

# **Local Industry in Global Networks**

**Changing Competitiveness, Corporate Strategies and Pathways of  
Development in Singapore and Malaysia's Garment Industry**

## Lokale Industrie in Mondiale Netwerken

Veranderende Concurrentiekracht, Bedrijfsstrategieën en  
Ontwikkelingspaden in de Kledingindustrie van Singapore en Maleisië

(met een samenvatting in het Nederlands)

Proefschrift

ter verkrijging van de graad van doctor  
aan de Universiteit Utrecht  
op gezag van Rector Magnificus, Prof. Dr. W.H. Gispen,  
ingevolge het besluit van het College voor Promoties  
in het openbaar te verdedigen op  
vrijdag 16 januari 2004 des ochtends te 10:30 uur

Floortje Smakman

geboren op 30 april 1973 te Velsen

Promotor: Prof. Dr. O. Verkoren  
Co-promotor: Dr. L.M.J. van Grunsven

Faculteit Geowetenschappen - Universiteit Utrecht

ISBN 90 5170 768 1  
NUR 740

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Figures and layout: Margot Stoete and Gerrit van Omme – Kartlab, Faculty of Geosciences, Universiteit Utrecht

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Rozenberg Publishers, Rozengracht 176A, 1016 NK Amsterdam, The Netherlands.  
Tel.: +31 20 625 54 29, Fax: + 31 20 620 33 95, E-mail: [info@rozenbergps.com](mailto:info@rozenbergps.com)  
[www.rozenbergps.com](http://www.rozenbergps.com)

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## List of Abbreviations

|         |   |
|---------|---|
| AFTA    | ASEAN Free Trade Area                                   |
| ASEAN   | Association of Southeast Asian Nations                  |
| ATC     | Agreement on Textiles and Clothing                      |
| BDCC    | Buyer-Driven Commodity Chain                            |
| bln.    | billion   |
| CAD     | Computer Aided Design                                   |
| CAM     | Computer Aided Manufacturing                            |
| CCC     | Computer Controlled Cutting (also lasercutting)         |
| CMT     | Cut-Make-Trim   |
| CPF     | Central Provident Fund (Singapore)                      |
| CSC     | Committee on Singapore's Competitiveness                |
| DBS     | Development Bank of Singapore                           |
| DOS     | Department of Statistics                                |
| EDB     | Economic Development Board (Singapore)                  |
| EOI     | Export Oriented Industrialisation                       |
| EPZ     | Export Processing Zone                                  |
| FDI     | Foreign Direct Investment                               |
| FTZ     | Free Trade Zone   |
| G(A)CC  | Global (Apparel) Commodity Chain                        |
| GATT    | General Agreement on Tariffs and Trade                  |
| GDP     | Gross Domestic Product                                  |
| HQ      | Headquarters  |
| HRDC    | Human Resources Development Council (Malaysia)          |
| HRDF    | Human Resources Development Fund (Malaysia)             |
| ILO     | International Labour Organization                       |
| IMP     | Industrial Master Plan (Malaysia)                       |
| ISI     | Import Substitution Industrialization                   |
| IT      | Information Technology                                  |
| JB      | Johor Baru  |
| JTC     | Jurong Town Corporation (Singapore)                     |
| KL      | Kuala Lumpur  |
| KLSE    | Kuala Lumpur Stock Exchange                             |
| LDC     | Lesser Developed Country                                |
| LMW     | Licensed Manufacturing Warehouse                        |
| MATAC   | Malaysian Textile and Apparel Centre                    |
| MEF     | Malaysian Employment Federation                         |
| MFA     | Multi Fibre Arrangement                                 |
| MGMA    | Malaysian Garment Manufacturers Association             |
| MIDA    | Malaysian Industrial Development Authority              |
| MIER    | Malaysian Institute for Economic Research               |
| MITI    | Ministry of International Trade and Industry (Malaysia) |
| MKMA    | Malaysian Knitting Manufacturers Association            |
| mln.    | million   |
| MTMA    | Malaysian Textiles Manufacturers Association            |
| MTI     | Ministry of Trade and Industry (Singapore)              |
| NEP     | New Economic Plan (Malaysia)                            |
| NGO     | Non Governmental Organization                           |
| NIC/NIE | Newly Industrialising Country/Economy                   |

|         |  |
|---------|--|
| NIDL    | New International Division of Labour                             |
| NPC     | National Productivity Corporation (Malaysia)                     |
| OBM     | Original Brand Manufacturing                                     |
| ODM     | Original Design Manufacturing                                    |
| OEM     | Original Equipment Manufacturing                                 |
| OPP     | Outline Perspective Plan (Malaysia)                              |
| OPT     | Outward Processing Trade   |
| PAP     | People's Action Party (Singapore)                                |
| PDCC    | Producer-Driven Commodity Chain                                  |
| QC      | Quality Control  |
| R&D     | Research and Development   |
| RM      | Malaysian Ringgit  |
| S\$     | Singapore Dollar   |
| SEP     | Strategic Economic Plan (Singapore)                              |
| SITC    | Standard International Trade Classification                      |
| SME/SMI | Small and Medium Enterprises/Industries                          |
| SMIDEC  | Small and Medium-Sized Industries Development Council (Malaysia) |
| TaFf    | Textile and Fashion federation Singapore                         |
| TDB     | Trade Development Board (Singapore)                              |
| TNC     | Transnational Corporation  |
| UPS     | Unit Production System   |
| UU      | Utrecht University   |
| WTO     | World Trade Organization   |

## Preface

When starting this project in the spring of 1998, I don't think I had any idea of what I was getting myself into. Perhaps that was a good thing. Particularly in the last year, when life seemed to consist of four walls, a computer and lots of coffee, I have wondered on more than one occasion what I was doing. Still, I am grateful to Otto Verkoren and Leo van Grunsven for getting me involved in this project, because looking back it has been nothing short of an adventure that I wouldn't have wanted to miss for the world.

Living and working in Southeast Asia has undoubtedly been one of the most exciting parts of the project. Seeing first hand the contradictions of the clothing industry in Singapore, with large international buying offices, fancy boutiques selling Versace and DKNY and small subcontractors, with some 20 seamstresses tucked away on the fourth floor of an industrial estate all operating within the same five square miles. Driving my old beat up Mazda through seemingly endless palm plantations in Johore, arriving at remote industrial parks, only to realise the hardest part was to actually find my way around the park itself (roads were usually numbered, but somehow 2 never logically followed after 1). The many occasions I was asked to join the person I was interviewing and some of his business partners for lunch, usually resulting in a 20 minute drive to 'a famous local sea food restaurant' and a copious meal accompanied by at least a litre of Chinese tea (I so miss the food!). These are just a few of the great, weird and frustrating experiences in the field that have contributed to the love-hate relationship I developed for the region. A relationship I think is characteristic for every place you feel at home.

A great number of people have contributed directly or indirectly to the completion of this project. The list is long, but there are a few I would like to mention here in particular.

First of all, I owe gratitude to all the people - garment producers, representatives of buying offices and fashion companies, government officials and industry representatives - who took out (valuable) time, to share information and thoughts with me. Setting up the appointments was often not an easy task, demanding a great deal of tenacity. Just getting past the receptionist (phone-etiquette was somewhat different than what I was used to) and getting a hold of the right person could be difficult and frustrating; as was actually convincing the managers to set up an appointment with me. Understandably, particularly the smaller producers were somewhat suspicious of my intentions (why would a young woman from the Netherlands be so interested in their business?!). But all frustrations and suspicion usually disappeared the moment we sat down and talked. I was amazed at the openness and willingness of many of the interviewees to share information, views and ideas on their business, but also on more general issues. Not to mention the hospitality I often encountered. I have come to admire the dedication and stamina of many of the clothing producers I talked to. I started realising I was in a rather comfortable outsider's position, while they faced so many small and big decisions on a daily basis that they often lacked the time to contemplate and analyse developments as thoroughly as I could afford to. It was to me the most vivid illustration of the highly competitive and dynamic nature of the industry and the fact that just surviving in it is a feat that demands respect.

In Singapore, we received great support from the Textile and Fashion Federation and particularly from its President, Mr. Patrick Lee and its Secretary General Mr. Chris Koh. Their help in arranging meetings with producers and the sharing of their extensive knowledge of, and experience in, the industry have proven invaluable. Mr. Koh always seemed to be able to make time free for me and I have enjoyed our conversations, which ranged from actual

business issues to broader contemplations of (future) developments in the Singapore and global garment industry.

Special thanks to Ms. Doreen Tan, of Temasek Polytechnic School of Design, who was always willing to help out where she could and has shown a keen interest in my work ever since my first visit to Singapore. In addition, she was involved directly in the case study on the fashion industry in Singapore and has given me the opportunity to work as an adjunct lecturer at Temasek Polytechnic for one semester. Something I have greatly enjoyed and which in my view has deepened my understanding of Singapore society.

Thanks also to the Institute for Southeast Asian Studies for acting as our local counterpart.

In Malaysia the assistance and support of Mr. Choy Ming Bil and Mr. Soo Chung Futt of the Malaysian Textile Manufacturers Association, which agreed to be our official local counterpart, has proven instrumental in setting up the initial database and helping arrange meetings. In addition they provided us with a place to work from in KL and a research assistant, Ms. Har, who joined in some of the interviews and helped out with translations. Moreover, the thorough knowledge of the industry of Mr. Choy and Mr. Futt proved useful.

In Batu Pahat, the tireless efforts of Ms. Rebecca Chiang - friendly, always helpful and hospitable - of the Malaysian Knitting Manufacturers Association, was invaluable for the success of our survey in the Southwestern region.

I owe gratitude to a number of graduate students from Utrecht University's section of International Economics and Economic Geography, who assisted in the gathering of empirical data for the project: Christiaan Münch and Ralph van Wijck in Singapore; Annemieke Leusink and Gert van Veldhuisen in the Central region; and Pieter Liebrechts and Thomas Akveld in the Southwestern region in Malaysia.

A word of appreciation and admiration for fellow PhD Anja Rudnick, whom I met at the very start of the project. Her research, on female Bangladeshi migrant workers in the clothing and electronics industry in Malaysia, touched on mine, yet took a fundamentally different approach. Through my conversations with her I was confronted quite directly with the darker side of some of the developments in the industry and the human tragedies they often entail. On a more personal level she has also inspired me, while her offer to sell me her Malaysian car, saved me the hassle of buying a second hand car as a woman in a strange country (a sure recipe for a total rip-off).

If there is one person that has been of crucial importance to me throughout the entire project it is Leo van Grunsven. Not only was he the one who got me involved in this research in the first place, his enthusiasm and involvement in the project, both in Utrecht and in Singapore and Malaysia, where he visited on several occasions, have been inspiring. Our many conversations and discussions helped me structure and focus my - sometimes chaotic - thoughts and ideas.

During the last two years, I particularly need to thank him for his patience with my lengthy and detailed writing, which he meticulously and seemingly tirelessly read, re-read and helped edit. I must admit, there were occasions when returning from one of our meetings, with text that seemed to disappear under red ink, desperation was near. On the other hand it made me want to do better, and constantly forced me to focus on the important things and strive for consistency and coherence throughout every chapter and every section and subsection. His supervision has contributed greatly to the work that lies before you here today.

Otto Verkoren, who initially brought the project to my attention, only became directly involved in it at a late stage. However, his pragmatic approach, mental support and reassurance during these difficult final stages have greatly facilitated the project's completion. Many thanks also to Margot Stoete and Gerrit van Omme, of the Kartografisch Lab, at the Faculty of Geo-sciences, who turned my manuscript into this beautifully laid-out book.

Returning from an exciting period in Singapore and Malaysia, to the rather uninspiring Unnik building at the university in Utrecht, was not an easy transition, especially since it coincided with perhaps the least exciting period of the research: the writing stage. However, the many lunch and coffee breaks with my colleagues on the 10th floor, Robine, Leendert, Paul and Gery made this transition and the last two years in Utrecht a lot more bearable. And then there was always Christiaan next door, willing to share a cup of coffee or a couple of beers after work. I'm sure we will stay in touch, as we have become friends rather than just colleagues.

My parents deserve a statue. They have always been supportive of my decisions and choices, although I am sure at times they must have wondered...

My father and Ineke provided me with the quiet haven I so needed in the last stages of the project, while financially supporting me during this period as well. Conversations with Ineke about the industry, in which she is involved as well, often enabled me to compare practices in Southeast Asia to those in Holland and Europe and broadened my perspective. Mom and Bill were always willing to lend an understanding ear and wired 'emergency funds' on more than one occasion. Without this practical and particularly moral support, I doubt I could have ever completed the dissertation.

I'd like to thank the many friends I made during my time in Asia, many of whom have since moved elsewhere, resulting in a truly *global network* of friends. They made my time in Asia even more enjoyable and currently assure me of a place to stay on virtually every continent. My friends back home were always there, whether at long distance, or close-by. Always interested and supportive, but perhaps even more importantly providing necessary diversion, dragging me away from behind the computer. I'd particularly like to thank Esther, Roeland, Doede and Iemy. I hope you realise how much your friendship has meant/means.

Finally I want to thank Drew for his patience and support. Although we met at a rather 'unfortunate' time, just before I left Singapore to return to the Netherlands and just as I was starting the difficult writing stage, he has stuck by me, even at long distance. Paying surprise visits, encouraging me, but also being tough on me when I needed it, urging me to 'get on with it'. In addition he has encouraged and coached me to take the first steps towards life beyond the PhD (apparently it does exist). With him, I look forward to it even more.

## Introduction

### (i) Theme of the research

There is general agreement that in the second half of the 20th century the internationalisation of economic activities has taken a flight, in terms of increasing interdependence of nations through the flows of goods, services and financial capital. More recently these processes have taken on an added dimension through FDI, international sourcing and subcontracting and a functional integration of these internationally dispersed activities. This is commonly referred to as *economic globalisation* (Dicken, 1992, 1998).

A plethora of studies on this evolving process of economic globalisation, or, as some claim, their fiction, have resulted in a “miasma of conflicting viewpoints and alternative discourses” (Dicken et al, 2001, p.89) on a range of aspects (see also Ruigrok & van Tulder, 1993; Hirst & Thompson, 1996, 2000; Gordon, 1988; Cox, 1997; for a general overview see Dicken, 1998). The theoretical meaning and practical impact of economic globalisation obviously remain highly contested (Storper, 1997). One of the aspects of the debate concern the local development opportunities that insertion into the global economy may present for less developed countries (LDCs)<sup>1</sup>. Within this discourse both a positive and a negative view exist<sup>2</sup>.

In the positive view economic globalisation is seen as an important lever for local development as firms and industries can take advantage of the opportunities opened up by the global economy and in turn spread these gains to benefit local communities and national economies. Although this view often acknowledges that economic globalisation produces both winners and losers, arguments are made that the gains outweigh the losses and there are only ‘temporary losers’, suffering in the short run to make advances in the future (Bonacich et al, 1994)<sup>3</sup>. This positive view of globalisation (see e.g. Ohmae, 1990, 1995) is by far predominant and has been adopted by both developing and developed country governments (most notably the US), TNCs, international agencies and academics (most notably economists) working in the neoclassical, liberal tradition.

Contrasting this view of globalisation and local development in LDCs is a negative one, in which globalisation is associated with growing inequality, both between and within countries (Kaplinsky, 2000; Jones, 1997; Dunford, 1994; Khan 1999; Wallerstein, 2002) and ‘immiserising growth’ (Kaplinsky, 2000, p.7)<sup>4</sup> of large parts of the world population and communities due to (Western) capital’s relentless search for the lowest cost production factors and locations and the pitching of workers and countries against each other to achieve these lowest costs. The proponents and arguments of this view are gaining in strength.

Within this discourse, the question of the forces underlying success or failure of LDCs in the global economy (see e.g. Gereffi & Kaplinsky, 2001; Kaplinsky, 2000; Humphrey & Schmitz, 2000) has thus become a central issue. The debate surrounding this question centres around the idea, agreed upon in both academic and policy circles, that there is a need to manage the mode of insertion into the global economy. This is necessary to ensure that industries, firms and people in LDCs do not get caught in “a race to the bottom”(Kaplinsky, 2000, p.32; see also Gereffi et al, 2001; ILO, 1998b), leading to possible lock-in in marginal positions or even exclusion. In the debate, ideas on the importance of the local environment for local development in LDCs, compete with a view that considers global forces, or external linkages, as the main driving forces.

This study is concerned with the interrelation between economic globalisation and local development, although framed in a less broad perspective than indicated above. It is narrowed down in two ways: local development is specified as local *industry* development<sup>5</sup>, while it focuses on a specific mode of economic globalisation and insertion of LDCs in the

global economy: the global expansion of production networks and commodity chains, and incorporation of LDC firms and industry's within them. This mode differs from a second, often referred to, mode of economic globalisation, so-called TNC driven globalisation, although the difference between the two modes seems to have blurred in recent years.

