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**RECURSOS NATURALES Y DESARROLLO:  
DESAFÍOS PARA LA CTI EN EL SIGLO XXI**

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**No place like home: The importance  
of domestic markets for upgrading  
in Global Value Chains**

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para la CTI en el Siglo XXI”

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Image: Toni Lozano

**A single Chinese SME produces 80% of all electrical plugs sold in the UK....**

A large, dense pile of white electrical power strips and cables. The power strips are rectangular with multiple outlets and are connected to various types of cables, including standard two-pronged plugs and more complex multi-pronged or specialized plugs. The cables are tangled together, creating a complex web of white plastic and metal components. The lighting is bright, highlighting the textures of the plastic and the metallic parts of the plugs.

**...is that an example of successful upgrading?**

# SMEs are expected to experience economic upgrading in GVCs

## Economic Upgrading types (excluding Interchain upgrading)

Process	Product	Functional
<ul style="list-style-type: none"> <li>■ Doing certain tasks better</li> <li>■ Indicators:                             <ul style="list-style-type: none"> <li>■ Investment in machinery</li> <li>■ Workforce training</li> <li>■ Changing layout</li> <li>■ New management techniques</li> <li>■ Introduction of total quality programmes</li> <li>■ Socially and environmentally sound practices (inc. OSH)</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>■ Making a product that is of better quality, more sophisticated or simply carries a better price.</li> <li>■ Indicators:                             <ul style="list-style-type: none"> <li>■ New models</li> <li>■ New lines</li> <li>■ Higher prices</li> <li>■ New materials</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>■ Acquiring skills in a chain activity that the firm did not possess before</li> <li>■ Indicators:                             <ul style="list-style-type: none"> <li>■ For instance, a producer starting to design its own products</li> <li>■ launching own brands</li> <li>■ coordinating its own supply chain</li> <li>■ Marketing activity</li> <li>■ Entering new markets</li> </ul> </li> </ul>

Source: Adapted from Humphrey & Schmitz, 2000 and Navas-Aleman, 2011

However the experience with upgrading has been uneven and far from 'automatic'

### Expectations vs Reality: a Summary

- Early GVC literature (1990s) was concerned with manufacturing and with **economic** upgrading
  - The more competitive/able firms/clusters would join GVCs and the rest would follow or would benefit from the dissemination of good practices
  - When widespread economic upgrading proved uneven, the role of **governance** by lead firms in GVCs took centre stage, particularly its relationship with different types of economic upgrading.
  - It was assumed that social upgrading (including labour practices) would follow economic upgrading.
- Later research (2000s) – spearheaded by Global Production Network scholars- analysed the issue of **social** upgrading in depth.
  - Differentiating types of employment contracts/conditions became key.

## What does the value chain literature say about functional upgrading by firms from emerging economies?

- All firms are (by definition) part of a Value Chain ( be it local, domestic, regional or global)
- Not all activities in the value chain are equally remunerated (Kaplinsky 1998, Humphrey and Schmitz 2000, 2002)
- Activities beyond production (functional upgrading) are usually better remunerated because manufacturing is so ubiquitous and well codified (Maskell, 1998)
- Lead firms in value chains may determine which activities are performed by other firms in the chain by '**governing**' them (Gereffi 1994, 1999)

## This leaves us with two views on how and where do firms from emerging markets start functionally upgrading...

### Learning by Exporting

- Exporting as a 'superior' way to learn and acquire any capability
- Early value chain studies (Gereffi 1994;1999), World Bank 1993, 1998
- Supported by the success of Korea, Taiwan and Hong Kong
- Brands such as Samsung, LG, Hyundai, Acer, Esprit, Liz Claiborne

### Domestic market first

- Global buyers may inhibit brand/design development in their suppliers, hence domestic markets may be more conducive
- Recent value chain studies in emerging economies (Schmitz 2004; Bazan and Navas-Aleman, 2004; Navas-Aleman, 2011)
- Supported by the experiences of brands such as Havaianas (Brazil), Haier, Lenovo, Huawei (China), Tata (India),

## However, most firms and clusters operate in several value chains (Multichain) including domestic and regional chains and are exposed to different types of governance

Evidence from cluster and value chain studies challenged conventional wisdom of the 'Exporting as a Golden Standard' for **economic** upgrading. Even before the crisis of 2008.

