

Technical Cooperation “Clusters, Value Chains and Competitiveness”
Agorà 2000, Italy for the Micro and SME Division, Department of Sustainable
Development (SDS/MSM) of the Inter American Development Bank (IADB)

HOW CAN SMEs IN CLUSTERS AND VALUE CHAINS MAKE THE BEST OF GLOBALIZATION?

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In the final two decades of the century virtually all developing countries increasingly liberalised their markets and forced producers to operate on a global market.

The key policy issue is **not**
whether to participate in
global markets,
but how to do so in a way
which provides for sustainable
growth.

There are two main paths of insertion in the global economy

- **The low road** in which producers are engaged in a “race to the bottom”. Example: if increased exports can only be paid for by lower wages (i.e. Synos Valley).
- **The high road** is one of increasing and improving participation in the global economy, realising sustained income growth.

What explains the difference
between these two paths?

A key capability is the capacity
to upgrade
(to innovate in a relative
context: how fast compared to
competitors).

There are four types of upgrading that firms or groups of firms might undertake:

- Process upgrading
- Product upgrading
- Functional upgrading
- Intersectoral upgrading

How can SMEs in developing countries respond to the upgrading challenge?

The analysis of **industrial clusters** is focused on the role of **local linkages** in generating competitive advantages in export industries.

The (global) **value chain** literature takes a very different approach emphasising **linkages between firms** in (global) production and distribution systems.

Clusters in developing countries

**A cluster is a spatial
concentration of specialized
firms.**

Firms located in clusters may benefit from **collective efficiency**:

- Together they generate **external economies** which spill-over to other firms (incidental – *passive* – effect of clustering);
- They engage in **joint actions** (consciously pursued – *active* - effect of clustering).

External economies could arise from:

- The availability of a pool of specialized skills;
- Cheap and ready available supply of specialized inputs;
- Easy access to specialized trade and technical knowledge and rapid dissemination of information;
- Improved market access: the concentration attracts customers.

Joint actions (Nadvi, 1999):

- **Joint action within vertical linkages:**with suppliers, sub-contractors, traders and buyers;
- **Joint action within horizontal linkages between two or more local producers:** joint purchasing of inputs, selling under a collective label;
- **Joint action within horizontal multilateral linkages among a large number of local producers:** _co-operation in trade associations, joint participation in trade fairs, collective provision of business development services.

