



Open Research Online

The Open University's repository of research publications and other research outputs

Financialized corporate strategies and restructuring of global supply chains

Other

How to cite:

Newman, Susan (2012). Financialized corporate strategies and restructuring of global supply chains. International Institute of Social Studies, The Hague.

For guidance on citations see [FAQs](#).

© [not recorded]

Version: Accepted Manuscript

Copyright and Moral Rights for the articles on this site are retained by the individual authors and/or other copyright owners. For more information on Open Research Online's data [policy](#) on reuse of materials please consult the policies page.

oro.open.ac.uk

Financialised corporate strategies and restructuring of global supply chains

Susan Newman, ISS

Newman@iss.nl

Industrial organization and Inter-firm relations within vertically disintegrated and spatially dispersed production systems emerged as a burgeoning area of research in the 1990s and 2000s across what might be broadly considered as development studies (see the article by Wouter Jacobs in this issue). Global commodity chain/global value chain approaches were initially concerned with the nature of 'globalization' in contemporary capitalism and the way in which developing countries have been integrated into the global economic system. These studies emphasized the need, as well as the opportunities, for developing country firms to 'upgrade'- that is to engage in higher value-added activities associated with downstream portions of the chain - in order to reap the potential rewards of integration into the global economy. Whether or not the opportunities for upgrading and their associated benefits were overstated at the time, it will become clear in what remains of this article that benefits of upgrading, if they existed at all in the first place, have all but disappeared with shifts in corporate structure and strategies of lead firms in the U.S and Europe – those which coordinate and control supply chains and suppliers in developing countries – associated with the process of financialisation.

What is financialisation and why does it matter?

Financialisation as a term is barely over a decade old. It has come to the fore since the onset of the global financial crisis in 2007. The term is variously defined but its broadest sense, financialisation refers to the 'the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies' (Epstein 2005, p.3). Non-financial corporations have been increasingly valued on the basis of the performance of their shares on financial markets rather than productive criteria. This is reflective of a shift in corporate governance and restructuring in the US, UK and parts of Europe in the 1980s and 1990s to what has become known as the 'shareholder value movement'. The idea is that left to the manager, resources may be inefficiently allocated or guided by motives of personal advancement; companies should therefore 'maximise shareholder value' since a higher return to shareholders represents a manifestation toward the more efficient allocation of resources. In addition, managers' interests should be aligned with those of shareholders by remuneration through share and stock options. Do increasing share prices necessarily mean a more efficient allocation of resources? The answer is a resounding no if by efficient we mean allocation of resources towards productive investments and innovation. Firms have raised shareholder returns by increasing their share of short-term financial assets (such as derivatives) and reducing investment in physical capital – in many cases contracting productive capacity, in order to distribute a higher share of profits in dividend payments. In addition, firms have sought to raise share prices through share buy-backs and mergers and acquisitions. Lazonick and O'Sullivan (2000) have documented the spate of hostile takeovers in the US during the 1980s and connected these to the shift in firms' decisions

on capital allocation from a principle of 'retain and invest' to 'downsize and distribute' and increased short-termism. Many financialised corporations have diversified away from production towards finance itself. Moreover, institutional investors, interested solely of returns from changing share prices, have increasingly become the major shareholders of corporations – in the U.S and U.K in particular. These processes have acted together to ultimately undermine longer term productive investments such as those for innovation.

'Disinvestment is the only certain way of increasing shareholder value: that is, selling off or closing down all but the most profitable parts of the business. This is guaranteed to generate higher returns on capital employed, thus providing a rational for an increase in the stock price' (Watson 2007, quoted in Milberg 2008, p.434)

How have supply chains become financialised?