- The knitwear cluster in Ludhiana, India (Tewari, 1999)
- The footwear cluster in Agra, India (Knorringa 1996, 1999)
- The Taiwan PC industry (Lee and Chen, 2000)
- Jeans producers in Turkey (Tokatli and Kizilgun, 2004)
- The footwear cluster in Sinos Valley and the furniture cluster in the Serra Gaucha, both in Brazil (Bazan and Navas-Aleman, 2004 and Navas-Aleman, 2011)
- The home appliances and garments sectors in China (Navas-Aleman, 2009)

## Why is this important? Because value Chain governance is crucial for upgrading

...because certain types of governance are linked to certain types of upgrading:

- Insertion in quasi-hierarchical or captive value chains offers a fast-track route to process and product upgrading but hinders functional upgrading (particularly in the areas of *marketing*, *branding* and *design*) (Schmitz & Knorringa, 2000; Bair & Gereffi, 2001; Navas-Aleman 2011)
- Evidence of upgrading in marketing, branding and design in market-based chains (Bazan & Navas-Aleman, 2004; Kishimoto, 2004; Navas-Aleman, 2011) – **they took place in Domestic chains first**
- Functional ‘downgrading’ also observed in developed countries (Rabellotti, 2004) when producers operated in captive value chains.

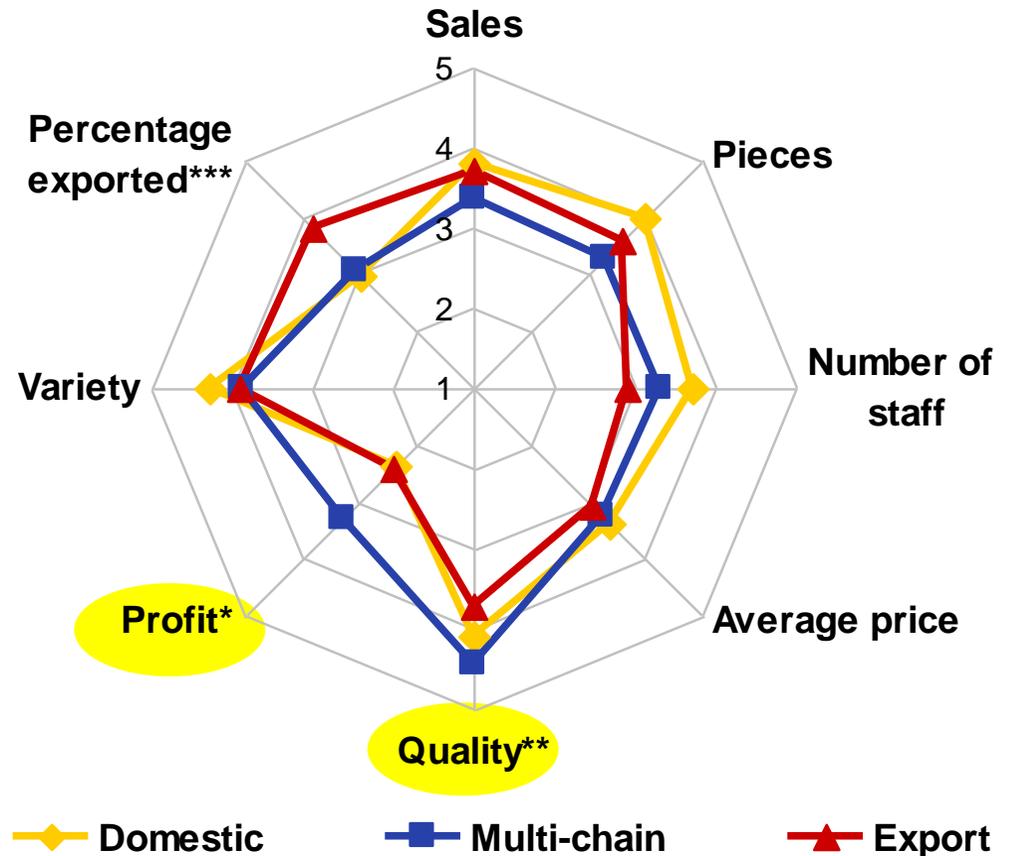
Multi-chain firms might have better performance in all types of economic upgrading

