors make rational choices whether to solve specific situations formally or informally. Misztal (2000) argues from a sociological perspective that a balanced relationship of formal and informal interactions is central to the emergence of trust. In times of global division of labour, informal encounters, trust-based relationships, and tacit understanding are essential to achieving organisational goals (ibid.). Informal ties enable flexible business arrangements to operate within formal structures (e.g. written contracts),

³Amendments in Table 2.3 are displayed in italics.

Table 2.3 Continuum of informal to formal practices and processes

Degree of formality	Institutions	Dominant actors	Nature of social ties	Traits of interactions
High: predominantly formal interactions	Generally applicable and legally binding laws; constitutions	State, supranational actors	Law, authority	Discursive knowledge, written communication, legally binding norms, rationality, impersonality, rigidity of rules, vertical relations
Medium-high: mostly formal interactions	Specific articles in directives and contracts	State, corporate enterprises	Market, competition	Discursive knowledge, mainly written communication, codified norms, rationality, impersonality, vertical relations
Medium: both formal and informal interactions	Modes of regulation of an arena	Corporate enterprises, leaders, middlemen	Market, negotiation, contestation	Discursive and practical knowledge, oral communication, socially defined codified norms, horizontal and vertical relations, personalised trust
Medium-low: mostly informal interactions	Unexpressed social norms, taboos, values, customs	Community, peer groups	Social control, identity	Practical knowledge, oral communication, socially defined codified norms, horizontal relations
Low: predominantly informal interactions	Personal agreements	Family, friends	Personal trust	Practical knowledge, face-to-face communication, socially defined codified norms, horizontal relations, personalised trust, strong social ties, intuition

Source Adapted from Etzold et al. (2009)

thus “securing transparency, accountability and partners’ rights” (Misztal 2000, p. 4). In other words, informal institutions are deployed to manage transaction risks (Steer and Sen 2010) and to reduce transaction costs incurred by firm-to-firm communication. Flexibility and freedom in making choices provide power.

Secondly, informality can be “*a habit or routine of doing things*” (Etzold et al. 2009, p. 10) understood as an informal institutionalised practice that is deeply rooted in society. Other than Etzold et al. (2009) suggest, routines or

institutionalised practices may develop detached from power. For instance, it is more convenient to conclude deals based on faith than on written contracts because transaction costs can be significantly reduced. Practical knowledge is used instead of codification.

Thirdly, actors need to find ways to circumvent dysfunctional formal institutions and therefore *adapt informally* by drawing on tacit knowledge. Adaptation strategies do not necessarily relate to survival activities as recent research on informal economy suggests (Staffeld and Kulke 2009; Etzold et al. 2009); even resourceful players are exposed to formal institutional constraints. Principal-agent relations (e.g. buyer/buying agent vs. supplier) often operate at different scales within dysfunctional formal institutions from which informal institutions emerge to solve arising coordination problems (North 1990).

Fourthly, informal institutions are the *organising logic* (Alsayyad and Roy 2004) of a specific system and structure, for instance, markets and transactions. Such informal regulatory regimes are more dominant and more powerful than formal ones (Etzold et al. 2009, p. 10). Persistency is particularly high and formalisation attempts are likely to fail. These dimensions provide the analytical framework for informal transactions in the leather value chain.

To sum up, informality exists even in the most formal spheres and serves a vital purpose in trust-building processes, innovation and industrial governance. The notion of informality, however, goes beyond mutually exclusive classes. Combining Etzold et al.'s (2009) approach which conceives of informality as an agency, Mistral's (2000) sociological lens and the NIE's (North 1990) transaction cost approach, this study conceives informality as a process-related, relational and strategic resource that also operates within hierarchical power relations. Within the logic of an informal-formal continuum, informal arrangements spanning informal ties, networks, trust, self-organisation *and* illicit practices may enable entry into highly competitive GVCs. As Wallerstein (2009, p. 86) puts it, "if there are barriers to crossing borders, there are ways to get around them".

2.5 Upgrading in Global Value Chains

It is inherent to the GVC framework that governance may change over time (Gereffi et al. 2005). With reducing complexity of a transaction, increasing codifiability of a product or improving competences, the governance structure and thus power inequalities between buyers and suppliers can be influenced alike.