Up until the late 1980's globalisation was seen as being driven by (vertically integrated) TNCs, through the expansion of their activities and organisation to LDCs to reap the benefits of lower costs and incentives. The range of complementary activities involved in designing, producing and marketing industrial outputs was spread across the globe, but remained integrated within one company. A significant number of the initial globalisation studies have therefore focused on LDC's as host economies of TNC branch plants. However, in recent economic globalisation processes, networks of independent, yet interconnected enterprises have assumed greater significance. This was already true for consumer goods such as garments, footwear and toys, but more recently also for consumer electronics, consumer durables, capital goods and intermediate goods. Therefore, next to the view of LDCs as branch plant economies, more recently a view focusing on *local firms in LDCs* and their capacity to become incorporated in global networks and chains based on capabilities and competencies has emerged. TNCs still feature prominently in the discourse, however, even in the case of TNC driven globalisation, local firms in LDCs have received more attention, in relation to local development issues, prompted by the increased inclination of TNC branches to develop local supply and subcontracting networks.

In accordance with the increasingly relevant network centred view of the world, this study considers local firm and industry development in LDCs in relation to global production networks and commodity chains driven by lead firms from the West that don't have direct ownership linkages to these firms.

Some problematic aspects with regards to how networks and local industry development are usually dealt with in the literature must be noted. It is generally argued that incorporation creates the conditions for upgrading (hence local firm and industry development), allowing international competitiveness and thus the reaping of gains from globalisation. Taking the argument further, by claiming that "(...) national development requires linking up with the most significant lead-firms in an industry" (Gereffi & Memedovic, 2003, p.4), it is postulated that incorporation into, and operating in, global networks and chains is the *only* way for LDCs to achieve national development, which is in turn often directly linked to the concept of industrial upgrading (see e.g. Gereffi, 1999).

Equally problematic is the fact that after incorporation, upgrading is almost seen as 'automatic' - with networks and chains as the lever, and upgrading as the outcome. However, the actual relationship between incorporation and local firm and industry development remains unclear and much of the discussion centres on the issue of *entry* into global production networks and commodity chains. As we shall explain in more detail below, the concept of upgrading - seen as such a crucial factor for entering into networks and chains, sustaining connections and improving positions - and especially *how* precisely it relates to incorporation in networks and chains and local industry development, is complex and raises many questions. What exactly is upgrading, how should it be defined? Is it a cause or an outcome, a condition or a process, externally induced or internally achieved? Or all of the above?

The discussion on the conditions under which gains from globalisation may be achieved has thus remained open-ended. Although there is recognition that incorporation alone is no guarantee for success in the longer term as the competitiveness of firms and countries constantly changes, there has been little consideration of global networks and local industry development in LDCs in the *longer term*. In other words, a consideration going beyond initial incorporation into global networks and chains and focusing instead on issues of changing

competitiveness and the implied questions of sustaining connections, improving positions within networks and chains and more general development paths.

The current study deals with these questions. Before focusing on our study in particular, we will first highlight and explain some of the main issues that are part of the debate.

## **(ii) Operating in Global Production Networks and Commodity Chains: Maintaining Roles and Advancing Positions**

Economic globalisation processes are increasingly conceptualised in terms of *global production networks (GPNs)* embedded in *global commodity chains (GCCs)*. Global production networks can be defined as “a set of inter-firm relationships that bind a group of firms into a larger economic unit” (Sturgeon, 2001, p.11) and in which actors co-ordinate activities across countries and even continents. A global commodity chains can be defined as ‘a set of networks (nodes) clustered around one final product or service and linking firms, industries and communities to one another across the world economy’ (Gereffi & Korzeniewicz, 1994; ILO 1998a, 1998b). It is formed by a set of complementary activities that may belong to different industries or be differentiated within one industry<sup>6</sup>.

These increasingly common organisational forms, in between markets and hierarchies, are often quasi-hierarchical in nature (Humphrey & Schmitz, 2000), and link together producers in developing countries and retailers, or other so-called buyers, in developed countries. Core or lead-firms are at the centre of the web, controlling critical information, skills and resources needed for the global network and chain to function (Reich, 1991). They command the most important strategic assets in the chains, through which access to sources of technology and markets is controlled (see also Hobday, 1995b; Gereffi & Korzeniewicz, 1994; Humphrey & Schmitz, 2000). Lead-firms consequently play a key role in the international expansion or transfer of production networks by orchestrating their geography, the selection of participant ‘dependent’ firms as well as their roles and the scope of their activities. Exercising *governance* throughout the chain has become a key source of competitive advantage, allowing for the use of networks as strategic assets (Gereffi, 1996). As these have been built up over years and with substantial investments, the activities or nodes that lead-firms are engaged in have high barriers to entry, allowing them to generate so-called rents (Kaplinsky, 1998, 2000) and operate in an environment where the relative intensity of competition is low<sup>7</sup>. The situation in lower tiers or segments of the chain is quite different. As more and more countries have developed capabilities in industrial activities, barriers to entry in – particularly lower-end - production have fallen and competitive pressures have increased. The primary economic rents in global chains increasingly are to be found outside production in areas such as design, R&D, branding and marketing and in controlling the actual organisation of the chain through for instance advanced information technology enabling so-called “systemic efficiency” (Kaplinsky, 2000. p.13). This further underscores the relevance of the issue of – opportunities for – *advancement* of firms and industries in LDCs in, or through, global networks and chains.

Some of the GCC literature therefore seems to point to the fact that incorporation into global networks and chains may be seen a *necessary* but not so much a *sufficient* condition for spreading the gains from globalisation - although this is rarely qualified more clearly or directly (Gereffi & Kaplinsky, 2001). It is at the entry positions, where competition is predominantly cost based, that the relative intensity of competition and subsequently the volatility (or ‘footlooseness’) of networks (e.g. Dicken & Hassler, 1999; Campbell & Parisotto, 1995), are highest. Labour and other cost advantages are relatively soon lost to new low-cost entrants in the chain (Campbell & Parisotto, 1995; Porter, 1990, 1998).

From the perspective of producers and industries in LDC, incorporation into global networks and chains means operating in a highly dynamic external environment, causing constant shifts in competitiveness of companies, countries and regions. Unless internal adjustments take place, changing competitiveness may lead to changes in selection (by lead firms) of producers and in *how* they are incorporated in the GCCs. For producers, the outcomes of this selection and mode of incorporation – whether an improvement or a deterioration of a firm or industries position and role – are thus in part dependent on the extent to which they manage to adjust to changing competitiveness by implementing successful adjustment strategies. The local business environment in which firms operate may form a source of support, or impediment for such successful strategies.

When *sustaining* connections and maintaining roles is already an issue, leveraging the opportunities offered by linkages to buyers for *advancing*, to more rewarding roles and positions, presents an even bigger challenge. However, it is precisely such advancement that defines to a large extent (longer-term) industry development. To qualify this advancement more clearly, the concept of governance is useful. Governance comes in degrees and lead firms in a chain are just those firms having *most* power and say. However, there are intermediate roles and positions possible (hence the quasi-hierarchical nature of chains), where firms may not be able to control all parts of the chain, but are capable of controlling certain parts of it (for instance regional production networks), often as a responsibility transferred to them by lead firms. The positions these intermediate firms fill are based on more complex capabilities and close working relationships with lead firms. Barriers to entry in these segments or nodes are therefore higher than in positions where firms have less or no discretionary power over other firms. Accordingly, advancing to more rewarding roles implies, inter alia, less competition, higher returns and less dependency.

Beyond the question of initial incorporation therefore lie the more important questions related to sustaining connections and advancing and repositioning within chains.

These issues are, however, still little understood. Moreover, they are further complicated by the matter of scale.

### **(iii) Scale levels**

Global production networks and commodity chains are manifested and operate at multiple geographical and organisational scales, that ideally should all be considered in an analysis of global-local developments. As Dicken et al argue:

“Too often a particular (for example local) or a bifurcated (for example global-local) scale of analysis is used in ways that, in effect, preclude alternatives and that obscure the subtle variations within, and interconnections between, different scale levels” (Dicken et al, 2001, p.90)

Local industry development under globalisation is best understood by considering actors and forces, and their ongoing relationships, at the global, regional and local levels. The industry context of local firms in LDCs includes multiple geographical levels. It consists of several governance systems, at different levels, not just the governance system within the networks and chains (exercised by lead firms), but also global systems such as international trade regulations and agreements, regional governance systems manifested in regional production networks and particularly local governance systems including local institutional arrangements, rules and regulations, government policies etc.

Local industry development under globalisation must also consider different organisational levels, in local, regional and global contexts. These are the firm and the industry level. An analysis at the firm level (i.e. of firm strategies) is essential for understanding the widespread and fundamental changes in the organisation of production. However, a purely micro level approach does not enable a clear understanding of what determines the competitiveness of a

firm, as competitiveness is inherently a relative measure – i.e. competitiveness compared to whom? Therefore the industry level of analysis is essential, for it is after all this level that defines the criteria for competitive success or failure (Campbell & Parisotto, 1995).

In addition, locally, firm level changes will have direct repercussions for changes at the industry level (i.e. changes in the profile and structure of a local industry). Obviously the different geographical and organisational levels of scale present complementary, interacting and often overlapping contexts that need to be integrated into studies dealing with local industry development under globalisation.

#### **(iv) The Current Study: Aims and Approach**

The current study takes up the issues identified in the above. It sets out to do two things in an attempt to unravel the relationship between (being incorporated in) global networks and commodity chains and local firm and industry development: First, to explore to which extent and under which conditions connections of firms and industries in LDCs to global networks and chains are sustained, and whether/how success in this respect contributes to industry development relative to other avenues. Second, to explore whether and how firms and industries in LDCs operating in global production networks and chains, as well as institutional actors, leverage the opportunities these linkages present, for advancing to more rewarding roles/positions relative to networks and chains.

To do this, the research is set in the context of (i) a specific industry branch: the garment industry; (ii) two Southeast Asian countries: Singapore and Malaysia; and, following the above made arguments, it (iii) explicitly considers both the firm and industry levels

The research is further conceptualised in terms of three elements, which are considered central to the issues of sustaining connections, advancing positions and industry development - defined broadly in terms of upgrading and diversification:

1. *Competitive adjustment strategies* implemented by local firms in LDCs
2. The outcomes of these strategies in terms of *development trajectories* and competitive positioning
3. Developments at the industry level as a result of development trajectories of existing firms and new entrants and outcomes in terms of *industry development trajectories*
4. Global, regional and local *determinants or sources* behind the strategies and trajectories, at the firm and industry levels with specific attention for lead-firm strategies and the local business environment.

These elements will be elaborated in detail in the theoretical and conceptual parts of this study. By identifying local firm and industry development trajectories in the garment industry in Singapore and Malaysia in the context of late industrialisation and uncovering the forces behind these trajectories, an attempt is made to shed light on the conditions under which connections to global networks and chains may have positive outcomes at the local level after incorporation. In doing so it hopes to contribute to the debate on 'gains from globalisation'<sup>8</sup>.

In the following, the rationale behind the specific choices for on the one hand the garment industry, and on the other hand Singapore and Malaysia, is briefly explained.

#### **(v) Why the Garment Industry?**

In order to shed light onto the local consequences of economic globalisation on firms and industries in LDCs, it is useful to take a closer look at the dynamics and structure of an industry (Gereffi & Bair, 2001), which operates globally, but has distinctly locally embedded structures.

Such analysis takes a significant but still manageable slice of the world economy as its object of study, revealing concrete actors in the global economy as well as the linkages that bind them into a larger whole (Sturgeon, 2001, p.9)<sup>9</sup>.

The choice in our case has been the (*global*) *garment industry*. This was motivated by a number of considerations. First, the industry has been at the forefront of globalisation processes and is an archetypical ‘network’ industry, in the sense that internationalisation and globalisation of the industry took place predominantly through the development of global production networks and the global expansion of commodity chains incorporating a large number of LDCs. These were driven by manufacturers and – increasingly – retailers (buyers) from the developed countries. FDI through TNCs play a minor role in the development of the global industry. The reason for the early global expansion of the industry lies in the fact that earlier than other industries, deverticalisation - i.e. the vertical disintegration of value chain activities – became one of its characteristic features, as design, making and distribution could easily be separated from one another. With ongoing developments in garment demand and markets, deverticalisation has become more pronounced and a large number of functionally specialized participants, such as designers, wholesalers, agents, manufacturers, jobbers, contractors and retailers are involved in the apparel commodity chain, each having their own specific (locational) requirements, making spatial segregation and internationalisation even more logical. As such, Bonacich et al (1994) argue that

“apparel production is the cutting edge industry in the globalization process; it is pioneering global processing (.....) and may be a portent of things to come” (Bonacich et al, 1994, p.13).

Second, being a ‘pioneering global industry’ has meant it has often been at the centre of the debate regarding the positive and negative sides of globalisation.

In the positive view, the industry is often seen as the starting industry for countries wishing to become inserted in the global economy. The labour intensive nature of production, the relatively low barriers to entry and the general divisibility of the value chain made the industry a favourite for initial stages of export-oriented industrialisation in LDCs. Although the industry initially merely makes use of cheap labour, the labour absorption capacity of the industry offers possibilities for income growth, while through garment exports foreign currencies are earned. Moreover, as economies grow and develop and workers and firms learn as a consequence, they may develop competencies in higher value added activities, or move onto more high-tech industries. Such positive (and somewhat mechanistic) views can be seen in for instance the literature on ‘Technology Ladders’ (Goh, 1996) and ‘Flying Geese’ (Kwan, 2002; Tung, 2002; Bernard & Ravenhill, 1995; Edgington & Hayter, 2000), where it concerns upgrading of industry structures within a location (with the garment industry being the ‘start-up’), or role succession models (from assembly to full-package to design and branding), where it concerns upgrading within the industry.

In the negative view however, the industry is illustrative of some of the worst forms of (labour) exploitation and subsequent immiserisation as a consequence of globalisation. Because global garment production can occur without ownership and relatively little commitment, the industry enjoys tremendous flexibility and buyers can shift production with relative ease to places and firms where they can get the best deals. As a result, the labour market for the industry truly is the world and all countries in the world are put into competition with one another to obtain work in clothing assembly (Bonacich et al, 1994).

An important characteristic of the garment industry is that it can command certain groups of the labour force that often cannot, or not so easily, be employed in other sectors (save other ‘garment-like’ industries such as footwear, toys etc.). These groups include (young) female workers, (illegal) migrant workers, home-workers, etc. In other words, groups that are willing to accept lower wages and lesser working conditions, no benefits, long hours and that are generally poorly organised. This makes for a relatively ‘exploitable’ labour force, both in

developing *and* in developed countries (labour in the latter often consist of (illegal) immigrants). As Appelbaum & Smith (2001) concede:

“We hold no illusions about the negative and exploitative aspects of “flexible production” at the lower levels of the garment commodity chains. “Flexible accumulation” is often equated with industrial upgrading through training, technological innovation, and reconfigured work organization and is seen as a key to global competitiveness in a “post-Fordist” world (.....) But flexibility can also have a dark underside: it frequently involves large amounts of subcontracting, temporary and casual workers, and aggressive anti-union practices ...” (Appelbaum & Smith, 2001, p.81)

In the political arena too, the industry has been a ‘hot’ issue. Global developments in the industry have been subject to political debate and trade conflicts between the developed and the developing nations in the world, as the ongoing restructuring processes in the developed economies entail displacement processes for individuals, communities and whole nations. Trade regulation has therefore been a major issue in the industry, and a strong influence on its global development over the past five decades.

Third, not only is this industry at the forefront of globalisation processes and at the centre of the local development under globalisation debate, it is also a highly dynamic and complex global industry with important, locally embedded structures in both developing and developed countries.

These notions and the supposed geographic volatility of the industry link directly to the theme and focus of this study.

### ***Map 1 Singapore and Malaysia in the Southeast Asian Region***

#### **(vi) The Cases of Singapore and Malaysia**

East and Southeast Asia have been among the most dynamic regions in the world, serving as an example of successful insertion into the global economy, through export oriented industrialisation and continuous adjustment and upgrading. In addition, the region is an important producer and exporter of apparel, being responsible for as much as 42.5% of world exports in 1999 (WTO, 2000).

The choice for the Southeast Asian region in particular was motivated by the fact that, while it has been one of the more successful late industrialising regions, it has generally been under-treated in comparison to East Asia in studies of local development and global networks and chains. The garment industry played an important role in the incorporation of most countries in this region in global production networks after the adoption of export-oriented industrialisation policies, yet has received a lot less attention than in East Asia.

The East Asian NIEs have been regarded as some of the more positive examples of LDCs managing incorporation into global production networks and chains to the extent that substantial upgrading and repositioning of their firms, industries and economies was achieved. This holds true for the garment industry in these countries as well. Starting at lower level entry positions as assemblers of imported inputs (often in export processing zones or EPZs), garment companies in the East Asian NIEs have shown remarkable resilience and have implemented a range of competitive strategies in order to survive and advance, enabling them to not just sustain connections to chains, but more importantly advance within them, despite mounting competitive pressures.