It is well known that offshoring of portions of the supply chain to developing countries has been driven primarily by cost considerations. For this reason, developing country actors tend to participate in chains that are 'buyer-driven' (Gereffiand & Korzeniewicz, 1994) - that is, coordinated and controlled by lead firms, operating in sections of the chain close to consumer, in the global north – and operate in low-cost, 'low value-added', activities. The process of financialisation starts with corporate restructuring at the level of the lead firm. This in turn has implications for the restructuring of production and social relations upstream along the supply chain, particularly in terms supplier relations, the distribution of income/value-added along the chain and conditions of labour.

There has been relatively little academic work conducted to date that looks deeply at the way in which supply chains and productive relations have been affected by the process of financialisation. A few exceptions include the work by William Milberg (2008), Florence Palpacuer (2008) and my work (Newman 2009) from which I will draw to illustrate some of the processes and implications of the financialisation of supply chains. While not limited to these, developing country producers have been most widely integrated into clothing, food and horticulture supply chains. For clothing and fresh produce, large retail firms act as lead firms in the supply chain, while transnational commodity trading companies 'drive' supply chains for non-perishable foods and agricultural products such as grains, coffee, sugar and cocoa. While the imperatives of financialisation have been felt across geographies and industries, the processes and forms of financialisation, as well as their outcomes, have been uneven.

From the 1980s, lead firms of clothing chains in the US and UK narrowed the scope of their activities to product definition, marketing and consumer lending and outsourced manufacturing related activities to reduce their cost of production, as well as the need to reinvest profits into the maintenance or expansion of domestic productive capacity which meant that more profit could be distributed as dividends (Milberg 2008).

'Many 'manufacturing' firms now do no manufacturing at all, providing only brand design, marketing, supply chain logistics and financial management services.' (Milberg 2008, p.425)

Palpacuer (2008) shows that the extent to which lead firms in clothing chains are financialised has profound implications on relations with developing country suppliers and hence labour conditions in developing countries. More financialised lead-firms, such as those in the UK and US had more reduced supply bases compared with their French and Scandinavian counterparts. In addition, the more financialised retailers placed more stringent criteria for the selection of new suppliers and made higher demands on suppliers by insisting on production flexibility, and inventory management – thus transferring risk of holding stock to the suppliers and supporting greater profitability. Lead firms are able to maintain and even increase their margins in spite of stagnant consumer prices in the US and Europe.

What we also see at the level of financialised lead-firms of clothing chains in the UK and US is increased industrial concentration through mergers and acquisitions guided by the principle of maximizing shareholder value. A parallel process of increased concentration of lead firms in coffee chains has also taken place. While initially driven by eroding margins, concentration of transnational coffee trading companies has increased as a result of the imperatives to engage in derivatives trading both as a hedging instrument in the context of volatile coffee prices since the collapse of the multilateral price stabilization scheme: the international coffee agreement in 1989, and as coffee trading companies themselves underwent a process of financialisation, increasing their share of income from speculative activities on derivatives exchanges. Engagement in derivatives trading is expensive business, and many smaller coffee trading companies simply did not have the financial resources to finance margin calls in periods of sustained price increases. Smaller firms were also less able to sustain large losses associated with adverse swings in the increasingly volatile coffee futures markets. The top 5 coffee trading companies together account for almost 60% of all trade in green (unroasted) coffee. (Newman 2009)

What are the implications for developing country suppliers?

A consequence of increased concentration of lead firms in both coffee chains and clothing chains has been the growing asymmetry in power between buyer and supplier. The asymmetry of power between buyers and sellers along the supply chains that span developing countries has allowed for greater arms-length relations between buyers and suppliers as opposed to vertical foreign direct investment with longer term benefits. In addition, the worsening in the asymmetry of power has allowed for the shift in the distribution of income/value-added from developing country producers towards lead firms in the US and Europe.

The shift in distribution and modes of appropriation by lead firms along the chain vary across industries and from place to place. Palpacuer (2008) shows how the financialisation of lead firms in clothing chains has driven a deterioration of working conditions at the base of the chain, with women disproportionately affected as a result of more stringent demands of buyers both in terms of price and flexibility that have spurred the reconfiguration of subcontracting into more tenuous and arms-length relations and more precarious labour contracts.