The activities firms command in a GVC determine the value they are able to capture (Miroudot and De Backer 2012). Most of this value is created at the two ends of the "smile curve" (Li Sun et al. 2010, p. 308) in upstream (e.g. R&D, design) and downstream activities (e.g. marketing, branding), while there is little scope for value creation at the manufacturing and assembly stages (Miroudot and De Backer 2012). With the value resting in non-tangible competences, gains are unevenly distributed in GVCs (see Fig. 2.3).

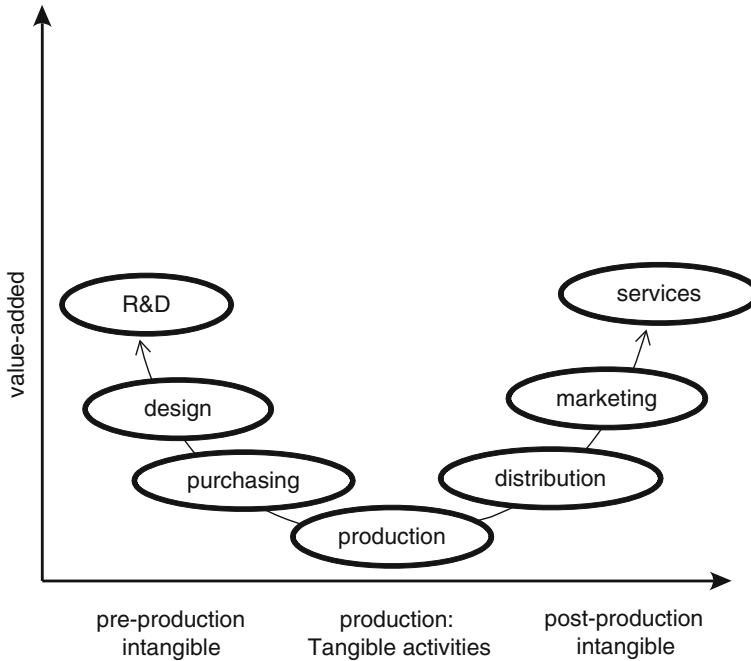


Fig. 2.3 Curve of value-added stages in the apparel chain. *Source* Adapted from Fernandez-Stark et al. (2011). Own illustration

Leaving aside environmental and social aspects,⁴ economic upgrading can be defined as “the process by which economic actors—nations, firms and workers—move from low-value to relatively high-value activities in global production networks” (Gereffi 2005, p. 171). Gereffi follows Porter’s (1990) economic theory of industrial upgrading that sees nations build up comparative advantages in capital- and skill-intensive industries once the endowment of production factors moves from labour to capital assets and knowledge. The GVC literature is convinced that upgrading is achieved by articulating low-skilled suppliers from the South to resourceful lead firms in developed countries (Gereffi 2005; Humphrey and Schmitz 2000; Gereffi 1999). Several studies provide evidence that upgrading in GVCs may help local producers acquire capabilities and move to new market activities (Ponte

⁴With asymmetric power relationships being an essential feature of global buyer-supplier relationships, issues of social and environmental upgrading have increasingly come to the fore (Barrientos et al. 2010; Jeppesen and Hansen 2004; Tewari and Pillai 2005). As a matter of fact, economic upgrading does not necessarily bring about social and environmental improvements (see Barrientos et al. 2010). It is, however, beyond the scope of this study to expand on the complex relations between economic, social and environmental upgrading. Environmental (e.g. central effluent treatment plant) and social issues (e.g. compliance with firm’s or international standards) will only be taken into account in relation to economic upgrading, that is, where the firm’s or industry’s competitiveness is affected (see Section “Assistance in social compliance”).

and Ewert 2009; Gereffi 2005; Humphrey 2004; Humphrey and Schmitz 2002/2000; Gereffi 1999). In the GVC literature, four types of industrial upgrading in developing countries have been discussed primarily (Humphrey and Schmitz 2002/2000):

- **Process upgrading** increases efficiency in transforming inputs into outputs either by reorganising the production process or by improving the technology (e.g. moving from manufactured to semi-mechanised footwear production or from mass production to just-in-time production).
- **Product upgrading** promotes more value-added products per employee by diversifying customers or increasing the complexity of products (e.g. from leather footwear to finished upholstery leather for the automotive industry).
- **Functional upgrading** enables firms to acquire new functions (e.g. design, marketing, branding, inbound logistics) in the value chain apart from assembly/production. Some of these more value-added activities may conflict with the competences and interests of foreign buyers (e.g. branding, direct marketing).
- **Inter-sectoral upgrading** refers to competencies being acquired in one chain and applied to another. For instance, Apple used its knowledge of producing computers to move into the development of smart mobile phones. Leather footwear producers may want to seek entry into synthetic footwear.