Although it is undeniable that there has been a shakeout in the industry in these countries - sometimes leading to a labelling as a so-called sunset industry - a still substantial part of the firms have restructured and upgraded their operations and have taken on an increasing range of responsibilities from lead-firms within the chains. Thus some have become orchestrators of extensive regional and even global production networks, have taken on responsibilities in

terms of quality control, product development or even design, or have even moved on to producing and marketing own brands. Others have specialised in high quality, specialised inputs, or have become global sourcing and trading agents for apparel. At the local level in these countries, the profile of the industry has changed markedly, due to the relocation of production activities elsewhere in the region, the changed functions of existing firms and the entry of new types of firms, both local and foreign, such as local design firms or regional headquarters of international buyers.

Not only are the East Asian NIEs good examples of successful upgrading and repositioning, they are also illustrative of the role of the local environment in these processes, with the government and other institutions playing an important supporting and encouraging role, both directly and indirectly and both via pressures and incentives.

All in all these East Asian cases paint a rather positive picture as to the longer-term prospects for local firm and industry development after incorporation. The question is of course, to which extent this positive example is emulated in other countries and regions, which indicates a need for comparative studies. For this reason we have chosen to focus on the garment industry in two different countries in a different region, viewing the East Asian experience as an antecedent.

The two specific countries chosen within this region have been at the forefront of developments in Southeast Asia and are two of the most successful exporters in the region.

In Singapore and Malaysia a number of manufacturing industries, including the garment industry, successfully achieved incorporation into GCCs in the 1960s and late 1970s respectively. However, more recently they have been confronted with major competitive pressures, raising questions as to whether and how firms have managed to sustain connections and improve positions.

The two cases were also selected because they are at distinctly different stages of development, which allows for dynamic comparisons, of not just their current positioning in chains but specifically the trajectories garment companies, and the garment industry in these two countries have followed, and the local industry environment in which they operate. Considering the different phases of development these two countries find themselves in, in the context of the garment industry a difference in terms of advancement is expected. More interesting though, is whether this difference is entirely attributable to the phases of general economic development of the countries, or whether other factors are at play as well and what this may mean for future developments.

## **(vii) Research Questions**

The study is guided by the following research questions:

- 1) What are the structure and characteristics of the garment industry in Singapore and Malaysia, in particular in terms of actors involved; the activities they perform; the composition of the global networks and chains they are part of and their position within these networks and chains; the national/local networks they have developed; and the employment patterns?
- 2) How have garment firms and the local garment industry community in Singapore and Malaysia responded (which strategies were implemented) to changing competitive conditions in the context of globalisation?
- 3) Which are the possible new sources of growth and diversification at the industry level, what has been their impact so far and to which extent will they be able to fundamentally change the profile of the industry locally?
- 4) Which are the firm and industry development trajectories that can be identified as outcomes of firm competitive adjustment strategies and industry level dynamics?

- 5) How does the local industry environment support or impede the capacity of local firms and industry communities to adjust to a changing competitive environment and advance their positions relative to global networks and chains?
- 6) What is the role of actors in the global commodity chain – specifically lead firms – shaping adjustment and development trajectories of local firms and industry communities?
- 7) Are there other factors promoting or impeding development trajectories at the firm and industry levels?
- 8) How do the Malaysian and Singapore cases compare? Which are the similarities and differences, and can they be explained in terms of the different phasing of the processes observed, or are other factors involved?

**(viii) Methodology and Timetable**

Given our research goal and the chosen analytical framework, the research required a firm level approach. Therefore the core of our research consists of empirical data gathered at the firm level through structured interviews with garment producers in both Singapore and Malaysia, over a period of 3 years.

In Singapore, these interviews were complemented with structured interviews with regional offices of lead firms and their agents and with a case study on the local fashion industry. In both countries these primary data were complemented with secondary data gathered at the industry and national level and with a closer look at programs and policies of government and other institutions. For a detailed description of the methodology, including an overview of the sources used for compiling an initial database of companies, coverage of the survey and organisation of the interviews, see annex A.

It must be noted that throughout the book both the terms ‘firm’ and ‘company’ will be used, which are in principle interchangeable. However, they are used differently. Thus, ‘firm’ denotes a certain organisational scale (firm level, firm level strategies, firm specific characteristics, etc.), while ‘company’ refers to the organisational unit that a business enterprise is. A company may consist of several units or establishments (for a detailed overview of all terms used in relation to this organisational scale level, see annex B). The terms ‘firm’ and ‘company’ are used to make a distinction between the analytical/ theoretical and the empirical.

**Figure 1** *Timeline Data Gathering and Analysis*

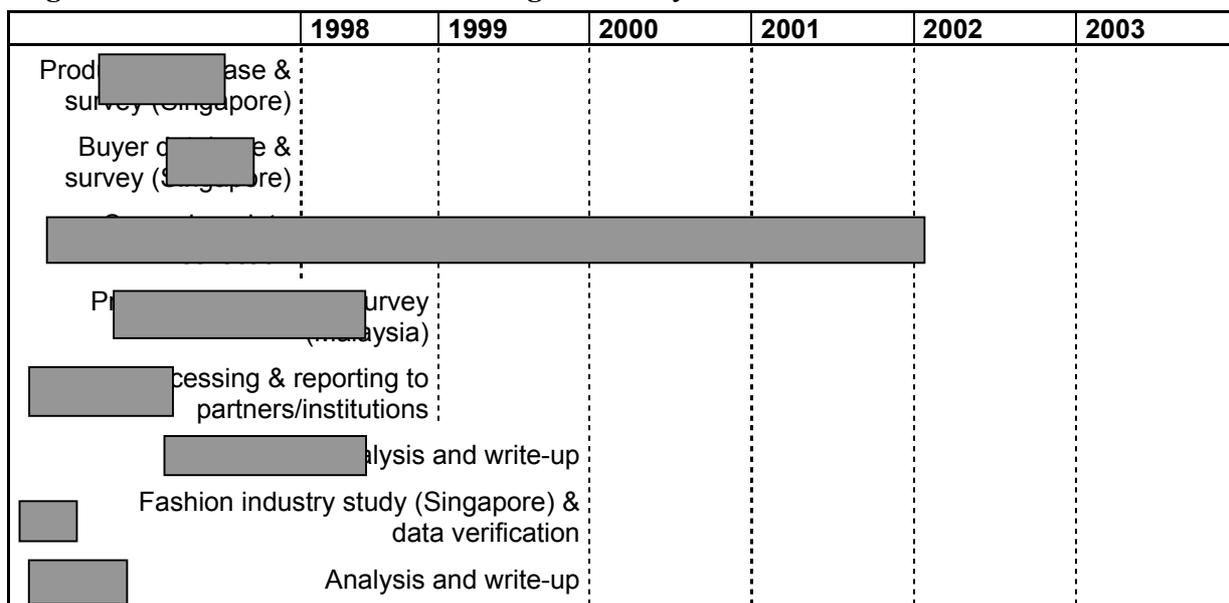
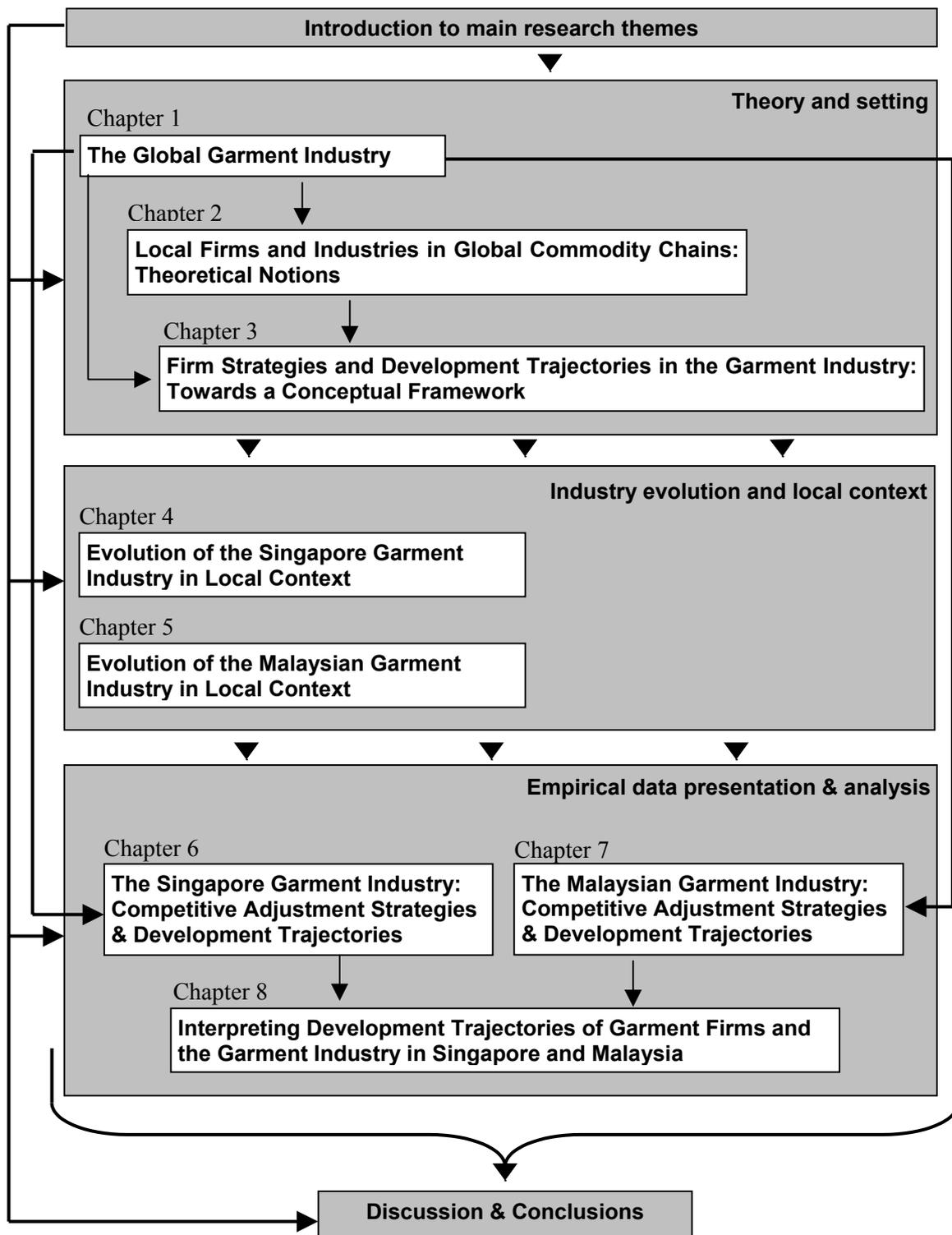


Figure 1 presents the time-table for the study, including both preparation time in the Netherlands, the field research, and analysis of data and writing of the book.

### (ix) Structure of the Study

The structuring of the book is illustrated graphically in figure 2

**Figure 2** *Structure of the Book*



The first part of this book consists of the setting and theoretical background for the study, culminating in the conceptual framework for the rest of the study. In the first chapter a comprehensive overview will be given of trends and developments in the global garment industry. This includes a closer look at the changing geography of trade and production over the past three decades, the configuration of production and distribution networks and the global apparel commodity chain (GACC), the different actors within this chain and shifts in power and control as a consequence of market changes and developments in the international institutional framework.

The second chapter gives an overview of the literature that has emerged on the main issues and themes dealt with in this study. Based on this literature, the general trends and characteristics of the industry as described in chapter one and the East Asian experiences, in chapter three a typology of firm strategies and firm and industry development trajectories is presented, which form the basis for the overall conceptual model presented in this chapter. This model incorporates strategies and trajectories as well as imperatives and determinants and forms the framework within which the remainder of the book is set.

The middle part, chapters 4 and 5, will introduce the two cases for this study: the Singapore and Malaysian garment industry respectively. In these chapters the general development of the garment industry in the two countries is considered, based on official statistics, our own initial inventory and existing literature. This development is explicitly considered within the local context, i.e. the local institutional context and national business system, as well as the industry specific context, so as to contextualise the development of the industry and demonstrate the impact of the local business environment. These chapters are followed by the analysis of strategies and development trajectories in chapters 6 and 7 and of determinants in chapter 8. They constitute the empirical core of this study and focus on the survey findings with regards to structure of the industry, implemented firm strategies, and firm and industry development trajectories in Singapore and Malaysia. Throughout the empirical chapters, case studies of individual garment companies are presented, to illustrate strategies and development trajectories at the firm level.

The concluding chapter finally reviews the main findings by answering the main research questions posed in this introduction and provides a reflection on the main theme of the study: (long term) local industry development in late industrialising countries under globalisation and whether/how gains from globalisation may be achieved.

## Notes

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<sup>1</sup> LDCs is a rather generalised term for a fairly large and heterogeneous group of countries, which in our view includes three main categories: newly industrialised countries (NIE's), late industrialising countries (or second generation NIEs) and the least developed countries.

<sup>2</sup> For a brief overview of these opposing views of globalisation or 'international restructuring', see Bonacich et al, 1994, pp. 8-13.

<sup>3</sup> Some even see it as history repeating itself and point to the fact that workers and communities in the developed countries suffered as well (during the industrial revolution), in order to achieve the levels of development and wealth they enjoy today.

<sup>4</sup> Kaplinsky (2000) defines immiserising growth as a situation in which there is increased output and more employment, but returns are falling.

<sup>5</sup> Thus the wider development implications of globalisation - such as poverty alleviation, changes in household income, local community development, etc. - are beyond the scope of our research.

<sup>6</sup> Throughout the study, global production networks and GCCs are often referred to together; it must be stressed here though that they are *not synonyms*, as the given definitions make clear. However, as global production networks are embedded as nodes in GCCs, operating in one often implies operating in the other.

<sup>7</sup> Different types of rents (derived from different barriers to entry or different strategic/scarcely assets within the chain) can be identified, such as technology rents; organisational rents; relational rents; trade-policy; and brand-

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name rents. For an explanation of these different types of rents see Gereffi, (2001); for a longer discussion of economic rents in general, see Kaplinsky (1998).

<sup>8</sup> The specific aims and approach taken for the current study have some important consequences for the theoretical and conceptual discourse within which the work is set, as will be explained in more detail in chapters 2 and 3. Other discourses abound and are by no means dismissed, yet are beyond the scope of our research. For instance, although an interesting body of literature exists on technological catch-up trajectories by latecomer economies, the current study explicitly does *not* deal with (latecomer) economies as a whole but takes on an explicit micro-analytical approach within a global networks and chains perspective.

<sup>9</sup> We must of course be cautious about trying to theorise about the global economy and local development processes as a whole, on the basis of an empirical study of a specific industry and conducted at particular times and in particular places, but such studies are indeed necessary to contribute to the body of work which is now emerging on the theme and which in its totality will be able to contribute to further theory development.

# 1 Developments in The Global Garment Industry and the Role of Asia

## Introduction

The garment industry<sup>1</sup> is one of the most globally dispersed of all industries across both developed and developing countries, with some garment companies having their goods produced simultaneously in as many as forty countries around the world (Bonacich, 1994). It is an organisationally complex industry, containing elements of both very new and very old organisational practices, and changing constantly in its organisation and geography (Dicken, 1998). As noted already garment manufacturing has been employed by many LDCs as an engine for export oriented industrialisation and employment creation. The sector has received more systematic and persistent protection than any other (Cline, 1987, Douglas, 1989) and has been the subject of trade tensions between developing and developed nations. Trade barriers continue to have a profound impact on the geography of production and distribution and the possibilities for incorporation and advancement of LDCs in global chains.

Given the relevance of the specific characteristics of the industry to our research problem, these will be discussed broadly in this chapter.

In the first section we will consider the global shift that has taken place since the 1950s leading to geographic dispersion of the industry as discernible today. Subsequently, in section two we take a look at the structure and organisation of the industry. The global apparel commodity chain (GACC) and the most important actors as well as their relationships within the chain are considered in particular. The following section (1.3) consider the global geographies of the different actors in the GACC in more detail, while section four gives an insight into the development and evolution of the garment industry in Asia in and into the intra-regional division of labour that has developed within this region.

Section five concludes the chapter with an overview of the most important developments in the industry over the past three decades and how these have affected producers in LDCs impinging on their competitiveness in global networks and chains after initial incorporation. In particular (the interplay between) changing consumer demand, market developments and buyer strategies, as well as technological developments, the international regulatory framework and socio-political developments are considered in more detail.

## 1.1 Globalisation of the Garment Industry: Global Shift and International Division of Labour

As part of restructuring processes in the industrialised countries, from the late 1950s onwards, an unprecedented shift of industrial production towards LDCs took place, most notably in labour intensive industries, such as the garment industry, which were in search of lower labour cost.

This shift dramatically changed the global economic landscape, and is clearly demonstrated by garment trade flows (see table 1.1), as the shift of production from the core to the periphery was accompanied by a massive rise in imports from LDCs into the core economies, competing with local manufacturers in the latter, often displacing companies and whole garment manufacturing industries in some regions. By the mid 1990 this had resulted in substantial trade deficits for most developed countries, with the exception of Italy.

