

Chapter 5

Integrating the Global Value Chain Perspective

The value chain approach towards the analysis of changes in preferential trade regimes and the effects on trade tends to emphasise how the governance structures within which producers trade influences the extent of transmission, for example whether upstream producers, at the node of production, experience a decline in prices for a given product, or whether retailers downstream are able to absorb price effects into their margins.

The approach is therefore able to inform us about the characteristics of the related value chain within which producers trade. This includes:

- how exports from non-graduated countries actually compete with exports from LDC graduates in particular countries and sectors of interest (e.g. in terms of price or quality);
- the associated governance structures of the value chain within which producers trade (producer or buyer driven), i.e. the type of firms involved (small-scale or multinational firms);
- linkages with other sectors (backwards and forwards).

The objective of the descriptive analysis is to identify how a trade shock, such as the removal of trade preferences, may be transmitted to producers, and the likely degree of absorption within existing structures of production. A key perspective that must be considered is therefore that of the buyers.

5.1 The buyer's perspective

Different buyers have different objectives, in line with their own corporate strategies. In view of this, a distinction is often made between price-driven versus quality-driven value chains (see Schmitz and Knorrnga 2001). Because opportunities for producers to upgrade within price-driven value chains may be fewer when there is a high concentration of buyers (Table 5.1), there might be more potential to downgrade because of the loss of a tariff preference. In comparison, a high number of opportunities to upgrade may be more amenable within quality-driven value chains, even if buyer concentration is high and gains are potentially uneven among suppliers. This may mean that the trade preference confers less competitive advantage in a quality-driven value chain than in a price-driven value chain.

Table 5.1 Type of value chain and posited opportunities to upgrade

Market segment	Buyer concentration	
	High	Low
Price-driven value chain	Probability of upgrading: low Gains: uneven	Probability of upgrading: low Gains: even
Quality-driven value chain	Probability of upgrading: high Gains: uneven	Probability of upgrading: high Gains: even

Source: Schmitz and Knorringa 2001.

A specific example of the differences in opportunities to upgrade that may arise because of the structure of the GVC and the influence of buyers' corporate strategies is clearly demonstrated through a comparison between the USA and the EU in relation to sourcing strategies in the textiles and clothing value chain. The main buyers from the EU and US markets differ in the size of their orders, which has implications for the kinds of services leveraged from suppliers.

Generally, US buyers tend to be more prescriptive, including dictating manufacturers' choices of fabrics (see Roberts and Thoburn 2003). Orders from the USA are often large and price is often the most important criterion. In such cases, where price is the main determining factor, there may be few opportunities to upgrade. This contrasts with the demands of EU buyers. Orders from buyers located in the EU are often more varied, with different standards for quality, fashion-related criteria and lead time.

What these two contrasting examples serve to highlight is how buyers can either be promoters of upgrading, or exploiters of low-cost labour or natural resources. The contribution of buyers to determining opportunities to upgrade will vary in line with producers' capabilities; buyer support is often crucial for entering a new market, but diminishes over time. At this point, the focus of buyers shifts from supporting intra-firm to inter-firm upgrading; some buyers subsequently help advanced producers improve the management of their supply chains.¹

When quality matters, the logical postulate is that buyers will invest more in producers' capabilities. This may entail a shift from intra-firm to inter-firm upgrading (e.g. through linkage development). Inter-firm relations in quality- (not price-) driven value chains may be more conducive to mutual learning and improvements in production. However, an important and crucial aspect in all of this relates to the ability of local producers and managers to learn from buyers.²

This approach has obvious implications for policy-makers seeking to understand how graduation from LDC status and the resultant loss of international support measures, such as tariff preferences, may affect their

lead firms' positions within preference-driven GVCs. The most obvious questions that arise are:

- Does the tariff preference matter to buyers?; and
- If so, why?
- Can the cost advantage conveyed be offset through other incentives or investments?