Table 2.4 illustrates how the acquisition of capabilities and buyer-supplier relationships determine upgrading trajectories (Humphrey 2004). Drawing on East-Asian countries successfully exporting apparel since the 1970s, Humphrey (2004) and Gereffi (2005) point to the leap from assembly to Original Equipment Manufacturing (OEM) that signifies a major challenge to producers from the global South. Exporters are expected to have capabilities in making samples, procuring raw material and inputs, manufacturing, meeting international standards in terms of price, quality and lead time as well as packaging and shipping the goods (Gereffi 2005, p. 171). Original Design Manufacturing (ODM) and Original Brand Manufacturing (OBM) exports require producers to assume capabilities in designing and marketing. Buyers only provide assistance in increasing capabilities if competition is avoided; that is, producers are expected to develop designs for low-value-added products and to enter marketing channels outside the lead firm's markets. Particularly MSMEs in developing countries, the main object of analysis of this study, have difficulties functionally upgrading at all. They first have to overcome crucial entry barriers such as capacity, quality and lead time to achieve market entry.

The governance structure determines also how and what type of knowledge is transferred. Tight governance schemes such as captive or hierarchical value chains tend to favour product and process upgrading. The buyers secure higher returns from investing in the supplier's capabilities to ensure product quality by transactionally locking them in (Humphrey 2004, p. 15). Large order volumes increase the producer's costs for switching customer. Tacit knowledge which is constituent for relational value chains is very difficult to transfer and requires intense

Table 2.4 Potential upgrading trajectories

Capabilities	Type of upgrading	Description
Assembly	Market entry	Supplier focuses on production according to the buyers' specifications; inputs may be imported or supplied by the buyer
Assembly	Process upgrading	Supplier improves productivity through new capital investment; increases efficiencies in the operation of productive activities
Assembly	Product upgrading	Supplier produces more value-added goods for which better material or higher capabilities are needed
Original Equipment Manufacturing (OEM), "full-package manufacturer"	Functional upgrading	Supplier performs more value-added manufacturing-related activities (e.g. sourcing of inputs; logistics); design and marketing are still the buyer's core competencies
Original Design Manufacturing (ODM)	Functional upgrading	Supplier contributes to design and product development; usually close collaboration with the lead firm's designers; products are sold under the lead firm's brand
Original Brand Manufacturing (OBM)	Functional upgrading	In addition to pre-production and post-production capabilities, the supplier is able to market products under own brand name
		Supplier may closely collaborate with lead firm to market product
		Supplier establishes own distribution channels and operates independently

Source Adapted from Humphrey (2004, p. 8), Fernandez-Stark et al. (2011, p. 16). Own composition

buyer-supplier interactions. Producer competences in both relational and modular value chains are high and require little intervention from buyers. In general, lead firms prevent producers in the South from functional upgrading to avoid competition (Schmitz 2006; Humphrey and Schmitz 2002; Schmitz and Knorringer 1999). This may keep producers trapped in low-wage and low-quality production. Case studies from the Brazilian footwear industry stress the risk of focusing exclusively on production (Humphrey 2004; Humphrey and Schmitz 2000). As buyers are permanently in search of low-cost production sites, other countries might offer similar quality at even lower prices. Without developing anything other than productive functions, low-cost producers take a high risk of losing markets. Hence, upgrading depends on the extent lead firms are willing to share information and knowledge with their suppliers (Bettiol et al. 2011).