What emerged was an international division of labour, as industrial restructuring processes in the core increased the subdivision of value chain activities into a number of partial operations at different sites throughout the world. While initially only garment assembly, the most labour intensive production activity in garment manufacturing, was shifted out (often to EPZs in LDCs), in later stages an increasing number of activities, including pre-assembly,

finishing, packing etc. were shifted out as well, eventually leading to a division of labour where production as a whole was relocated. Earlier than in other industries the vertical disintegration of value chain activities, became the norm (Dooren, 2003).

**Table 1.1 Trade Balances in Clothing, 1995**

| <i>Developed Economies</i> | <i>millions US\$</i> | <i>Developing Economies</i> | <i>millions US\$</i> |
|----------------------------|----------------------|-----------------------------|----------------------|
| Belgium-Luxembourg         | -1.724               | Hong Kong                   | +8.634               |
| Canada                     | -1.674               | South Korea                 | +3.884               |
| France                     | -4.664               | Malaysia                    | +2.118               |
| Germany                    | -16.845              | Taiwan                      | +2.374               |
| Italy                      | +9.438               | Portugal                    | +2.827               |
| Japan                      | -18.228              |                             |                      |
| United Kingdom             | -3.695               |                             |                      |
| United States              | -34.716              |                             |                      |

Source: Dicken, 1998

With ongoing developments in clothing demand and markets, this deverticalisation has only become more pronounced and a large number of functionally specialized participants, such as designers, wholesalers, agents, manufacturers, jobbers, contractors and retailers are currently involved in the apparel commodity chain, each having their own specific (locational) requirements.

With continuing internationalisation and globalisation of the industry, the geographical pattern became more complex, with different locations performing different functions or roles, instead of the initial almost dichotomous division of labour between the core and periphery as suggested in for instance the New International Division of Labour (NIDL) theory (Fröbel, Heinrichs & Kreye, 1980). What became clear was that a cheap labour hypothesis (Elson, 1988) alone could not account for these patterns. States and governments, distributors of garment (i.e. the lead-firms in the chain); international trade regulations and individual company strategies all played an important role in the geographical spread of the industry and its complex international division of labour.

Global shifts in production, but most notably in trade patterns, are reflected in the figures presented in table 1.2.

**Table 1.2 The World's Leading Clothing Exporting Countries, 1999**

| <b>World leading exporters (15)</b> | 1980 | 1990 | 1999 | <b>World leading importers (10) (1999)</b> |           | <b>World leading producers (10) (1999)</b> |           |
|-------------------------------------|------|------|------|--|-----------|--|-----------|
|                                     |      |      |      | countries                                  | share (%) | countries                                  | share (%) |
| China <sup>1</sup>                  | 4.0  | 9.0  | 16.2 | USA  | 30.0      | USA  | 24.7      |
| Hong Kong                           | 11.5 | 8.6  | 5.1  | Germany                                    | 10.6      | Japan                                      | 12.2      |
| Italy                               | 11.3 | 11.0 | 7.1  | Japan                                      | 8.4       | Italy                                      | 11.5      |
| USA                                 | 3.1  | 2.4  | 4.4  | UK   | 6.4       | France                                     | 3.7       |
| Mexico <sup>1</sup>                 | 0.0  | 0.5  | 4.2  | France                                     | 5.9       | UK   | 3.6       |
| Germany                             | 7.1  | 7.3  | 4.0  | Italy                                      | 3.0       | Brazil                                     | 3.2       |
| Turkey                              | 0.3  | 3.1  | 3.5  | Netherlands                                | 2.6       | Germany                                    | 3.2       |
| France                              | 5.6  | 4.3  | 3.1  | Belgium                                    | 2.5       | Spain                                      | 3.0       |
| Korea, Rep. of                      | 7.3  | 7.3  | 2.6  | Mexico <sup>1</sup>                        | 1.9       | Canada                                     | 2.8       |
| India <sup>2</sup>                  | 1.5  | 2.3  | 2.6  | Spain                                      | 1.8       | China                                      | 2.7       |
| Total                               | -    | -    | 52.8 |  | 73.1      |  | 70.6      |

<sup>1</sup> Includes significant shipments through processing zones

*Sources: WTO annual report (1999), Table IV.80; UNIDO (2001)*

Global, regional and local dynamics (corporate and political) all contributed to the trade patterns as they are discernible today (see table 1.2). The actual organisation and global geography of the industry, can be best understood in terms of global production networks and the global apparel commodity chain (GACC), in which different functions and nodes can be identified, each with their own geography. These chains are driven by large retailers, manufacturers and marketers from the USA and Europe, commonly referred to as (global/international) buyers.

Before taking a closer look at the geographical patterns of the GACC, first the structure and organisation of the industry, and the configuration of the GACC, are considered.

## **1.2 Structure and Organisation of the Global Garment Industry: The Global Apparel Commodity Chain**

What had emerged by the mid 1990s in the garment industry was a detailed dis-aggregation of stages of production and consumption across national boundaries, under the organisational structure of densely networked firms or enterprises (Gereffi & Korzeniewicz, 1994), which in turn form (organisational) nodes in the GACC. The GACC connects synthetic and natural fibre production networks to textile and fabric production networks, then to garment production networks, export and distribution networks and finally marketing and retailing networks. Figure 1.1 gives a schematic illustration of the GACC.

Core nodes in a GCC are those in which the activities generating the principle surpluses take place (Gereffi & Korzeniewicz, 1994). As we shall explain in more detail, in the GACC these activities are design, marketing and retailing. Consequently lead-firms are found at the 'end' of the chain in the marketing and retailing networks, from where they exercise governance over almost all other parts of the chain. In the context of the garment industry lead-firms are often referred to as 'buyers', as most of them are not, or no longer directly involved in production. They buy or source their products from specialised garment producers/manufacturers, which in turn are not involved in marketing or retailing.

An intermediate or transition group is formed by the so-called 'brand-named garment companies'. Originally manufacturers, over the years many have substantially reduced their involvement in actual production, farming most of it out and concentrating instead on marketing and sometimes even directly on retailing through their own retail outlets. A good example is Levi Strauss Company. This group is shown in the upper right part of figure 1.1.

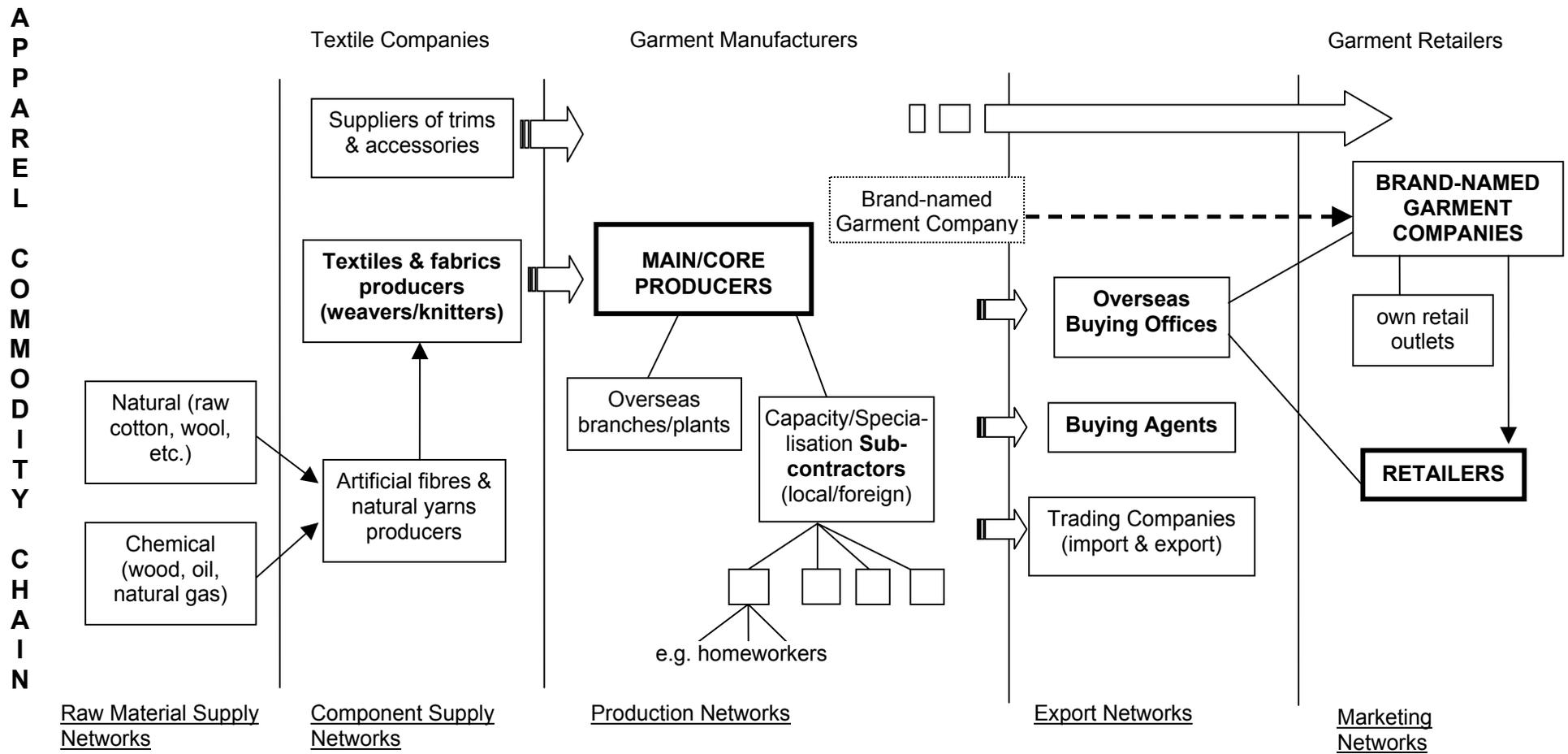
Both manufacturers and buyers form a heterogeneous group of companies, each with specific characteristics, roles and relationships within the GACC.

### *1.2.1 Garment Manufacturers and Garment Production Networks in the GACC*

The garment manufacturing industry is characterised by a fragmented structure - i.e. a large number of relatively small companies - and geographical dispersion.

As a group, garment manufacturers are heterogeneous, and the position and relationships in networks and the GACC of a garment producer are related to the range of production activities (stages of production and handlings) the company performs.

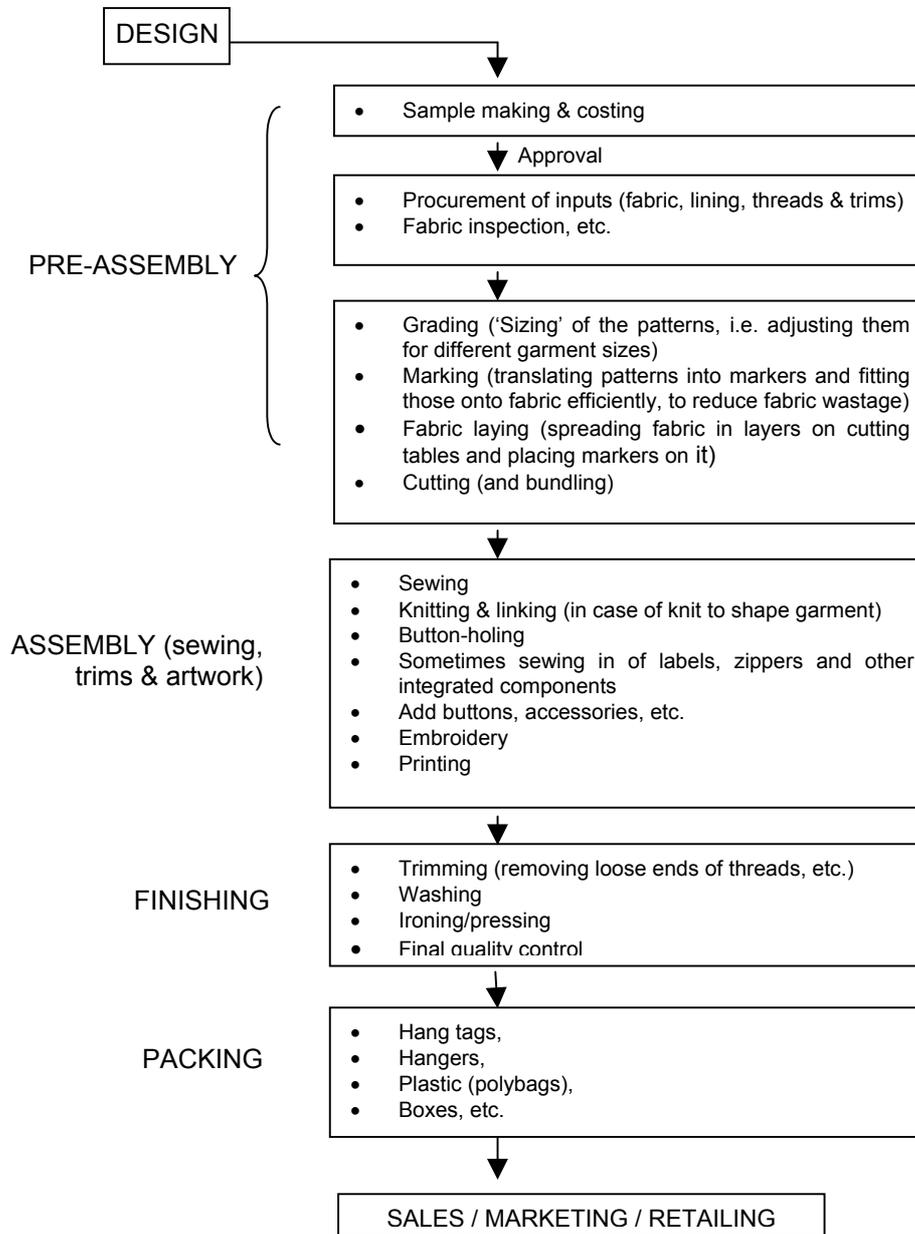
Figure 1.1: The Apparel Commodity Chain



Source: Modified after Appelbaum & Gereffi (1994); Dicken (1998)

Figure 1.2 gives a schematic illustration of the different stages in the process of garment manufacturing. Obviously this is a very general overview and activities may vary with type, complexity and quality of the garment.

**Figure 1.2 Stages of Production in Garment Production Process**



Although in principle the design stage is part of the production process, this stage is usually taken care of by the buyers, as it constitutes a main strategic asset within the chain. Thus, not all of the stages of the production process as depicted in figure 1.2 actually take part within the production networks, depicted in figure 1.1. A direct consequence of the deverticalisation process referred to earlier.

Although marketing and retailing of the final product (to the consumer) is taken care of by the buyer, producers will have to market themselves with buyers (finding and acquiring new buyers or negotiating with existing buyers) and therefore will often have a separate sales and marketing department. Based on the production stages and activities illustrated in figure 1.2,

it is possible to identify the different firm roles and functions of garment manufacturers within production and distribution networks<sup>2</sup>. These are considered in table 1.3.

**Table 1.3 Firm Roles and Functions in Garment Production Networks**

| Firm Role                                    | Function(s)/characteristics   | Other names   |
|--|---|---|
| <b>(Industrial) Subcontractor</b>            | 'Parts' production for use by other manufacturing companies. ( <i>process (assembly) specialisation</i> ) Two types:<br><b>Export-Platform Manufacturer</b> → foreign owned, labour intensive assembly of manufactured goods in export-processing zones also: Outward Processing Trade (OPT)<br><b>Component-Supplier</b> → production of component parts or entire garments for final assembly and/or finishing by the core manufacturing company. Inputs supplied by core manufacturing company. Two important sub-categories: (1) "capacity" or concurrent subcontracting (to increase flexibility) and (2) "specialisation" or complementary subcontracting (e.g. embroidery, washing, dyeing). | <ul style="list-style-type: none"> <li>• Second or lower tier supplier</li> <li>• Assembler</li> <li>• Sub-contractor/ Make &amp; Trim/ Jobber</li> <li>• Cut-Make-Trim (CMT) producer</li> </ul> |
| <b>Original Equipment Manufacturer (OEM)</b> | Production of finished garments by locally owned companies (full package deal), output is designed, distributed and marketed by large chain retailers and their agents. Some OEM, particularly in the East Asian NIEs, have increasingly outsourced production to overseas subsidiaries/subcontractors, concentrating on production co-ordination and planning, and have taken on more responsibilities in the chain, such as product development, sourcing, distribution and QC/follow-up. They have thus developed into important intermediaries or <b>OEM+</b> ( <i>process &amp; production organisation specialisation</i> )   | <ul style="list-style-type: none"> <li>• Commercial (sub-) contractor</li> <li>• Full package supplier</li> <li>• Contractor</li> <li>• Turn-key supplier</li> </ul>                              |
| <b>Original Design Manufacturer (ODM)</b>    | Independent supplier with full control over the development, design and fabrication of its product, but is willing to enter into a subcontracting arrangement to supply a dedicated or proprietary part to the purchasing [or parent] company (buyer only provides general product specifications, design details are left to ODM) ( <i>design, process &amp; production organisation specialisation</i> )  | <ul style="list-style-type: none"> <li>• Supplier-Subcontractor</li> </ul>  |
| <b>Original Idea Manufacturer (OIM)</b>      | Manufacturer develops own product ideas, which is still sold under the brands of other established companies.   |   |
| <b>Original Brand Manufacturer (OBM)</b>     | Finished-goods export industries in which there is no subcontracting relationship between the manufacturer and the distributor or retailer of the product. OBM designs, markets and sometimes even retails own brands, actual production often becomes less important or is even abandoned ( <i>product &amp; marketing specialisation</i> )  | <ul style="list-style-type: none"> <li>• Independent Exporter</li> </ul>  |

Source: Modified after Gereffi (1992), Sturgeon (2001), Wong (1999) & Hobday (1995b)

A greater number of activities and responsibilities make a producer less dispensable as these more sophisticated roles require more capabilities and therefore entry barriers are higher.