Obviously, within price-driven GVCs, any increase in costs could have detrimental effects. Because more competitive producers will tend to have lower average unit prices than others, any change in tariffs will lead to differences in the percentage reductions in exporters' margins because of these characteristics. While the data may be suggestive of a cost of adjustment, this may be absorbed (as well as offset) in different ways, including by buyers. Hence, the buyer's perspective must be considered. In the following sections, some specific research tools to explore this aspect are introduced.

5.2 Survey instruments

Given that the market structure of most GVCs is dominated by a few dominant players, obtaining the buyer's perspective does not translate into a comprehensive firm-level survey. Instead, contract manufacturing, farming and fishing are typically undertaken for a limited number of global buyers. In order to understand how the GVC may be affected by the removal of tariff preferences, it is crucial to understand the buyer's perspective in relation to country and producer capabilities. This approach is crucial to enabling policy-makers to make informed decisions regarding transition arrangements.

This means identifying multinational firms' sourcing strategies and undertaking a short survey to better understand how they consider country capabilities. An example of the type of questionnaire that could be utilised in order to obtain the buyer's perspective on country capabilities is included in the **annex**. This questionnaire is structured in such a way as to obtain information on sourcing strategies and the opinion of the buyer on country capabilities.

The questions are grouped into the following thematic areas:

- **The buyer's strategy:** why does the buyer source from firms based in your country?
- **Producers' capabilities:** what are your producers' relative strengths, and weaknesses?
- **Producers' relative capabilities:** how do your producers fare with those from other competitors?

The overall objective of the buyer's survey, which could be complemented by similar surveys for lead firms operating within a country, is to clearly ascertain sourcing strategies and producers' capabilities. In order to clearly ascertain producers' relative capabilities, buyers sourcing from multiple countries (including the competitors identified from the quantitative analysis described in Chapter 4) could be selected.

Often such a research approach reveals that countries do not always compete in the same market segment and that the market is far more differentiated than previously thought. A semi-structured interview process can help to delineate the evolution of production networks and the relative position of countries within these, while avoiding commercial sensitivities regarding buyers' sourcing strategies.

Obtaining the buyer's perspective is not easy. However, through the causal chain analysis and line of enquiry developed in this guide, there are various ways in which strong contacts with lead firms could be developed so as to obtain the necessary trust for highly sensitive commercial information to be conveyed.

Development partners could be approached to provide assistance in this process. Given that donors now recognise the need for support for LDCs as they begin their transition process (notably in the case of Samoa, which has continued to receive Aid for Trade support post LDC graduation), there may be a greater appetite for closer collaboration between public and private sectors.

5.3 Assessing country capabilities

The typical challenges of upgrading within GVCs may be intensified because of the increase in trade costs, which may arise because of the removal of tariff rents. These challenges must be anticipated by policy-makers. In order to adapt, firms may need specific assistance to acquire new capabilities and explore new markets. This requires investments in equipment, organisational arrangements and people. It is therefore important that country capabilities are assessed.

Producers are integrated into the value chain based on their capabilities. These relate not only to labour costs, but also increasingly to other aspects of production, including logistics and supply chain management, compliance issues and the avoidance of reputational risks.⁴ It is recognised that comparative costs create incentives to unbundle stages of production. In comparison, co-location or agglomeration effects may create forces that can bind some parts of a process together. As a result, the position of some countries within particular segments of GVCs may become more, rather than less, consolidated over time.

Because production is co-ordinated by decentralised, globally dispersed production networks co-ordinated by lead firms that control value added