Finding

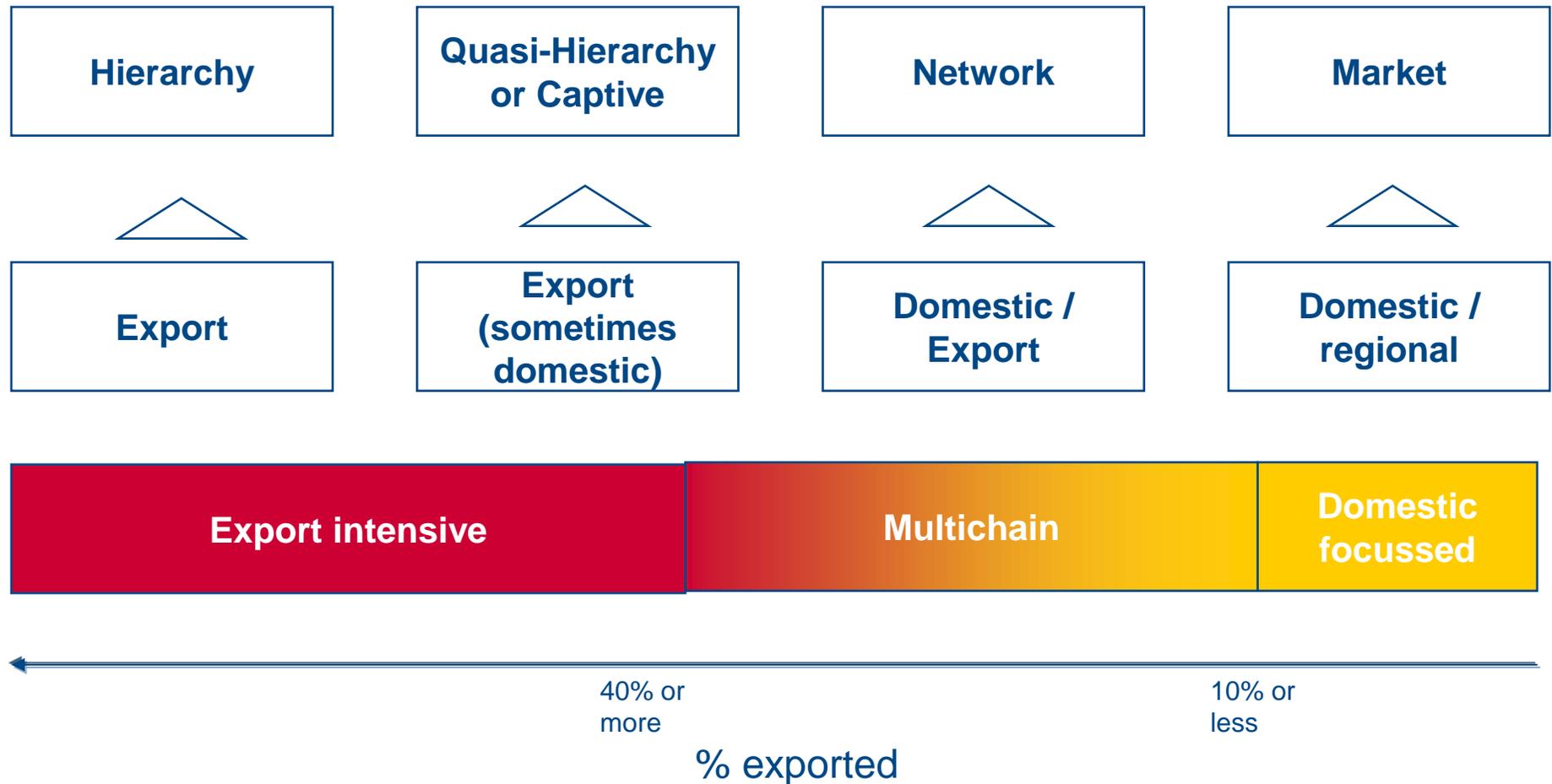
- Multi-chain firms presented high levels of product and process upgrading...
- ...and high levels of functional upgrading.
- Firms operating in several value chains tend to lead on the three types of upgrading: functional, product and process.
- **Multi-chain firms seem to have better performance**
  - Multichain firms achieved higher profits
  - Multichain firms achieved higher quality