Thus (industrial) subcontractors perform a limited number of core production activities, such as assembly and trimming and are dependent on other actors in the chain for procurement of inputs, design, marketing, etc. They have little leverage for independent decision making and perform the most volatile roles in a chain, being relatively easily replaced by newcomers, as their activities do not require a high degree of capabilities. Entry barriers to these roles are low.

Subcontractors are sometimes linked directly to manufacturers in developed countries, more often they form a second tier of producers and are dependent on other manufacturers (first tier) that are involved in contract manufacturing for retailers (OEM). OEM suppliers are capable of performing or organising a much broader range of production and value chain activities, including all procurement, pre-assembly, assembly and finishing activities (see figure 1.2) and distribution services. While still dependent on lead-firms for design and specifications, the dependency relationship is less one-sided. The added activities and responsibilities often involve investments and learning and aren't as easily copied as the basic

production activities performed by subcontractors. OEM producers are still more dependent on other actors in the chain (most notably buyers) and more easily replaced than OEM+/ODM/OIM producers. Finally, the producer role with the highest entry barriers and capability requirements is OBM. Essentially OBM suppliers have started assuming driving roles (lead-firm) in chains and may become buyers in their own right as they start concentrating more on non-production activities, or even completely phase out involvement in actual production.

It must be noted that next to these 'intra-chain' roles, 'extra-chain' positions may be identified as well. These include for instance producers for the domestic market, often also producing to the order of local buyers such as local department stores or brands, and producers with their own local or regional brands and labels sold to wholesalers, in local department stores, or even own outlets. Surprisingly such producers are often not, or hardly considered in studies of the clothing industry in LDCs, yet they may follow alternative routes to internationalisation, establish regional and even international production networks, and become like OBM suppliers (see e.g. Hassler, 2003). They are interesting from the perspective of development trajectories, as we will discuss in more detail later. In the current study, and particularly in the empirical chapters, these producers will be considered as well.

Producers' relationships with buyers are influenced by the segment for which they produce or the type of chains in which they are incorporated. Taking a closer look at buyers, the lead-firms in the GACC, will help clarify these relationships.

### 1.2.2 *Lead-firms in the GACC*

As a prototypical 'buyer driven commodity chain' (BDCC) (Gereffi & Korzeniewicz, 1994, Bonacich et al, 1994), the key strategic assets in the GACC lie outside production, in design, marketing, knowledge of global sourcing networks and systemic efficiency (Kaplinsky, 2000). With the exception of those that started out as manufacturers, buyers have little to no experience in manufacturing. Technological innovations are not as crucial as design innovations, and even these concern more the selling of a new image, than the introduction of radically new products. Buyers are aware that the activities they are directly responsible for account for only a small share in the total product cost (Kaplinsky, 2000), and that they are ultimately held responsible for the final product both in terms of its quality and the way in which it has been produced. Hence the need for governance and systemic integration of the entire chain. It is argued that herein lies the learning potential of incorporation into GCCs for companies in LDCs, as buyers actively engage in teaching and 'upgrading' their suppliers.

Buyer involvement in the chain ranges from production related issues to labour issues and often includes:

- selecting input suppliers and designating them as preferred suppliers, sometimes helping them with product development;
- selecting producers and providing them with designs and specifications;
- specifying which input suppliers producers must use for the principal inputs (most notably fabric and threads), or sometimes even supplying these themselves;
- imposing strict quality, environmental and labour standards for all participant companies in the chain (whether fabric suppliers, garment manufacturers, sub-contractors, etc.);
- providing information, technical assistance and/or even training programs to help dependent companies in the chain attain and maintain the required standards;

Buyers are not a homogenous group and their involvement in the chain differs per type of buyer and per market segment. Table 1.4 gives an overview of the different types of buyers.

**Table 1.4** *Categorisation of Garment Buyers*

| Buyer (market) | Description | Synonyms/other | Examples |
|----------------|-------------|----------------|----------|
|----------------|-------------|----------------|----------|

| segment)                             |   | names   |   |
|--------------------------------------|---|---|---|
| <b>1. Garment Merchandiser (4)</b>   | Generally design and market clothing, but contract the actual production to manufacturers; sometimes own stores   | * Branded Marketer  | Nike, Adidas, Polo Ralph Lauren, Calvin Klein                             |
| <b>2. Buying Agent (N.A.)</b>        | Locate, qualify and inspect foreign suppliers/ producers of garments, and negotiate orders with them, often monitor production for QC and compliance with other standards.  | * Sourcing Agent<br>* Global commission buying agent      | Li & Fung, Swire & Maclain, Connor Group,                                 |
| <b>3. Branded Manufacturer (3-4)</b> | Large, often integrated and/or diversified manufacturers, which do their own designs, production and marketing. Often contract out (parts of) production and/or have overseas facilities.   | * Larger Manufacturer<br>* Original Brand Manufacturer    | Levi's, W.F. Company, Fruit of the Loom, Sara Lee                         |
| <b>4. Designer label (5)</b>         | Companies centred around one or more specific designer(s), but having expanded into large companies outsourcing actual production heavily involved in marketing and retailing of their products, sometimes in their own stores.   |   | Yves Saint Laurent, DKNY  |
| <b>5. Retailers (1-4)</b>            |   |   |   |
| <b>a) Department store (3)</b>       | Market and sell garment, along with other consumer goods such as cosmetics, soft-goods, upholstery, house-wares, etc. Next to sales of other brands usually also sell private labels, either from own designs or through merchandising department, which they source on OEM or ODM basis.                             |   | JC Penney, C&A, May Dept. Stores, Federated Dept. Stores, Marks & Spencer |
| <b>b) Mass Merchandiser (1-2)</b>    | Retailers/supermarkets of garment and other consumer products, usually very large scale, which enables them to reap economies of scale and the lowest prices. Compete primarily on low prices, source for their private labels, either based on own designs or through merchandising department, on OEM or ODM basis. | * Discounter  | Sears, Kmart, WalMart, Carrefour  |
| <b>c) Retail Chain (3-4)</b>         | Large retailers running own chains of stores, often internationally, selling only their own labels. Often source world-wide on an OEM basis (most will do all their own designs, but the lower end ones may also source on ODM basis through a merchandising department).   | * Specialist clothing retailer<br>* (Inter)national Chain | GAP, The Limited, Hennes&Mauritz, Liz Claiborne                           |
| <b>d) Speciality store (4)</b>       | Retailer of specific products, e.g. sports-wear; sources/buys from garment merchandisers or their designated contractors; sometimes also own labels.  | * Concept store   | Footlocker, Royal Sporting House  |
| <b>e) Mail-order company (2-3)</b>   | Sell their products through catalogues, from which consumers can pick and order. Source products/ labels, either based on own designs or through merchandising department, on OEM or ODM basis  | * Catalogue company                                       | LandsEnd, Otto International, Littlewoods, Quelle, Wehkamp                |

Sources: Gereffi (1999); Dooren (2003); Gibbon (2000b)

The numbers between brackets in the first column denote market segments in which these buyers generally market their products, referring to quality, image and price. These range from low-end (1), low to middle-end (2), middle-end (3), middle to high-end (4), to high-end (5). Similar types of buyers may operate in different segments. For instance, Hennes & Mauritz and Liz Claiborne are both retail chains, yet the former positions itself in the low to medium quality and price range, targeting mostly teenagers and young adults, while the latter positions itself in higher quality and price segments and targets the 30+ age groups.

The extent and type of involvement as well as the power to exercise governance differ substantially per (type of) buyer. Some factors influencing the strategies and relative bargaining power of buyers, and their level of involvement in the chains are:

1. *Type of garment or market segment.*

It is possible to make a distinction between ‘basic’ garments and ‘fancy’ garments (Gereffi, 1999; Gibbon, 2000b), or rather between high-end and low-end garments (and subsequently high-end and low-end buyers). Initially the division between basic and fancy garments was seen to involve on the one hand standardised garments (e.g. jeans, plain shirts, some children’s wear etc.) and on the other hand products with a high fashion content, which are typically less standardised and for which production runs and lead-time are shorter. However, as Gibbon (2000b) argues, changes in the industry and lead-firm strategies with regards to branding, segmentation and differentiation<sup>3</sup>, have caused boundaries between the basics and fancy garment chains to become porous and shifting. Thus even basics such as jeans, t-shirts, etc., have been marketed as higher-end products, solely on the basis of the brand name and imaging. We therefore prefer to use the terms higher-end and lower-end products as market positioning seems to have gained in importance over product characteristics perse.

As buyers in the higher-end and even middle segments increasingly concentrate on branding, marketing and image creation, more and more pre-assembly and even design activities have been transferred to producers, while at the same time quality, social responsibility and timeliness requirements (compliance) have become more stringent.

On the contrary, lower-end buyers, such as mail order companies, discounters, wholesalers, etc., exercise considerably less control over their vendors. As long as basic standards are met, most decisions and choices are left to the individual producers. Manufacturers in these chains may operate in lower price point markets, but often also face lower compliance costs.

In this respect Schmitz & Knorringa (1999) make a distinction between ‘quality driven chains’ and ‘price driven chains’ and argue that producers in the former will often have closer relationships with buyers and be allowed more responsibilities in terms of quality control and perhaps even product development, than their counterparts producing lower-end products in price-driven chains.

## 2. *Origin of the buyer.*

There seems to be a difference in organisation between chains evolving around European buyers and those around US buyers. Because quota have been less important in gaining access to the EU market than to the USA, the geography of EU sourcing has been much more governed by price considerations. Consequently, until recently only lower-end EU buyers have been sourcing on a truly global basis (Gibbon, 2000b), including particularly specific types of buyers, such as mail order companies and the French ‘hypermarchés’.

As consumer movements appear to be less strong in the EU than in the USA and more focused on environmental issues, codes of conduct of EU buyers are generally less stringent with regards to labour standards, unless they carry a ‘global brand’ (e.g. Adidas).

EU and US buyers also organise their global sourcing differently. The latter frequently set up tiered networks of small representatives, quality control (QC) and support offices, and local sourcing offices, in strategic locations world-wide, depending on total volume of sourcing (Gibbon, 2000b). Thus US buyers exercise relatively tight and direct control over suppliers.

European buyers on the contrary usually only have one sourcing office outside Europe usually located in Hong Kong. They are less likely to set up a global network of local/regional sourcing offices, but prefer contracting out certification and QC to independent local agents or local branches of global companies providing QC services (Gibbon, 2000b). European buyers thus seem to ‘drive’ their LDC producers in a more hands off way and leave more up to the producers.

Finally the European market is much more fragmented, especially in terms of private labels, which means that especially private label buyers (a substantial share of buyers) have considerably less bargaining power than US ones.

## 3. *Size*

Buyer size influences bargaining power and the ability to exercise control over other segments in the chain. Sometimes this even implies that smaller buyers cannot be as selective about their manufacturers, or that they do not have the means to exercise tight control or educate their producers. For instance if a large buyer places an order with a specific producer, this may take up a producer's full capacity. Should a smaller buyer at that point want to place an order the producer will most likely turn him down. In addition, large size also offers scale advantages so that producers are willing to offer lower unit prices.

Box 1.1 gives an example of the set-up and operation of a large, American branded marketer.

### **Box 1.1 Polo Ralph Lauren: Branded Marketer and International Buyer**

#### **Company background**

The American Polo Ralph Lauren Corporation, a company specialised in the design, marketing and distribution of lifestyle products, established its first brand 'Polo' in 1967 when Mr. Ralph Lauren - the owner and main designer - introduced a collection of men's ties. In 1968, Polo was established as an independent menswear company offering a line of premium men's clothing and sportswear. The company logo (a polo player astride a horse) and Ralph Lauren womenswear were introduced in 1971. In that same year the first shop-in-shop boutique dedicated to Polo Ralph Lauren products was opened in Bloomingdale's flagship store in New York City and the first Polo store was opened by an independent third party. Starting in 1973, womenswear products were produced and distributed by a third party under the company's first licensing alliance.

From these beginnings the company further developed its brand (brand stretching), both through diversification into related products such as fragrances, accessories, footwear and home collections, and through internal brand differentiation (development of different sub-brands for different target groups, e.g. Polo Sport, Ralph Lauren/Purple Label Collection, Polo Golf, RALP/Ralph Lauren, etc.).

The company's net revenues, which were comprised of wholesale and retail sales net revenues and licensing revenue, amounted to US\$1.2 billion in FY 1997, while income from operations totalled US\$157.4 million in FY 1997. As of end of March 1997, Polo had approximately 4000 employees, including approximately 3760 in the United States and 240 in foreign countries.

In 1998 Polo Ralph Lauren launched its IPO on the New York Stock Exchange and became a publicly listed company.

#### **Current company structure, marketing and production organisation**

Polo Ralph Lauren is a design driven company, which has outsourced all production and part of the distribution and retailing of its products, so it can focus on this core business of design, product development and marketing, all of which are centralised. The Polo trademark can be defined as a higher-end lifestyle brand (though not really high-fashion) with a distinctly American style or character, covering a range of products (under different sub-brands) from sportswear to men's and women's casual wear, corporate wear and even childrenswear.

Polo's business presently consists of four integrated operations: wholesale, Home Collection, direct retail and licensing alliance. As part of these licensing alliances, Polo conceptualises, designs and develops the marketing for a broad range of products under its various brands for which the company receives royalties from the (international) licensing partners. The licensing partners generally contribute the majority of product development costs, provide the operational infrastructure required to support the business and own the inventory. International licences typically grant the licensing partner the right to distribute broad range of Polo Ralph Lauren products within a defined international market. While product licenses may employ their own designers, Polo oversees the design of all products and licensing partners will visit the sample shows of the main company design team in the United States, which develop new products in co-operation with the sales and marketing department and based on customer feedback. International licensing partners may adjust designs for regional preferences, but approval from the Polo headquarters in New York is always required.

The company has offices/facilities in New York City (headquarters, design offices, showroom and direct retail department), New Jersey (administrative offices and support), North Carolina (distribution), Hong Kong (QC and sourcing) and Singapore (main sourcing and QC).

The company's garment products are produced by approximately 160 different manufacturers worldwide. In 1997, roughly 30 percent (by dollar volume) of men's and women's products was produced in the United States, and 70 percent in Asia (e.g. Hong Kong, Saipan, Malaysia) Latin America (predominantly Mexico under NAFTA) and the Caribbean Basin countries, Europe (Italy and

England) and some other foreign countries. The majority of product sourced outside the United States is produced in Asia.

Sourcing is divided between purchase of finished products (full-package) and purchase on a CMT basis. Working relationships with vendors have become closer in recent years, so as to reduce lead times and permit re-orders of successful programs. Thus the company has been able to increase the number of deliveries within certain brands each season. For instance, for the 'Polo Sport' and 'Polo by Ralph Lauren' brands in 1997 there were eight and ten annual deliveries respectively. Suppliers operate under close supervision of the product management department in the United States and in the Far East (South, Southeast and East Asia) under that of a wholly owned subsidiary, which performs buying agent functions for the company as well as for third parties.

As the company generally sources less product from Europe and South America (Central America is managed from the United States), it retains independent buying agents in these regions to assist the company in selecting and overseeing independent third-party manufacturers, sourcing fabrics and other products and materials, monitoring quota and other trade regulation as well as performing some quality control functions.

All garments are produced to Polo's specifications, while production and quality control staff in the United States and the Far East monitor manufacturing at supplier facilities. Quality assurance is further achieved through strict vendor certification programs, which also includes requirements regarding labour standards and -rights.

Concern about human rights issues and possible repercussions of being linked to human right abuses, has meant the company will only source from 'reliable' countries, avoiding politically instable countries and countries with a bad track record regarding human rights (e.g. Myanmar).

Although the largest share of products is still sold in the United States, the company has decided to shift its focus towards a global philosophy, at least at the management level, as most of its products are manufactured outside the United States. Thus, for instance, it centralised the management of all (global) sourcing operations in its Far East subsidiary.

The development and general operation of the Polo Ralph Lauren Corporation reflects many of the industry developments described in this chapter. As a branded marketer, high quality levels, shorter lead times as well as flexibility in more regular product changes (6 to 10 deliveries each season) have become ever more important for the company.