Table 5.2 Country capabilities in the textiles and clothing value chain

Functional capabilities	Country examples	Description of activities	Firm ownership and size	Employed
Cut, make and trim (CMT) (assembly)	Cambodia	This is a form of subcontracting in which garment sewing plants are provided with imported inputs for assembly, most commonly in export processing zones (EPZs). CMT, or CM (cut and make), is a system whereby a manufacturer produces garments by cutting fabric provided by the customer and sewing the cut fabric into garments for delivery to the customer in accordance with their specifications. In general, companies operating on a CMT basis do not become involved in the design of the garment, just the manufacture.	FDI: 90%; local: ~7%	352,000
Supplier tier: marginal supplier 1st tier	Vietnam		FDI: 45%; state-owned enterprise (SOE): 10%	2 million
Package contractor (original equipment manufacturing (OEM)) sourcing	Bangladesh	OEM is a business model that focuses on the manufacturing process. The contractor is capable of sourcing and financing piece goods (fabric) and trim, and providing all production services, finishing and packaging for delivery to the retail outlet. In the clothing industry, OEM companies typically manufacture according to customer specifications and design, in many cases using raw materials specified by the customer. Free-on-board (FOB) is a common term used in industry to describe this type of contract manufacturer. However, it is technically an international trade term in which, for the price quoted, goods are delivered on board a ship or to another carrier at no cost to the buyer.	Domestic FDI outside EPZs, FDI within EPZs	3 million
Supplier tier: preferred supplier 2nd tier	Indonesia		Foreign and local firms	1 million
Package contractor (OEM) sourcing	Sri Lanka		Foreign and local firms	270,000
Supplier tier: niche supplier	Mexico		Foreign and local firms	750,000

(Continued)

Table 5.2 (Continued)

Functional capabilities	Country examples	Description of activities	Firm ownership and size	Employed
Full package provider (original design manufacturing (ODM)) Supplier tier: strategic supplier	Turkey	This is a business model that focuses on design rather than on branding or manufacturing. A full-package garment supplier carries out all steps involved in the production of a finished garment, including design, fabric purchasing, cutting, sewing, trimming, packaging and distribution. Typically, a full-package supplier will organise and co-ordinate the design of the product; the approval of samples; the selection, purchasing and production of materials; the completion of production; and, in some cases, the delivery of the finished product to the final customer.	Many small and medium-sized firms	n/a
	India		Local dominates; foreign firms must be a joint venture; small firm size	35 million
	China		FDI: 45%; SOE: ~2%	30 million

Source: Adapted from Gereffi and Frederick 2010.

activities, firm-level ownership structures and investment destined for particular market segments should be analysed carefully. It is important to distinguish between functional capabilities, in order to ascertain how lead firms within a country are positioned.

An example of such an assessment within the textiles and clothing industry is presented in Table 5.2. A similar type of analysis would apply to, for example, the fisheries sector, the horticultural sector and high-value and 'heavy' industries such as the automotive sector. A detailed overview of each of these sectors, the lead firm drivers and buyers are summarised by Keane and Baimbill-Johnson (2017).

To conclude, the deployment of mixed research methods becomes necessary so as to understand the nature of intra- and inter-firm relations and the sectoral dynamics of contemporary GVC engagement.⁵ The causal chain analysis advocated in this guide leads to a focus on tariff-dependent exports, modes of production, and the strengths and weaknesses of producers alongside the buyer's perspective. It requires an understanding of average unit costs, values and the role of the tariff preference conferred on LDC producers. The potential for trade shifts to arise must be approximated. Subsequently, potential measures to offset any adverse effects on trade competitiveness must be identified.

Notes

- 1 This action is increasingly being undertaken with the support of donors.
- 2 Schmitz and Knorringa (2001) concluded that producer countries differ substantially in terms of their 'willingness to learn from foreigners' and differences in these aptitudes can help explain producers' relative competitiveness.
- 3 According to media reports, the least compliant factory on Better Factory Cambodia's list, Best Tan Garment Ltd in Meanchey district, was found to produce clothes for Spanish brand Pull&Bear, owned by Inditex (Henderson and Sovuthy 2014).
- 4 This view was expressed by several key informants as 'where the market is heading'.
- 5 For example, UNCTAD (2013) supplemented its TiVA (Trade in Value Added) data analysis with qualitative analyses, tracing company ownership structures so as to derive an estimation of 30% of contemporary global trade occurring within the boundaries of one firm.

References

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