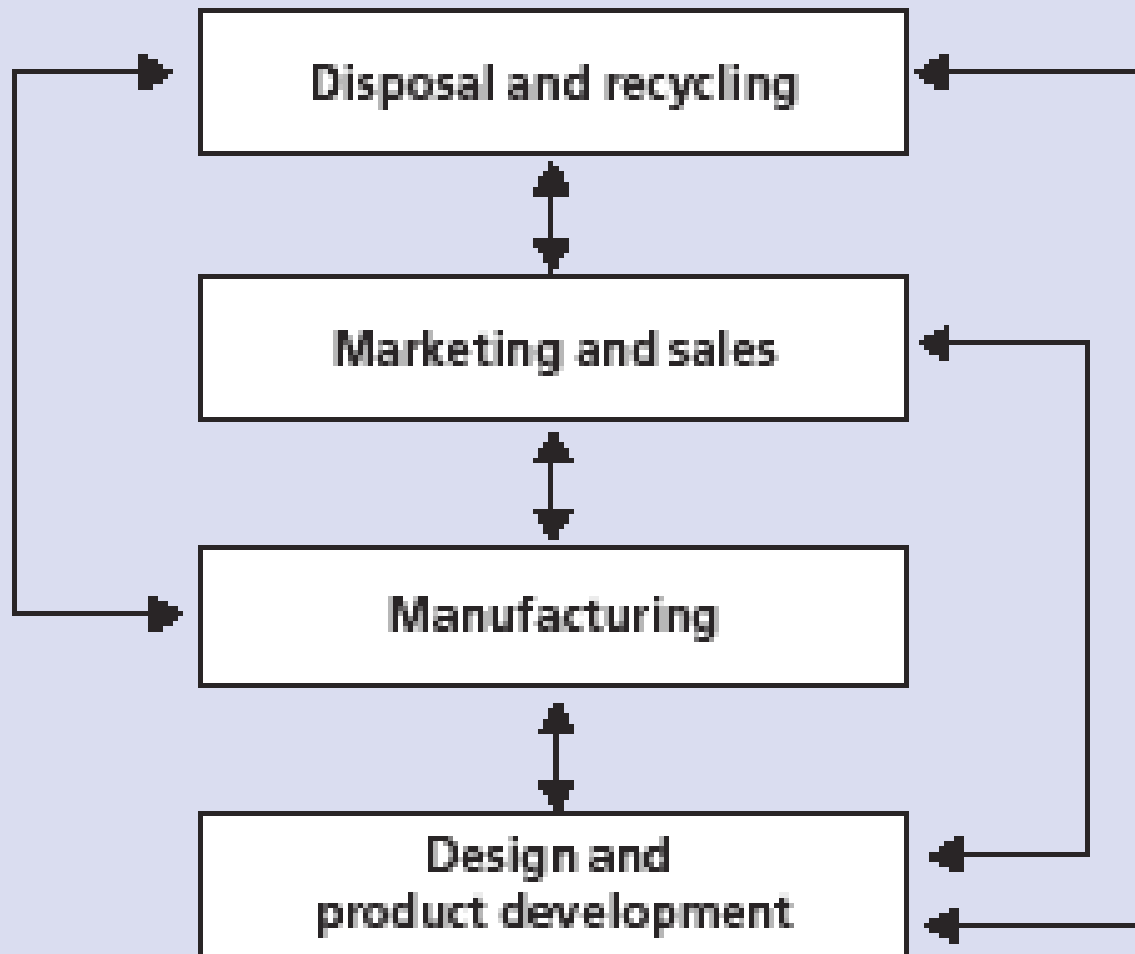
Global Value Chains in developing countries

What is a **Global Value Chain**?

A simple idea:

- The design, production and marketing of products involves a chain of activities divided between different enterprises often located in different places.
- Rarely single companies do everything: turn raw materials into finished products and sell them.
- Production *per se* is only one of a number of value added links, related to design and product development, marketing, distribution, recycling, etc.
- This requires adequate government and coordination of all the links: adequate **GOVERNANCE**.

A simple form of Value Chain



Source: UNIDO.

At any point in the chain, governance and coordination of the following is required:

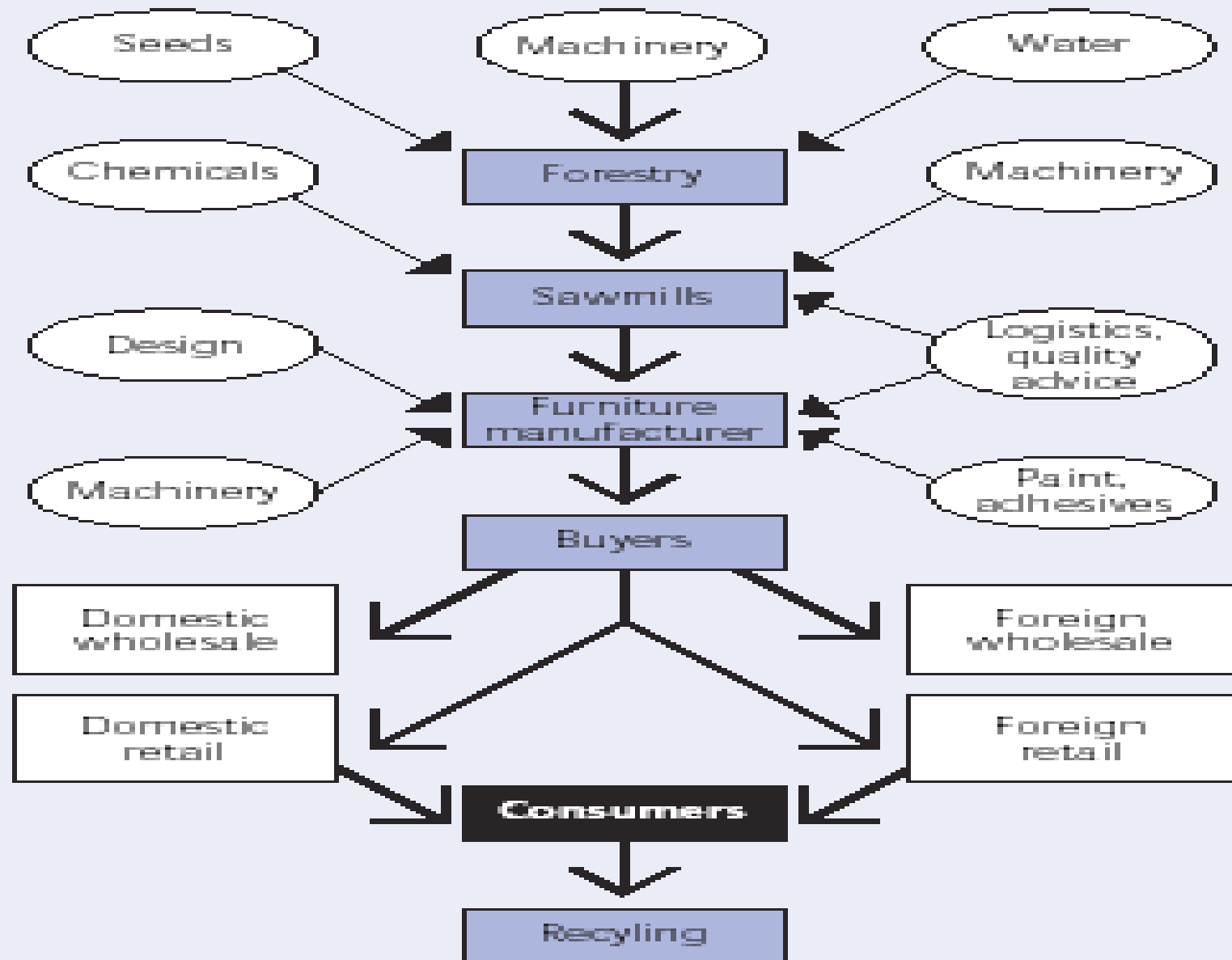
- What is to be produced (design of products)
- How it is to be produced (definition of the production process: technology, quality standards)
- How much has to be produced.

Within such context, International standards - set and monitored by the leader or by international norms - need to be fulfilled throughout the chain and continuously

In addition:

- Links are not only between enterprises, but also with non-market institutions (Universities, Training centers,..),
- Links may be vertical and horizontal
- A crucial issue is WHO adds value WHERE along the chain

A more complex form (e.g. Furniture)



How is Governance ensured along a Value Chain?

Forms of coordination of economic activities	
Williamson	Humphrey and Schmitz
Market	Arm's-length market relations
Network	Network
	Quasi-hierarchy
Vertical Integration (TNCs)	Hierarchy

Three possible types of non-market governance:

- **Network** implying co-operation between firms of more or less equal power which share their competencies within the chain;
- **Quasi-hierarchy** involving relationships between legally independent firms in which one is subordinated to the other and with a leader in the chain defining rules that the rest of the actors have to comply with;
- **Hierarchy** when the local firm is owned by an external firm.

In addition to these forms of private governance there may also be public governance through a range of governmental agencies.

⇒ Or hybrids of public-private governance that may include business associations, technology centers, business development service centers, groups of business leaders, ...