Source (Navas-Aleman, 2011)

Example from: Brazilian footwear industry



**Multichain firms may experience looser chain governance in domestic and regional markets which is linked to functional upgrading.**



## Multichain firms leverage the resources and learning from one value chain when operating in another which allows for overall economic upgrading and greater resilience to shocks

- The knitwear cluster in Ludhiana, India (Tewari, 1999)
- The footwear cluster in Agra, India (Knorringa 1996, 1999)
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Evidence from cluster and value chain studies challenged conventional wisdom of the 'Exporting as a Golden Standard' for all **economic** upgrading. Even before the crisis of 2008. Upgrading attainment became a more nuanced goal.

## Research design in China – building on previous research in Brazil

<p><b>Project</b></p>	<p>UK ESRC funded project: Global brands from China?: A comparative study of the acquisition of branding capabilities in domestic and global value chains</p>
<p><b>Systematic comparisons &amp; <u>Lit review</u></b></p>	<ul style="list-style-type: none"> <li>•Global and National Value Chains</li> <li>•Different types of value chain coordination/governance</li> <li>•Attainment in branding</li> <li>•Other enhancing, hindering factors</li> </ul>
<p><b>Case Study sites</b></p>	<ul style="list-style-type: none"> <li>•Garment and home appliances :China’s largest exports</li> <li>•Zhejiang province: populated by Chinese-owned firms</li> <li>•Ningbo (in Zhejiang province) provided an ideal setting for a comparison between domestic oriented and export firms</li> <li>•Ningbo hosts strong garment and home appliances industries.</li> <li>•Sample: 200 firms for questionnaire survey and 30 for in-depth interviews with CEOs; interviews with buyers .</li> </ul>

## Ningbo's firms upgraded functionally in domestic markets first

Typology of firms					
Firm Category	% of sales in domestic market	Garments		HAI	
EXP	0-9.9%	47	57%	13	24%
	10-19.9%	12		6	
MC	20-29.9%	12	26%	13	72%
	30-39.9%	4		15	
	40-49.9%	0		8	
	50-59.9%	6		15	
	60-69.9%	4		4	
	70-79.9%	1		2	
DOM	80-89.9%	2	17%	2	4%
	90-100%	15		1	
	Sample	103		79	

Comments
<ul style="list-style-type: none"> <li>Intensive EXPorters: tend to work as Original Equipment Manufacturers so do not have their own brands (Well represented in Garments)</li> </ul>
<ul style="list-style-type: none"> <li>DOMestic oriented producers usually have their own brands for the domestic market but can also be OEM for other Chinese firms.</li> </ul>
<ul style="list-style-type: none"> <li>MultiChain (MC) producers operate in several value chains simultaneously and usually have brands for domestic and export markets (Well represented in HAI)</li> </ul>