Over the years the production base has shifted out of the United States towards Asia and more recently towards Latin America due to favourable agreements such as NAFTA and the Caribbean Basin Initiative. Sourcing requirements have also become increasingly strict and although the Company is still expanding its product base, it is selective of its vendor and vendor locations and prefers close working relationships with vendors so as to assure quality, timely delivery and adequate labours standards. As the company operates in the higher end retail markets, it can also command premium prices for its products. As such, working with a company like Polo will put tremendous pressures on quality and other production standards, but may also offer good learning potential and higher price-points for producers.

*Source: Polo Ralph Lauren, International Prospectus for Initial Public Offering (1997); Interview (1999)*

Gibbon argues that there is a broad development underway in the GCC for garments, for outright 'buyer-drivenness' to be somewhat diluted by (i) a trend toward longer-term strategic partnerships between buyers and a selected number of core suppliers (Gibbon, 2000b, p.8); and (ii) the transfer of more strategic activities to these so-called first-tier suppliers, such as certain parts of system integration in the chain and the provision of production services and inputs to other, less key suppliers in the chain. This transfer, and subsequently the decreased control of buyers, however, concerns a relatively small share of all suppliers and most of them are from Hong Kong.

However, it could also be argued that buyer drivenness has increased for the less key suppliers, as certification systems and compliance rules have become a lot more stringent and all encompassing. From the point of view of these companies, whether execution of buyer set standards and requirements is taken care of by intermediate or first tier companies, agents, or by the buyers themselves makes little difference.

### *Buying Agents*

Buying agents may operate on a local, regional or global scale. Quite often big (usually US) buyers will work with only a few such agents on a global scale. Global sourcing agents sometimes originate from the USA or Europe and simply follow their customers in the internationalisation drive (e.g. Swire & Maclain from the U.K. and Halmode from the USA), or they are first tier suppliers, from LDCs, which do not manufacture at all, but are commission agents. The leading companies in the latter group (e.g. Li & Fung and the Connor Group) originate from Hong Kong (Gibbon, 2000b). Agents occupy a position in between producers and buyers, which enables them to exercise some extent of governance over other segments in the chain, through selection, inspection and, sometimes, even education of producers.

Besides forward linkages, garment producers have backward linkages with input suppliers such as textiles and fabric producers, accessories suppliers, etc. These are at the centre of the component supply networks within the GACC (see figure 1.1).

### *Textiles and fabrics producers*

Although the textile and garment industries have often been amalgamated in analyses and statistics, they have little in common, both in nature of final products and nature of production processes, even if both industries are linked via transactions and ownership relations (Scheffer, 1992).

Compared to the garment industry, the textile industry is more automated and capital intensive and less fragmented, consists of relatively large production units, operating sophisticated technology and employing relatively few workers<sup>4</sup> (Dicken, 1998). Production is often large scale (although this holds true more for weaving mills than for knitting factories). Profitability is driven to a much greater extent by product innovations. Many product innovations in garments in fact are based on new types of textiles and fabrics<sup>5</sup>.

Due to these characteristics their relative bargaining position within the chain is often stronger than that of garment producers. Although many garment producers have forged closer relationships with their textiles suppliers in order to jointly cut back lead-times, very few garment producers have managed to forge closer relationships in terms of product development and innovation. Besides technological and product innovations, textile manufacturers' competitiveness strategies have included forming alliances with buyers rather than garment producers for joint product development and acquiring nomination (preferred supplier status); developing and patenting new products and/or specialisation in small quantity, high quality/high price production for niche markets.

For garment producers the image that has often been portrayed is of being sandwiched between textile producers on the one hand and buyers on the other.

## **1.3 Global Geographies: Geographical Patterns of the GACC**

### *1.3.1 Production Roles*

The current geography of the global garment industry reveals the different phases of the global shift that has taken place since the 1960s in terms of production roles and locations. The most advanced production roles, are occupied by companies in the old core, such as Italy, the UK, France and Japan, and by a few companies in the East Asian NIEs, whereas later entrants occupy roles further down the hierarchy (see table 1.5)

**Table 1.5 Current Geographies of Export Producer Roles**

| Firm Role | Geography |
|-----------|-----------|
|-----------|-----------|

|   |  |
|---|--|
| <b>(Industrial) Subcontractor Role</b> <ul style="list-style-type: none"> <li>• Export-Platform Manufacturer (OPT)</li> <li>• Component-Supplier</li> <li>• CMT Manufacturer</li> </ul> | <u>Newly entered</u> : Southern Africa and least developed Eastern Europe <sup>1</sup> , Central America <sup>2</sup> & South/Southeast Asia <sup>3</sup> ;<br><u>Established</u> : China, Mexico, Central America <sup>4</sup> , Central/Eastern Europe <sup>5</sup> , North Africa <sup>6</sup> , Turkey & South Asia <sup>7</sup> ; Caribbean |
| <b>OEM Role</b>   | <u>Evolving</u> : China, Mexico, Latin America, Turkey & South Asia, Eastern Europe<br><u>Established</u> : Southeast Asia, Central Europe;  |
| <b>OEM+/ODM/OIM Role</b>  | <u>Evolving</u> : Southeast Asia;<br><u>Established</u> : East Asia (excluding China),   |
| <b>OBM Role</b>   | <u>Evolving</u> : East Asia (excluding China)<br><u>Established</u> : Italy, France, UK, Japan, USA.   |

<sup>1</sup> includes: Belarus, Ukraine, Baltic States

<sup>2</sup> includes: Guatemala, El Salvador, Costa Rica,

<sup>3</sup> includes: Pakistan, Bangladesh (South Asia), Vietnam, Cambodia, Laos, Myanmar (Southeast Asia)

<sup>4</sup> includes: Dominican Republic, Honduras, Caribbean basin countries

<sup>5</sup> includes: Poland, Hungary, Slovak Republic, Czech Republic, Slovenia, Croatia (Central Europe);

Romania, Bulgaria, Albania (Eastern Europe)

<sup>6</sup> includes: Egypt, Tunisia and Morocco

<sup>7</sup> includes: Sri Lanka and India

Established and evolving exporters in the first and second categories of production roles, account for the bulk of clothing imports in the USA and Europe. It must be noted that this categorisation only presents an aggregate picture at the national scale level and thus doesn't reflect internal variations (i.e. variations at the firm level) per country, which are of course always present.

### 1.3.2 Buyers

The geography of buyers is less dispersed as they continue to be closely tied to markets and the main markets are still the USA and Europe. However, a few trends should be noted.

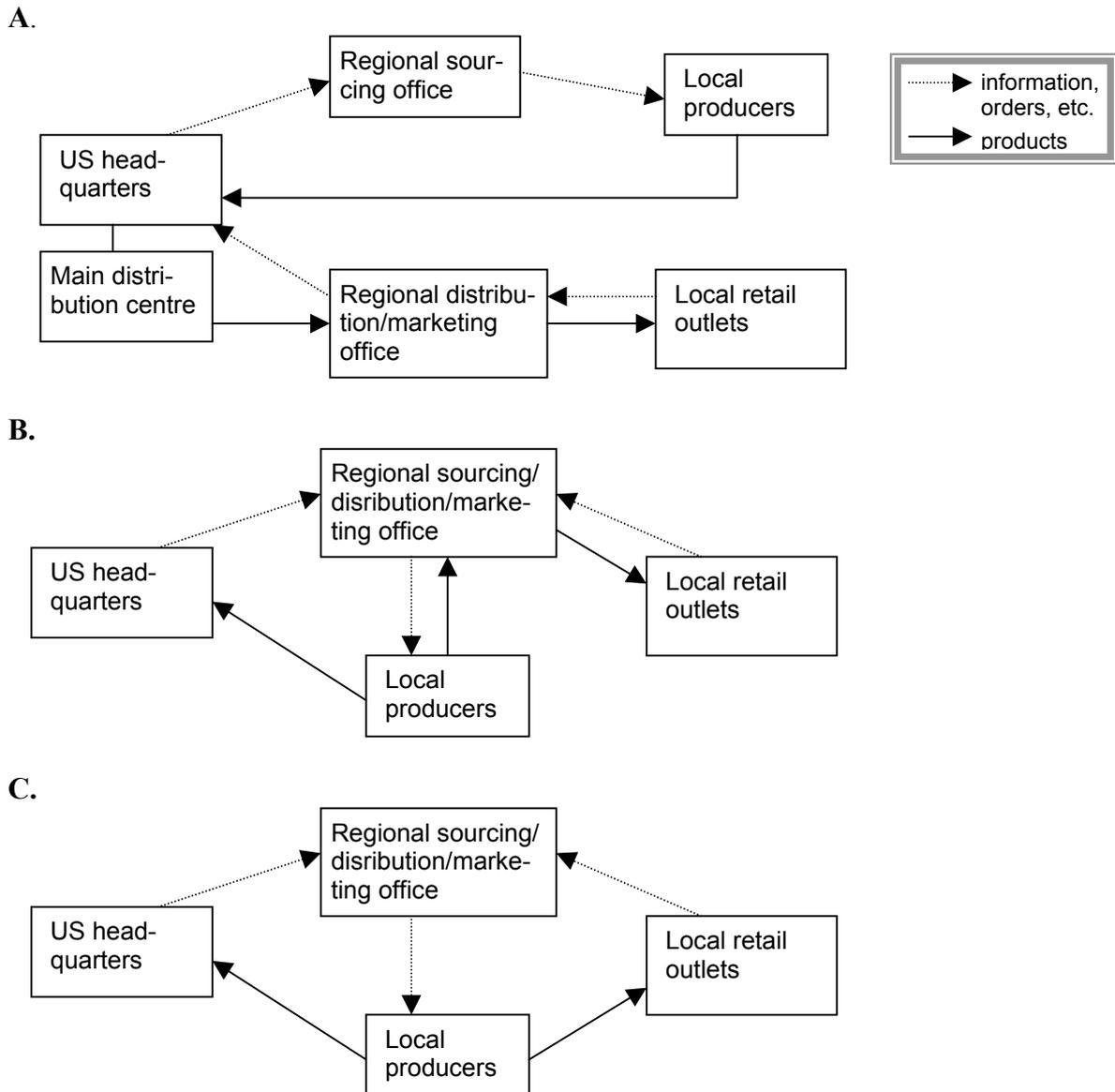
1. Starting as early as the 1970s, many, especially US, buyers have set up (regional) buying offices in their main sourcing regions or even in individual countries (see above). These form the most direct link to their suppliers. Prior to the formation of such offices, importers were the main link between US retailers and foreign factories. Regional buying offices function as extensions of the main office and have little scope for strategic decision making in the organisation. As explained above, European buyers have been less inclined to set up regional sourcing offices.

2. Many US and European brands have expanded globally, with distribution and marketing facilities in virtually all corners of the world. A general trend for the internationalisation of retailing is observable, as more recently even non-branded apparel companies such as department stores and mass merchandisers are moving into new markets such as Latin America and even Asia, setting up stores and outlets there. In most of these cases production sourcing and distribution is still organised globally (i.e. through the head offices in the USA and Europe) though and the local functions of such retailers do not include sourcing. However, Gereffi (1997b) has suggested that in the case of for instance Mexico, these retailers could drive a regionalisation of value chains, as they may establish local supplier networks. These may become more pronounced with the development of markets in the late industrialising countries of Asia and Latin America. Already some buyers have integrated their production sourcing and distribution operations in for instance Asia, where these were previously separate units.

Figures 1.3A-C give a schematic illustration of how this could eventually lead to a situation where the buyer function actually becomes 'localised', i.e. the regional buying office (also)

serves local markets, instead of merely supporting the buying process for distant markets. The current situation is probably a transition between figure 1.3A and B.

**Figure 1.3 Evolution of Sourcing and Distribution Networks of Buyers**



3. In Asia, several large Japanese department stores have achieved a considerable presence in the region (e.g. Sogo, Isetan and Takashimaya). Often these department stores source locally for their private labels and will assign space to local brands in their stores as well. In addition several regional brands, mostly Hong Kong owned, have set up retail outlets in the rest of the region. They often source locally/regionally for products. For instance Giordano, a branded manufacturer from Hong Kong, sources part of its products intended for the Malaysian market in Malaysia. The rest of the products come from other countries in the region, while part of the production of Giordano's Malaysian contractors goes to stores in e.g. Singapore. Many (smaller) producers in Asia are thus also producing to the order of regional buyers, although the volume of these orders are often considerably less than those of US or European buyers and regional buyers will generally only account for a portion of total orders.

4. Finally, as mentioned in the previous section, several buying agents are expanding globally as well, commanding some of the key strategic assets in the chain, most notably the actual knowledge of global production sourcing networks.

### 1.3.3 Textile and fabric producers

As a consequence of the relatively higher capital intensity and automation of textile and fabric production, the global shift in this industry has been less dramatic and several developed country producers (e.g. Italian producers) have been able to more or less maintain positions as competitive producers of higher end products (see table 1.6).

**Table 1.6 The World's Leading Textile Exporting Countries**

| Country                             | Value<br>bln.<br>US\$ | Share in world<br>exports (in %) |      |      | Change in<br>position |
|-------------------------------------|-----------------------|----------------------------------|------|------|-----------------------|
|                                     | 1999                  | 1980                             | 1990 | 1999 | 1980 → 1999           |
| 1. China                            | 13.04                 | 4.6                              | 6.9  | 8.8  | 8 → 1                 |
| 2. Hong Kong domestic exports       | 1.22                  | 1.7                              | 2.1  | 0.8  | -                     |
| re-exports                          | 11.05                 | -                                | -    | -    | -                     |
| 3. Germany                          | 11.89                 | 11.4                             | 13.5 | 8.0  | 1 → 3                 |
| 4. Italy                            | 11.78                 | 7.6                              | 9.1  | 8.0  | 3 → 4                 |
| 5. Korea                            | 11.62                 | 4.0                              | 5.8  | 7.9  | 10 → 5                |
| 6. Taiwan                           | 10.99                 | 3.2                              | 5.9  | 7.4  | 11 → 6                |
| 7. USA                              | 9.51                  | 6.8                              | 4.8  | 6.4  | 4 → 7                 |
| 8. France                           | 7.03                  | 6.2                              | 5.8  | 4.8  | 6 → 8                 |
| 9. Japan                            | 6.59                  | 9.3                              | 5.6  | 4.5  | 2 → 9                 |
| 10. Belgium-Luxembourg <sup>1</sup> | 6.59                  | 6.5                              | -    | 4.5  | 5 → 1                 |
| 11. Pakistan                        | 4.51                  | 1.6                              | 2.6  | 3.1  | 13 → 0                |
| 12. India <sup>2</sup>              | 4.56                  | 2.1                              | 2.1  | 3.0  | 12 → 1                |
| 13. United Kingdom                  | 4.48                  | 5.7                              | 4.2  | 3.0  | 7 → 1                 |
| 14. The Netherlands                 | 3.86                  | 4.1                              | 2.8  | 2.6  | 9 → 1                 |
| 15. Turkey                          | 3.48                  | 0.6                              | 1.4  | 2.4  | - 2                   |
|                                     |                       |                                  |      |      | 1                     |
|                                     |                       |                                  |      |      | 3                     |
|                                     |                       |                                  |      |      | 1                     |
|                                     |                       |                                  |      |      | 4                     |

<sup>1</sup> For 1999 Belgium only    <sup>2</sup> 1998 instead of 1999

Source: WTO annual report (1996) table IV.51 & WTO annual report (2000) Table IV.72

In addition, the shift that has taken place is mostly towards the more advanced new industrialisers in Asia (the NIE's) and the shift to the lesser developed countries or second generation NIEs is not as obvious as in garment (yet), with the exception of China.

The Asian region has played and continues to play an important role in the internationalisation and globalisation of the garment industry. Although the region's position has been declining in the last decade, it still occupies the most dominant position in the global garment industry, both in terms of production, employment and trade (Dicken, 1998). Within Asia the picture has changed dramatically though and we will therefore take a brief look at these changes.

## 1.4 Evolution of the Garment Industry in Asia

### 1.4.1 The Shift Towards the East Asian NIEs

Hong Kong, South Korea and Taiwan were the first Asian countries outside Japan to which a noticeable shift of garment production took place. Not only were labour cost here low at the

time, but governments in these countries also offered incentives and kept their labour force subordinated (Bonacich, 1994). In the first phase the Asian NIEs served mostly as low cost assembly sites. Contract manufacturing often took place in EPZs and involved outward processing trade (OPT)<sup>6</sup>.

Many East Asian garment manufacturers managed to develop the required competencies and capabilities for such contract manufacturing (on a CMT basis) at an early stage, which put them in a favoured position as to the sourcing by garment companies from the USA and Europe, that included not just garment manufacturers, but more and more non-manufacturing companies, such as retailers, branded marketers, merchandisers and discounters. The key to success of the Asian NIE producers in capturing and producing for non-manufacturing buyers as well, lay in their capacity to move from mere assembly to full-package or OEM supply. Non-manufacturing buyers were more prone to outsource other value chain activities as well in the areas of design and product development. In general producers were required to take on more responsibilities and Asian producers managed to adequately full-fill these. Some – more recently – even managed to move beyond the OEM export role towards OEM+ and ODM roles, whereby they were actively involved in the design and development of garment collections for their buyers or had started developing and marketing their own brands (OBM) (Gereffi, 1999).