Categories of Global Value Chains

Depending on who exercises control over the chain even in the absence of ownership (Gereffi, 1999):

⇒ **BUYER-DRIVEN**

or

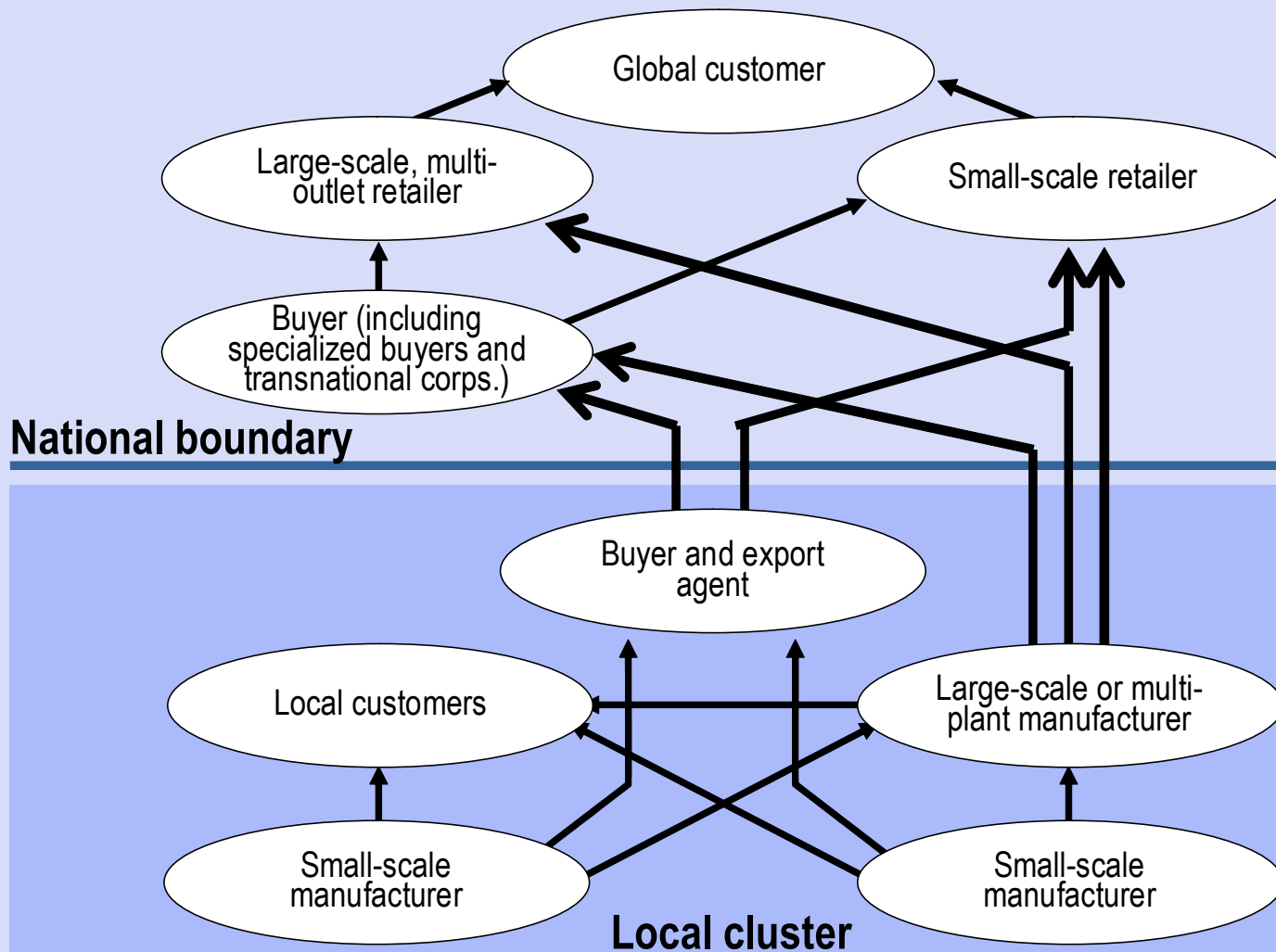
⇒ **PRODUCER-DRIVEN**

Categories of Global Value Chains

Characteristics:	Producer-driven Chains	Buyer-driven Chains
Driver of GVC	Industrial capital	Commercial capital
Main governing actors	Large, Trans-national manufacturers	Large retailers, marketers, branded manufacturers
Core competencies	R&D, Production	Design, Marketing
Sectors	Consumer goods, Intermediate goods, Capital goods	Non-durable consumer goods
Typical Industries	Cars, Computers, Aircraft	Apparel, footwear, toys, agro-industry, consumer electronics
Ownership	Transnational corporations	Local enterprises, especially in LDCs
Main Network Links	Investment-based	Trade-based
Source: adapted from Gereffi, 1999		

Thus, local clusters in order to get access to the international market, increasingly need to participate in Global Value Chains

Linking local clusters to global value chains



Source: UNIDO [IDR 2002-03](#)

How does insertion into global value chain affect local upgrading strategies?

- Upgrading may be fostered by participation in Global Value Chains.
- However, this may also hinder local SMEs' upgrading, and notably slow their learning process.

Where to strike the balance?

Let us see some stylised facts from different regions of the world

What may be the role of public policies?

Upgrading in the Sinos Valley Footwear cluster, Brazil (Schmitz, 1999)

- In the early 1990s due to **Chinese competition**, Brazilian producers were faced with sharply declining prices for their products.
- The upgrading imperative was clear, but the lead firms favoured the sphere of production and **neglected the areas of design and marketing.**
- A **collective initiative** aimed at raising Brazil's image in the world marked **failed** because of the opposition of the lead firms. They feared that advancing into design and marketing would encroach on the core competence of their main buyers.

The Brenta shoe district (Italy): a case of functional downgrading (Rabellotti, 2002)

- During the second half of the 1990s many shoe firms in Brenta became **subcontractors** of high fashion companies