For coffee producers and local marketing agents in Uganda, financialisation has meant more volatile prices for coffee and weakened bargaining power exacerbated by the dismantling of the national coffee marketing board as part of structural adjustment – coffee traders used to negotiate with the marketing

board, today they deal with disorganized small-holder producers through local middlemen. Faced with volatile prices, local middlemen have little alternative but to buy as low as possible from the farmer in order to buffer sudden falls in the world price. This means that farmers receive a low farm-gate price regardless of whether world markets are going up or not. This has serious implications on reinvestment into coffee production. This calls to question the interdependency of production and financialised appropriation of the surplus. Financialisation is about the appropriation of surplus accelerating the concentration of wealth into the hands of what is now popularly known as the one percent. But the production of this surplus is being undermined by the process of financialisation itself.

Interdependence between off shoring/ restructuring of supply chains and financialisation

The global value chain literature has tended to offer efficiency gains as an explanation of the vertical disintegration and the globalization of production made possible by innovations in communications (see the article by Wouter Jacobs in this issue). This explanation is limited in that it does not take into account broader systemic changes in the global economy over the past three decades. While off-shoring and the restructuring of supply chains in what has been described as the globalization of production was not entirely driven by the process of financialisation, the interdependence of financialisation and productive restructuring should be clear from this article. The very process of vertical disintegration and off-shoring by firms in the US and parts of Europe has fed into the promotion of shareholder value by lead firms since profit margins are maintained through low-cost suppliers even when prices in consumer markets were stagnant. These mark-ups have been susceptible to what Milberg has called leakages – profits that are not reinvested in production but diverted towards financialised accumulation. (Milberg 2008) In turn, in many cases, the restructuring of production along supply chains has been in response to new imperatives set by the process of financialisation.

The false separation of finance and production

In the wake of the global financial crisis, it has become evident that countries and regions that have avoided the worst effects have been those which have shielded themselves from the processes of financialisation, and where a strong manufacturing base has been developed and maintained (China and Germany being prime examples). Speaking at London Fashion Week in February 2012, the head of the Arcadia retail group – responsible for some of the largest British fashion retailers including Top Shop and BHS – Sir Philip Green sent a rallying cry to rebuild Britain's garments manufacturing capacity which has been in decline since the 1980s precisely as a result of the explosion in offshoring that his and other retailers were responsible for. Despite this, policy responses to the crisis have been limited to restoration of the financial sector funded through austerity measures, reflecting both the tendency to separate the spheres of finance and production in policy and scholarly thinking and the continuing centrality of finance and financialisation in contemporary capitalism.

With the aim of promoting research focused on the relationship between financialisation and productive restructuring, ISS has organized a seminar series on the topic which brings together a number of speakers from various discipline and theoretical perspectives to present on theory, specific

contemporary case studies as well as historical work. Both Palpacuer and Milberg will be speaking as part of the series. For more information see www.iss.nl/DRS

Epstein, G. A. (2005) 'Financialization and the world economy' Cheltenham, UK; Northampton, MA, Edward Elgar.

Gereffi, G. and M. Korzeniewicz (1994) 'Commodity chains and global capitalism' Westport, Conn, Praeger.

Lazonick, W. and M. O'Sullivan (2002) 'Maximizing shareholder value: a new ideology for corporate governance', Economy and Society, 29(1).

Milberg, W. (2008). 'Shifting Sources and Uses of Profits: Sustaining U.S. Financialization with Global Value Chains', Economy and Society , 37(3), 420-451.

Newman, S.A (2009) 'Financialization and changes in the social relations along commodity chains: the case of coffee', Review of Radical Political Economics, 41 (4), 539-559

Palpacuer, F. (2008) 'Bringing the social context back in: governance and wealth distribution in global commodity chains', Economy & Society, 37(3), 393-419.