Key in these processes of moving to more rewarding export roles was the ability to establish close linkages with a diverse array of lead-firms in the evolving global apparel commodity chain, as they constituted the primary sources of material inputs, technology transfer and knowledge in these organisational networks (Gereffi, 1999).

Doing so provided producers in the NIEs with extensive knowledge of buyers' requirements and standards, which turned out to be a valuable asset, as became clear in the 1980's, when the East Asian producers saw their initial comparative advantage (i.e. cost advantage) rapidly decline and their exports limited by restrictive trade measures in the West.

#### *1.4.2 The Evolving Intra-regional Division of Labour in Asia*

With economic development and consequent rises in wages and currency appreciation, the cost of garments produced in the NIEs rose substantially. Simultaneously the Asian NIEs faced increasing quota restrictions for their exports to the USA and Europe (see section 1.5 below), while many producers in other countries in East and Southeast Asia managed to develop the required competencies for CMT or even OEM production as well (at a substantially lower price) and weren't hindered by quota restrictions. However, these developments haven't implied an en masse exit of Asian NIE producers from the industry. Company closures and diversification have occurred, but many companies have also shown a range of responses to adjust (Simon, 1995). We will take a more in-depth look at these strategies in chapter 3, but should mention here briefly one of the most commonly applied strategies by NIE garment producers, as it profoundly affected the geography of production within Asia: the shifting of (the most labour intensive) production processes overseas – either through overseas investments or subcontracting in lower cost locations. Thus NIE garment producers became managers of intricate regional production networks within Asia, a position they managed to obtain because of their established (trust) relations with buyers, largely through the process of 'triangle manufacturing'. The essence of 'triangle manufacturing' is that overseas buyers place their orders with the NIE producers they have sourced from in the past, which in turn shift some or all of the requested production to affiliated offshore factories in one or more low-wage countries. These offshore factories may or may not have equity investments by the East-Asia NIC producers: they can be wholly owned subsidiaries, joint-venture partners, or simply independent overseas contractors. The triangle is completed when

the finished goods are shipped directly to the overseas buyer, under the import quotas issued to the exporting nation (Gereffi & Korzeniewicz, 1994).

Initially production was outsourced to e.g. Singapore (quota advantage) and other countries in Southeast Asia, most notably Malaysia and Thailand. In addition an increasing number of local producers in these countries became incorporated directly into the networks and chains of buyers.

The process didn't end here though. As costs increased in these late industrialising countries (or second generation NIEs) as well, quota regulations and restrictions included more and more countries in Asia and a new group of producers in countries in Southeast and South Asia acquired export production capabilities, (low-end) production migrated further into the region, to India, Bangladesh, Vietnam, Cambodia, etc. Economic reform in China and the imminent accession of the country into the WTO, caused an enormous boom in its garment production and exports, making it the world's dominant garment exporter by the late 1990s.

This further migration took place in several ways. Firstly the garment companies from the Asian NIEs expanded their production networks to these new countries; secondly, buyers started sourcing from the new locations directly, bypassing the East Asian NIEs. This was often done through regional sourcing offices set up in for instance Hong Kong or Singapore; thirdly, garment companies from the second generation NIEs started relocating (low-end) production to lower cost locations as well, either through FDI or subcontracting arrangements.

What had thus emerged by the late 1990s was an intricate and multi-tiered regional division of labour or hierarchy of production (Bonacich, 1994). Japan has developed into a final market for the region's garment production and has emerged as an important supplier of textiles and fabrics to the rest of the region. The NIE's and in particular Hong Kong and more recently Singapore have become hubs in the regional production and distribution networks, from where production co-ordination and marketing and distribution often take place. In addition Hong Kong is distinguishing itself as a regional (and possibly international) fashion and design centre. Taiwan has developed into a specialised supplier of inputs such as fabrics, accessories and machinery. It distinguishes itself through a very competitive price quality ratio. Coupled with close proximity to the major producers in Asia this has given the country a distinct competitive edge, rapidly replacing many suppliers from the developed countries. Many buyers have designated Taiwanese textile, fabrics and accessories suppliers as the preferred inputs suppliers for their Asian contractors. The late industrialisers have established themselves as high quality, relatively cheap producers, developing from simple CMT suppliers to OEM. Recently, producers in these countries too are developing (sub)regional production networks through outsourcing and FDI. Finally, Indonesia, the Philippines, Vietnam, South Asia and China in particular are important low cost producers to the region.

#### *1.4.3 Globalisation of East Asian Garment Companies*

Despite the internal dynamics within Asia, the region has experienced increased competition from other (new) production regions in the world, most notably Central and South America, Eastern Europe and Northern and Southern Africa. Several factors have made these new regions increasingly attractive for buyers as sourcing locations and have caused a shift away from Asia. Such factors include: (i) continued and increased quota limitations for East and Southeast Asian countries; (ii) trade agreements and preferential treatment arrangements between the USA and Central America (especially Mexico and the Caribbean basin) and to a lesser extent the rest of Latin America, between the EU and Eastern Europe and between both the EU and the USA and Africa; (iii) the development of full-package capabilities in these new regions (especially Mexico and Eastern Europe), enabling the sourcing of products by non-manufacturing garment companies; and (iv) trends towards shorter lead-time requirements for certain (fashion sensitive) garment items (see also section 1.5)

As a response to these developments, garment manufacturers from South Korea, Taiwan and Hong Kong have set up lower-cost production facilities and subcontracting activities in Latin America, the Pacific Rim and Eastern Europe to gain better access to European and US markets (Chan, 1998). More recently, East Asian and even some Southeast Asian producers have also set up production facilities or subcontracting arrangements in Africa, in for instance Mauritius (Gibbon, 2000b), South Africa and Lesotho.

Finally, several Asian commission or buying agents have extended their activities to these regions as well, providing global reach and services to their buyers.

By the late 1990s a truly global production hierarchy and a highly complex set of production networks (nodes) had evolved, in which Asian producers, in a variety of different roles and locations, play an important part.

Figure 1.4 illustrates how production networks have taken on global, multi-tiered dimensions with a host of different actors in different locations performing production, intermediary and buyer roles, connected and interacting through both ownership and contracting linkages. In the last section of this chapter some the main driving forces behind the development of these global production networks and chains are briefly considered

## **1.5 Recent Developments and Changes in the Global Garment Industry, Markets and Buyer Strategies: Effects on LDC Producers and Locational Outcomes**

Garment producers are faced with continuous changes in their production environment, most notably changing consumer demand, market developments and consequent changing buyer strategies, technological developments, changes in the international regulatory framework and socio-political developments. All these factors impinge on their competitiveness in global networks and chains after their initial incorporation, although effects differ per country or region. Generally changes in these areas have affected the *competitiveness* of producers in LDCs in terms of their *profitability* (increased cost incurred, pressure on prices, etc.), their *capabilities* (increased production, product and organisational capabilities required to stay in the network) and the general *attractiveness of their location*. The next section presents a brief consideration of the most important developments producers in the industry have been confronted with, and their (sometimes differential) effects.

### *1.5.1 Market Developments*

Since the late 1960s, the market for garments in the USA and Europe has changed substantially, due mainly to the qualitative and quantitative changes in consumer demand and the reactions to these changes by the main marketers and retailers. Retail prices have been stagnant or even decreasing over the past few years. This has been attributed mostly to market saturation (Piore & Sabel, 1984) and increased production.. On the other hand consumer demand has changed and is increasingly for higher quality, more differentiated, fashion and branded garment, which explains the rise of specialist clothing retailers such as The GAP, Hennes & Mauritz and Liz Claiborne and brands and designer labels such as DKNY and Yves Saint Laurent. Some have argued that fashion and differentiation was supply rather than demand/consumer driven, as a reaction to market saturation and stagnating prices (Harvey, 1989). In any case, what has taken place is a shift in value added from the product to the image (thus to the marketing end of the commodity chain), hence a shift in power from producers to buyers/retailers, also referred to as the 'Retail Revolution' (Scheffer, 1992).



price-takers. Subsequently, as Appelbaum & Gereffi (1994) note, a ‘downward profit squeeze’ in the GACC has taken place, where market pressures on retailers’ profits are diverted to manufacturers by reducing prices or holding them at ‘price point’. The manufacturer reduces the margin paid to his contractors and these are then forced to reduce cost, often through squeezing labour, achieved through (further) subcontracting to lower wage countries. This has stimulated a further tiering of production networks and deepening of the international division of labour.

- In order to cut cost, buyers have placed greater emphasis on inventory control. The major implication has been that retailers no longer want to hold large stocks and either expect their producers to take care of this (hence shifting the cost and risk to the producers) or force them to deliver on a ‘just-in-time’ basis. The latter requires the development of new capabilities by producers, in order to produce smaller batches, be flexible in mid-season re-orders or adjust rapidly to orders, etc. Again, the burden of this cost cutting by buyers is shifted to the producers.
- Quality control has become increasingly strict, to reduce rejects and increase efficiency. Buyers have placed a larger part of the responsibility for this control with their producers, according to standards and rules set by them. One of the common measures in this respect is the nomination of input suppliers<sup>7</sup>
- To capture niches and new markets, buyers have placed more emphasis on segmentation, which usually means an increased emphasis on fashion and design, demands for smaller batch sizes and more frequent style changes (see box 1.1). This has implied increased demands for quality and flexibility from the producers, thus the development of new and enhanced capabilities.
- With increasing emphasis on rapid fashion and style changes, lead-time considerations are becoming ever more important. On the one hand this has led to an increased importance of producers’ proximity to markets for certain (fashion sensitive) market segments. On the other hand buyers prefer to source from locations where material inputs are readily available, hence where large parts of the apparel commodity chain are present. Thus countries/regions, which are relatively far from the main markets but have a strong and flexible material supply base, can still retain an advantage.
- Many buyers have pushed for capability enhancement of producers world wide (i.e. regardless of their location), through upgrading and teaching. This has led to an ever greater number of producers (no longer solely Asian ones) being able to supply on a “full-package” basis and meet buyer’s more stringent quality and delivery times requirements. Competition among core (OEM) producers has therefore increased substantially, as is reflected in the shifts of sourcing from Asia to countries in Latin America.

A number of non-market developments have guided consumer behaviour and thus the strategies of buyers as well and these have particularly affected producers in developing countries.

### *1.5.2 Consumer Awareness, Codes of Conduct and Standard Setting*

In recent years consumer awareness in the area of human rights, working conditions and environmental issues with regards to production (sourcing) from LDC’s has increased. Many buyers have experienced the consequences as through the actions of NGOs mal-practices in factories of their contractors in LDCs received extensive media publicity. This directly affects their image and sales, and many buyers have therefore become mindful of where and how their goods are produced. Many have implemented ‘corporate codes of conduct’, which deal with production circumstances and environment (William, 2000).

The main consequences for LDC producers have been on the one hand further pressure on cost (compliance cost) and on the other hand organisational and locational limitations:

- buyers are no longer willing to source from countries with a ‘bad reputation’ in terms of human rights violations and labour standards. This is reinforced by Governments imposing trade restrictions on these grounds, often pressured by special interest groups (see box 1.2)
- Buyers limit further outsourcing of production by main producers, as further subcontracting by main producers may cause the lead-firm to lose sight of what is going on in factories, while they are the ones held responsible for labour standards and human rights issues throughout the chain.

#### **Box 1.2 Global Codes of Conduct and Standard Setting: Protection or Protectionism?**

Although codes of conduct have been heralded as private sector attempts at improving labour conditions in LDC factories, some scepticism about these codes and similar attempts at labour conditions improvement has also been vented, most notably by LDC producers and governments, but also by human rights movements.

Some (producers in) LDCs claim industry codes of conduct are in reality a form of trade barriers, whereby developed countries can exclude the imports from certain countries which threaten to flood their markets by setting standards, not (yet) achievable by producers in the least developed countries. In some cases protectionist lobbies in the US and Europe have indeed had a say in the formulation of these codes of conduct, even if only indirectly.

Others claim the standards set in these codes of conduct are unrealistic for LDC producers, as they are based on Western industrial relations regimes, which differ substantially from the industrial relations regimes present in LDCs. They claim the industries in the West did not abide by such stringent standards when they first industrialised their economies. If the codes of conduct set standards above the national standards in the LDC concerned, this may pose too high a compliance cost for producers, especially since buyers generally do not increase the prices paid for products when they increase requirements.

Finally, the effectiveness of such codes of conduct in terms of solving human rights abuses in LDCs are questionable considering their relatively limited scope. Although supposedly aimed at improvement of worker conditions and human rights in LDCs, the motivation for producers in LDCs to actively engage in promoting human rights is often more related to gaining a reliable reputation with their buyers. This has meant that the human rights considerations often stop at the factory door and do not so much concern a society wide pre-occupation with human rights. As human rights abuses in LDCs are hardly ever confined to one industry, solving the problems in one, may just lead to a shifting of the problem to others (for instance children ending up in other sectors, possibly the informal one, where labour conditions are often worse). A seemingly positive example of a socially responsive program aimed at improving the working conditions of LDC workers, illustrates this issue.

In 1995 a Memorandum of Understanding (MoU) was signed between the Bangladesh Garment Manufacturers and Exporters Association (BGMEA), the ILO, Unicef and the government of Bangladesh, on elimination of child labour from the garment sector in Bangladesh. It was prolonged in 2000. The main objective of the program was to establish the basic right of the children by rehabilitating and providing elementary schools for the under age workers eliminated from the garment factories.

The program thus recognises that viable alternatives need to be offered to children (in terms of education) and families (in terms of compensation for much needed lost income). Second, it recognises that such more comprehensive programs necessitate the involvement of not just lead companies setting standards, but also of local institutions, governments and even international organisations.

The results of this program are said to be positive, by all signatories and participants in the program, however, human rights lobby groups have pointed to the fact that although the program may in principal be well intended, it has some serious shortcomings in practice. As one organisation claimed:

“The vast majority of child workers (in the industry) were sacked prior to the signing of the MoU and have been deprived of any kind of rehabilitation measures as mentioned in the agreement. Nothing

has been said about the potential entrants who would have come every year to work in the garment sector. (.....) Most of the dismissed children moved on to even worse and more dangerous jobs. (.....). The elimination of child labour did not automatically result in the enrolment of children in schools. The MoU would have been doing more justice if the children could keep their work in the garment factories half-time, while being provided with education the other half. The children need a job as much as they need education. But consumer groups and trade unions from the industrialised countries only accept the complete removal of children from the garment industry. Bangladeshi employers, fearing a boycott, could do nothing but obey.” (*Clean Clothes Campaign*, 2002)

The latter point suggests that the MoU, at least on the part of the BGMEA and the Bangladeshi government, was as much, if not more, motivated by foreign pressures (the threat of a boycott) and the wish to retain their export market, as it was motivated by a genuine wish to eradicate child labour. Their commitment to the eradication of child labour in itself may therefore not be that strong at all.

Sources: *DOL/ILAB (1996)*; *BGMEA (2002)*; *Clean Clothes Campaign (2002)*

Finally, in part due to issues dealt with above, and in part to reduce the cost of co-ordinating networks, sourcing for new vendors and ‘educating’ new producers, there is a tendency for lead-firms to work closely with a smaller number of established, core producers, i.e. to consolidate their sourcing networks. Instead of taking the risk and cost of looking for new suppliers themselves, in many cases buyers prefer to press, encourage and help their existing suppliers adjust and upgrade e.g. through relocation, automation and quick response systems, training and standard setting, etc. Thus lead-firms invest in the relationships within the networks and these ‘sunk costs’ increasingly prevent them from switching to new producers.

The international, regional and local institutional context in which garment producers in LDCs operate, have also had a profound impact on the competitiveness of companies, countries and in turn on the global geography of production and distribution.

### 1.5.3 *International Trade Regulations, Trade Blocs and Preferential Treatment*

Textiles and garments are unique in that they are the only industries to which special international trade regulations apply (for a detailed overview of global textile and garment trade policies see Dickerson, 1991, chapter 10).

Under the General Agreement on Tariffs and Trade (GATT), a series of protective measures were taken for the clothing industry, which today cover the majority of all world trade in textile and clothing (Dicken, 1998).

Faced with increasing low price garment imports from Japan, Hong Kong and some other Asian countries, both the United States and the United Kingdom negotiated separate agreements with the Asian exporters for voluntary reduction of exports to their markets, for a limited period. By 1962, these had become broadened into the Long-Term Arrangement (LTA) within GATT, which regulated international trade in cotton textiles. The LTA remained in place for eleven years. As the world picture became more complex, in 1973 a much broader trade agreement, which also included the European countries, and synthetic fibres, was negotiated: the first *Multi Fibre Arrangement (MFA)*. Initially negotiated for a limited period of four years, it aimed to create an orderly development of trade in textiles and garments, through the imposition of individual quotas, which set precise limits on the quantity of textile and garment products to be exported from one country to the other. For every single product a quota was specified in these agreements (Dicken, 1998).