It has been widely acknowledged that upgrading is highly conducive to increasing the income of firms in developing countries (Giulani et al. 2005; Dolan

and Tewari 2001; Humphrey and Schmitz 2000), even though GVC governance can obstruct local upgrading (Humphrey and Schmitz 2002/2000; Gereffi 1999). Navas-Alemán (2011), drawing on the Brazilian furniture and footwear industry, takes on a quite critical view of exporting and points to the opportunities regional and domestic value chains provide for learning and developing capabilities other than production. Local lead firms were also identified to steer upgrading processes in the Indian automobile (Reps and Braun 2012) and textile industries (Bettiol et al. (2011). Moreover, the pervasiveness of informal practices as a strategy for adapting to complex transactions (e.g. trading in raw hides and skins; international modes of payment) that exceed the supplier's capabilities is often overlooked. Therefore, this study follows Ponte and Ewert (2009) who hold upgrading to be a "better deal" for local producers from developing countries striving to enter global markets, taking into account the informal approaches they have been internalising and the opportunities the domestic market provides. If upgrading is to strengthen the firms' competitiveness, strategies have to be devised for the firms' needs against the backdrop of their socio-cultural context and the degree of their integration into the global value chain. The traditional view of learning from buyers appears to apply more to lead firms directly monitoring large producers in developing countries. Here, spill-over effects such as technology transfer and training of employees are expected to benefit local producers (Li Sun et al. 2010, p. 317). It is often ignored that the competence level of MSMEs in developing countries mostly allows only for mediated buyer-supplier relationships (see Section "Buying Houses—Facilitating or Preventing Market Entry?"). This calls for upgrading strategies that reduce dependencies from downstream actors that prompt unsustainable informal adaptation strategies and harmful illicit practices.

Having outlined the analytical framework, the research questions can be refined as follows.

2.6 Research Questions

Four specific research questions seek to analyse the complexities of inter-firm relationships within Bangladesh's leather industry, their informal dynamics and potential strategies to reposition themselves within GVC governance and to overcome structural constraints.

First, the structure and linkages of the Bangladeshi leather value chain are to be analysed at different spatial scales (local for Dhaka and national), delineating central actors as well as dominant product and information flows along the value chain.

1. How is the Bangladeshi leather value chain organised?

As Bangladesh's leather industry consists of a highly export-oriented but low-competitive tanning subsector and a more dynamically growing, though from a very low level, manufacturing subsector, both subsectors are expected to

contain specific dynamics. In examining inter-firm interactions with regard to the exchange of knowledge, (intermediate) products and services, governance structures including (inter-)dependencies are expected to be identified.

- (a) How is the Bangladeshi leather processing industry organised?
 - (i) Who are the actors and what are the commodity and information flows in the leather processing industry?
 - (ii) How is the leather processing chain segment governed?
- (b) How is the Bangladeshi leather goods and footwear industry organised?
 - (i) Who are the actors and what are the commodity and information flows in the leather goods and footwear industry?
 - (ii) How is the leather goods and footwear chain segment governed?

Having understood the structure of the local production network, it is necessary to analyse power asymmetries and drawbacks that obstruct better market integration. Both formal and informal institutions may explain overt and covert dynamics in the global value chain. The formal institutional framework (policies, regulations, influence of external actors) that firms are embedded within is expected to be crucial to the competitiveness of the leather production network. A major challenge is to explain the importance of informal institutions for value chains.

2. How is the Bangladeshi leather industry integrated into the global market?
 - (a) What formal institutional framework does Bangladesh's leather industry rely on to join in the global leather value chain?
 - (b) To what extent are informal arrangements understood as institutions, practices and strategies conducive to global market entry?
 - (c) What is the impact of informal institutional arrangements on power relations?

In a third step, the practices producers resort to in order to deal with institutional constraints and power asymmetries to uphold competitiveness and manage market entry will be identified.

3. How do export-oriented tanneries and leather goods/footwear producers adapt to power asymmetries in the global leather value chain?
Based on the governance structure and institutional constraints, strategies are to be devised to improve the producers' competitiveness. Upgrading can be achieved by learning from (global) buyers or from external actors (e.g. development organisations). Informal institutions need to be taken into account when looking for a "better deal" for local producers.
4. What upgrading strategies are conducive to improving the competitiveness of Bangladesh's leather industry?

- (a) What upgrading strategies does the leather industry require to address weaknesses and seize opportunities in the global leather value chain?
- (b) How are upgrading strategies to be devised that cater to the reality of informal dynamics in a GVC in order to improve the local producers' competitiveness?

To examine these research questions, in particular to capture the informal dynamics in economic transactions, it is of vital importance to draw on a suitable methodological approach.

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Bangladesh's Leather Industry

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