- These firms **abandoned their design and marketing capabilities** to focus on production
- Nonetheless, **these firms are performing better** than the rest of the district's enterprises because profits in the luxury fashion industry are very high.

Other examples of Upgrading SMEs in Global Value Chains

Crompton Greaves Ltd (CGL) Electric Motors in India

(Humphrey, Kaplinsky, Saraph, 1998)

INTEL Semiconductors in Malaysia

(Kaplinsky, Readman, 2001)

How to assist SMEs Clusters to access and gain from GVC? What role for public/private policies ?

- Policies often directly assist individual SMEs to participate in global markets
- However, it is often more effective and cheaper to support groups (clusters) of firms

First, there is a key choice of the institutional set-up that should be preferred

Operate through (and together with) :

- SMEs and their associations.
- Relevant local institutions (Service Centers, R&D Centers, Universities, Business Associations ..)
- Large local leader firms.
- Foreign buyers-producers-TNCs.

Some examples of **networked collaboration between firms** which may be promoted (Kaplinsky & Readman, 2001):

- 1. Hearing the market.** Join efforts to undertake market research, too costly for individual firms.
- 2. Joint selling.** Supporting joint-marketing efforts.
- 3. Joint buying.** Economies of scale in purchasing.
- 4. Product development.** Strong incentives towards firms selling with a common brandname and to a common standard. Volumes may be much bigger.

- 5. *Process improvements.*** Especially for disembodied inputs (e.g. joint hiring of consultants)
- 6. *Standards and codes:*** Join to spread the costs of monitoring.
- 7. *Learning networks.*** A useful mechanism for promoting the gainful participation of SMEs in global product markets. Enable SMEs to come together, share their experience, move forward programs of continuous improvement. Examples from Europe and the South African Auto Components Industry.

The research questions:

- 1.** Have clustered SMEs a better chance to upgrade within value chains than isolated firms?
- 2.** Does the insertion of clusters into global value chains enhance or undermine local upgrading strategies?
- 3.** What can be done to assist SMEs located in clusters to participate gainfully in global value chains? What role for the IADB?