## Ningbo's firms showed a strong branding vocation with clear differences between the two sectors

Prevalence of brands				
	Garments		HAI	
	Firms with Brands	%	Firms with Brands	%
<b>DOM</b>	16/17	94%	3/3	100%
<b>MC</b>	17/27	63%	32/57	56.0%
<b>EXP</b>	10/59	17%	11/19	58%
<b>Total</b>	43/103	42%	46/79	58%

Comments
<ul style="list-style-type: none"> <li>■ Most DOM firms have brands. Also common for the majority of MC in both sectors.</li> <li>■ Branding is very common with home appliances exporters, but rare with garment exporters.</li> <li>■ <b>Domestic brands are key in a fiercely competitive national market requiring after-sales services and networks as well as investment in innovation and sales channels.</b></li> <li>■ OEM export remains the most common sales channel despite growth of the domestic market.</li> <li>■ Financial crises forced unbranded OEM firms to reconsider their strategies.</li> </ul>

## **After the Domestic market, Chinese firms use regional markets and other ‘third markets’ to upgrade functionally**

- The Middle East, Africa and Latin America have been used as ‘training ground’ for functional upgrading where firms can compete in third markets with global brands from developed countries
- Chinese firms have often used functional upgrading abroad to increase their appeal in the highly competitive domestic market.

## Qualitative findings supported the relationship between domestic markets and functional upgrading in HAI



### Governance in the value chain:

Most firms are 'multichain' and sell directly to distributors

The most common type of value chain coordination is market

### Branding

- More domestic and international brands than in the garments sector
- Younger and smaller firms
- Ningbo brands are getting recognition in other emerging and developing economies
- Branding is widespread even among smaller firms
- Subsidies by the government have been as important (such as the rural consumption programme) as chain governance for functional

## ...and in Garments



### Governance in the value chain

Most firms are suppliers to other large domestic or international firms.

Quasi-hierarchy is the most common type of chain governance, even for large firms

### Branding

- Fewer and weaker brands
- Older and larger firms
- Cash-rich firms are investing in foreign brands as a way of speeding up the acquisition of branding capabilities
- Hiding Chinese origins of the brand is more widespread than in the home appliances sector

## Conclusions (I)

Industrialisation advice to emerging economies has become too obsessed with exporting to the 'Global North' at any cost and overlooks opportunities for upgrading in domestic and regional value chains.

- The importance of local and regional markets for learning and developing capabilities in functional upgrading needs to be stated explicitly.
- Functional upgrading tends to appear in 'arm's length' value chains
- Product and process upgrading is 'fast-tracked' in Captive chains
- Functional upgrading tends to happen first in the domestic market and is then transferred to export markets, however, Chinese firms have tried the opposite due to the intense local competition (not common).
- Operation in several value chains (multi-chain firms) offers superior prospects for all three types of upgrading

## Conclusions (II)

- Underestimating regional markets and developing country markets might be a costly mistake by those aiming to upgrade functionally gradually, without confrontations with lead buyers in GVCs.
- Lessons from ‘commoditised’ manufacturing can inform policies to support NR-based firms in emerging economies to upgrade in GVCs
- When domestic markets are either not large enough or sophisticated enough, experimenting with neighbouring markets is key.
- It’s a matter of resilience and exploiting opportunities that are local and familiar but also of developing capabilities and products that can be commercialised internationally from an advantageous position.
- In the case of Natural-Resource rich countries, a sophisticated domestic demand and supporting technologies are key towards functional upgrading in NR-based GVCs as proposed by Marin, Perez and Navas-Aleman (2015).

**Dr. Lizbeth Navas-Alemán is a Value Chain Analysis specialist with 20 years' experience in the field of international development. In 2013 she founded the consultancy Navas-Aleman & Co in order to collaborate with other independent international development specialists in delivering high-quality research and advisory services to a wider range of clients in developing countries. She carries out academic research, training and consultancy on private sector development, industrial organisation and development cooperation in Latin America, Asia and Europe.**

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