Since 1974 the MFA has been renegotiated or extended four times (in 1977, 1982, 1986 and 1991) and the lists of products and countries included under the system have become longer. In general the MFA became more restrictive rather than more liberal.

This continued regulation on a global scale has limited trade and expansion of production in developing countries, but it has not prevented the latter from increasing their share of world trade *vis à vis* the developed nations. It has, however, profoundly impacted the geography of production and distribution networks within the GACC, as buyers have been limited in the amount of products they could source from specific locations. Thus buyers have had to spread orders over a larger number of locations than might have been the case without these restrictions.

It has been argued that the quota system has actually made some developing countries more competitive, as it had the unanticipated effect of stimulating the substituting of high value added for low value added activities (quota go by volume and not value) and diversification into other product categories (O'Connor, 1993). However, generally speaking it provided the industry with a less competitive international environment.

Yet from a trade perspective, the LDCs as a group were not happy with the MFA. Despite outwardly presenting a unified position, in reality divisions occurred, as countries varied in their competitive position. Those that had become proficient in production and already had large quotas for United States and European markets could retain these, whereas other countries would have little access to the major markets based on their prior exporting records. In a sense, earlier quotas provide guaranteed market access in an intensely competitive market with an overabundance of producers.

The irreconcilability of the MFA with the core principles of GATT eventually led to a series of negotiations in the late 1980s and early 1990s in the so-called Uruguay Round, in an attempt to integrate the MFA into the GATT. This resulted in 1995 in the Agreement on Textiles and Garment (ATC), which was incorporated into the WTO - the successor of the GATT - and contained provisions for trade liberalisation, and the abolishment of the quota system over a ten-year period (1995-2004). The planned, gradual, removal of trade barriers and the general trade liberalisation will again have a profound impact on world textiles and clothing production and trade. One can expect low cost countries that are currently restricted by binding quotas to gain from trade liberalisation.

With the accession of China into the WTO there is fear, especially among the smaller Asian countries, that most production and sourcing will end up in China. Others have argued that Pakistan and India will profit from trade liberalisation, as both countries not only have abundant labour resources, but also important local material inputs, most notably cotton and supplying industries (Hiebert, 2003).

Despite the planned phasing out of the quota system, there is some skepticism as to how free garment trade will really be. The most difficult liberalisation within the ATC is left to the very end of the transition period and although tariffs will also be lowered, some will remain, even after completion of the ATC. Generally it remains to be seen, whether claims of domestic industries suffering damage will serve as a reason to place new or other restrictions on import. There is a possibility that developed countries will use other, non-tariff and non-quota barriers (quality and phytosanitary requirements, labour issues, environmental standards etc.), to stem the inflow of garment imports from LDCs.

Next to the international regulatory framework, the establishment of free trade agreements and preferential treatment of certain countries and/or regions in terms of their access to developed countries markets, have profoundly affected producers in LDCs in recent years. Examples of such agreements are the North American Free Trade Agreement (NAFTA) between Canada, the United States and Mexico, the Caribbean Basin Trade Partnership Act (CBTPA) and the Africa Growth and Opportunity Act (AGOA) for Sub-Sahara Africa.

These agreements have all given the involved countries trade advantages over non-included countries, of which the Asian NIEs and late industrialisers were the major affected group.

NAFTA gives Mexico a considerable advantage in export of garment to the United States (see box 1.2), as there are no quota and hardly any tariffs imposed on Mexican imports into the United States (see also Dooren, 2003). The CBTPA provided Caribbean Basin countries such as the Dominican Republic with lowered tariffs, which weren't as favourable as the NAFTA provisions, but definitely more favourable than what most of the Asian countries had to work with. Coupled with the proximity of these production countries to the United States market, and the fact that producers in this region have developed OEM capabilities as well, this has given the region a considerable advantage over specifically the Asian countries. This is reflected in trade flows, which clearly show that imports into the United States from these countries have increased substantially, with Mexico now being the number one source of US clothing imports (see table 1.7)

To prevent non-NAFTA and non-CBTPA (i.e. Asian) producers from taking the back-route – by re-exporting goods via Mexico, or assembling Asian cut fabrics in Mexico for export to the US market – strict rules of origin were introduced under the so-called yarn-forward clause. This implied that 'textile and garment goods (with certain exceptions) must be produced from yarn that is made in a NAFTA country in order to have access to the full benefits of the NAFTA Agreement' ([www.strtrade.com](http://www.strtrade.com), 2002). It has, however, further encouraged the globalisation of Asian garment as well as textile producers, as several have opted for the setting up of vertically integrated operations in Central America.

**Table 1.7 US Apparel Imports, Top Ten Suppliers**

| Rank | 1993                      |      | 1996                      |      | 1999                      |      |
|------|---------------------------|------|---------------------------|------|---------------------------|------|
|      | Countries                 | %    | Countries                 | %    | Countries                 | %    |
| 1    | China                     | 18.4 | China                     | 15.3 | <b>Mexico</b>             | 13.5 |
| 2    | Hong Kong, China          | 12.0 | Hong Kong, China          | 9.7  | China                     | 13.2 |
| 3    | Taipei, Chinese           | 6.9  | <b>Mexico</b>             | 9.0  | Hong Kong, China          | 7.7  |
| 4    | Korea, Rep. of            | 7.4  | European Union (15)       | 5.2  | European Union (15)       | 4.2  |
| 5    | European Union (15)       | 4.4  | Taipei, Chinese           | 5.0  | <b>Dominican Republic</b> | 4.1  |
|      | <i>First 5</i>            | 49.1 | <i>First 5</i>            | 44.2 | <i>First 5</i>            | 42.7 |
| 6    | <b>Dominican Republic</b> | 4.2  | <b>Dominican Republic</b> | 4.2  | Korea, Rep. of            | 4.1  |
| 7    | <b>Mexico</b>             | 4.0  | Philippines               | 3.7  | <b>Honduras</b>           | 3.8  |
| 8    | Philippines               | 3.9  | Korea, Rep. of            | 3.7  | Taipei, Chinese           | 3.7  |
| 9    | India                     | 3.4  | Indonesia                 | 3.5  | Indonesia                 | 3.3  |
| 10   | Indonesia                 | 3.2  | India                     | 3.4  | Philippines               | 3.3  |

Source: WTO, Textile Monitoring Board (1997, table 16), WTO, (1999, table IV.79)

Under the Africa Growth and Opportunities Act effective from 2000, some 35 countries from SSA are given preferential access to the US market. It allows qualifying textiles and garment articles from a beneficiary SSA *duty-free* and *quota-free* entry into the United States. If the fabrics used originate from outside the eligible SSA countries and the US, quota and tariffs do apply, except for the lesser developed SSA, defined as having a per capita GNP below US\$1500,- per year ([www.strtrade.com](http://www.strtrade.com), 2002).

The European Union has extended similar preferential treatment to North African and Central/Eastern European countries. The former because of old colonial ties, the latter as a prelude to entry of a number of countries in this region into the European Union. Thus by 1999, five out of the top ten suppliers of apparel inputs into the EU were from these regions. Particularly countries such as Tunisia (5th supplier of apparel inputs into the EU in 1999) and Romania (6th supplier) benefited from these trends (WTO, 1999)

The most recent development in this respect has been the signing of a Free Trade Agreement between the United States and Singapore, which is seen by some as a test-case that, if proven

successful, may clear the way for more such FTAs between the USA and other Asian countries. Understandably, there is a strong lobby in favour of such FTAs within Asia, yet there is probably an even stronger lobby against within the USA.

Overall, preferential trade agreements have differential effects on the export competitiveness of different countries and regions as buyers have started sourcing more products from countries and regions included under such agreements. This has also involved encouragement of local producers in these countries and regions to develop full-package capabilities.

#### 1.5.4 *Labour Availability and Cost*

The labour intensive nature of garment assembly makes it sensitive to both labour availability and cost, and changes in these factors profoundly affect the competitiveness of companies. Although the two – availability and cost – are obviously related, this relation is not always as simple as might be assumed.

As countries achieve success in economic development, several factors contribute to both shortages and increased cost of labour in the garment industry.

First, economic development tends to push up wage levels, making labour more expensive relative to new entrants in less developed countries to the industry.

Secondly, with economic development education levels usually increase, often leading to people being less inclined to want to work in such industries as the garment industry. As other industries emerge and develop, people seem to prefer working in such new industries. This problem is especially pronounced in countries with a relatively small population base. Usually garment producers cannot afford to follow the general trend of wage increases and pay in the industry is often amongst the lowest of all manufacturing industries and mostly based on piece rates. Competing for labour with other industries such as electronics or services, becomes increasingly hard. Labour turnover also tends to increase as a consequence, as workers ‘shop around’ for jobs, looking for the producer offering the best benefits and because producers may ‘poach away’ (Dooren, 2003) workers from each other. Labour shortages may therefore pose a big problem for producers and drive up the cost of labour even more because of recruitment cost and increased cost of training (due to higher labour turnover).

Thirdly, paradoxically economic development tends to increase especially the shortage of *skilled* labour. Although the industry is generally defined as commanding relatively unskilled labour, the actual sewing process does require a certain level of dexterity and skill, mostly obtained through on the job experience. In addition certain more ‘artisanal skills’ are required in pre-assembly processes such as patterning, marking and grading (if this is still done manually). As economic development and education levels in a country rise, and labour turnover increases, experienced and skilled workers become scarce.

Governments too may put pressure on labour markets for the industry due to specific labour policies.

### **Conclusion**

In this first chapter a detailed overview was given of the developments in the global garment industry and particularly of the globalisation of the industry and the complex international production and distribution networks that have evolved in the past four decades. These are a consequence of the specific characteristics of the industry (most notably its vertical disintegration and high labour intensity), market and technological developments, trade related issues and dynamics within late industrializing countries, particularly in Asia. The consequent international division of labour patterns in the industry are best captured in the

global apparel commodity chain, which illustrates how actors in different countries and regions, operate in distinct networks and perform specialised operations and services, and are linked together through a variety of sourcing, contracting and ownership arrangements. The specific geographies of the different elements of the GACC revealed distinct locational patterns tied to specific export roles, ranging from simple assembly to brand manufacturing.

Regional dynamics within Asia, driven to a large extent by (companies in) the Asian NIEs, have led to a distinct regional division of labour and production hierarchy, that buy now span virtually all of East, Southeast and South Asia. Such dynamics have in fact enabled the region as a whole to maintain a dominant export role within the GACC, despite increasing pressures from other countries and regions entering this chain.

As argued, the industry is a very relevant case for the study of globalisation and local industry development in LDCs. In the next chapter we will first turn to the some of the main theoretical notions on the broader issue of the relation between firms and industries in LDCs operating in global networks and chains, and local industry development. Subsequently, in chapter three these theoretical considerations will be linked more specifically to the case of the global garment industry and its specific dynamics and characteristics - as presented in this chapter - and to developments in the East Asian NIEs. This results in the presentation of a framework for analysis in chapter 3, which forms the conceptual basis for the empirical part of the study.

## Notes

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<sup>1</sup> The words garment and apparel have roughly similar meanings and it is therefore highly common to use them as synonyms. However, while they overlap greatly in subject matter, it is important to note that the term apparel is broader and that the apparel industry produces a wider range of sewn products, encompassing not just wearing apparel, but also household and industrial apparel, two types of non-clothing products not part of the garment industry (Dooren, 2003) and excluded from this study.

<sup>2</sup> Export and marketing networks are together referred to as distribution networks

<sup>3</sup> Such strategies have included 'brand stretching' (Gibbon, 2000b, p.7), internal brand diversification; clothing specific diversification, i.e. extending the product range to include for instance children's wear; diversification into new market segments, etc. For an extensive overview, see Gibbon (2000b)

<sup>4</sup> This is even more true for the next industry upstream, the synthetic fibres industry, which serves as a supplier to the textiles industry

<sup>5</sup> Such innovations involve for instance the use of new, or blending of different, types of yarns and fibres to develop 'new varieties' of fabric such as cotton-blend fabrics (mixing natural cotton yarn with synthetic fibres, thus combining the advantages of both), wrinkle free fabrics, water proof but 'breathing' fabrics such as Goretex, etc

<sup>6</sup> Under such arrangements, products assembled in free trade zones in specific countries from (sometimes cut) fabrics supplied by the US company, could be imported into the USA paying duty only over the value added in the EPZ. Similar arrangements existed in Europe.

<sup>7</sup> This so-called supplier nomination or designation by buyers cuts the cost of quality control and ensures world-wide quality levels. It enables buyers to spread an order over different producers, or have tops and bottoms of sets made in different locations. In addition it gives them a stronger bargaining position vis-à-vis input suppliers, as they can buy in bulk allowing them to command better prices.

## **2 Local Firms and Industries in Global Commodity Chains: Theoretical Notions**

### **Introduction**

The actuality of the global production networks and commodity chains perspective of economic globalisation is demonstrated by the number of recent publications and research projects dealing with it (e.g. the UNIDO Industrial Development Report 2002/2003, (UNIDO, 2002); the UNCTAD World Investment Report 2003 (UNCTAD, 2003); the joint research project on Global and Local Governance and Industrial Development undertaken by the IDS and INEF<sup>1</sup>; and work by the ILO/International Institute for Labour Studies (ILO, 1998a, 1998b)). Studies seem to agree that opportunities for development for LDC firms and industries are related to incorporation into global production networks and commodity chains and lie in the possibilities to leverage access to markets and information through the linkages with lead firms. Such successful leverage was demonstrated by the achievement of export competitiveness by manufacturing firms and industries in a number of LDCs over the past 20 years. The dangers after incorporation, are seen to lie in the possibility to get locked into a race to the bottom where competitiveness is maintained by further exploiting production factors, particularly labour and non-renewable ones. This would at best lead to immiserising growth, where there is increased output and more employment, but returns are falling (Kaplinsky, 1998). To achieve sustainable income growth, rather than just export growth, it is argued that developing country producers can capitalise on the opportunities presented by economic globalisation for the upgrading of their activities (Schmitz, 2000; Gereffi, 1999; UNIDO, 2002) and the achievement of local (industry) development. Industry development is often associated with ‘upgrading’ at the firm and industry levels. However, given the numerous views and approaches to this concept, this raises more fundamental questions as to what upgrading really means and how, following which routes it may be achieved. Only after dealing with these complex issues can we move on to the central question concerning the longer term development prospects of continued incorporated in networks and chains, given the necessity for firms and industries to adjust to changing competitive advantage factors and competitiveness of firms/industries in specific locations.

In the approach taken in this study these aspects are considered by (i) identifying firm competitive adjustment strategies in response to competitive pressures and opportunities; (ii) identifying the outcomes of these adjustments in terms of firm development trajectories and changing roles/positioning of firms relative to networks and chains (iii) identifying whether changes at the industry level have taken place, how they are produced and what their implications are in terms of industry development trajectories; and (iv) determinants or forces behind these strategies, adjustments and trajectories.

Before dealing with these elements specifically in the context of the garment industry, in this chapter the first three elements are explored in a more general, theoretical way. The fourth will be discussed in detail in the next chapter.

The discussion starts with a consideration of the most important aspects of GCC analysis in section 2.1, after which, in section 2.2, we will take a brief look at how, within the GCC discourse, firm and industry development in relation to economic globalisation is generally conceptualised. Here a definition of firm and industry development is offered, to which the - rather problematic - concept of upgrading in the context of global networks and chains is linked. In section 2.3 the discussion therefore continues with a more detailed consideration of the upgrading discourse, and specifically an explicit problematisation and definition of upgrading, as this is often omitted or only superficially considered in existing literature (see e.g. Meyer-stamer, 2002). This allows for a more comprehensive approach to the notion of

upgrading in relation to sustaining connections, and advancing roles and positions relative to global production networks and chains.

Next, section 2.4 turns to firm competitive adjustment strategies and introduces the idea of firm development trajectories, reviewing existing literature and studies that have modelled local firm development under globalisation based on concepts of learning, upgrading and improving competitiveness. Section 2.5, takes the analysis to the industry level, exploring the effects of both existing segments and new entrants into an industry in terms of changing industry profiles.

## 2.1 Global Production Networks and Commodity Chains

Global trade and production is increasingly organised in networks of independent, yet interconnected enterprises, and globalisation is no longer driven predominantly by TNCs, but increasingly by global lead firms. In the debate on globalisation and local industry development attention has accordingly shifted to the capabilities of *local firms in LDCs* and their capacity to become incorporated in global networks and chains driven by lead-firms from the West. The Global Commodity Chains discourse, and related literature, argues that incorporation into global production networks and GCCs forms a possible option for creating the conditions for upgrading (hence local firm and industry development), allowing for the achievement of international competitiveness and gains from globalisation. Before taking a closer look at this discourse, we will first give a brief overview of the most important aspects and dimensions of GCC analysis.

The commodity chain, as employed and popularised in the GCC literature, was first described by Hopkins and Wallerstein (1986) as “a network of labour and production processes whose end result is a finished commodity”. It was later extended by Gereffi, who broadly defined a global commodity chain as ‘a set of networks (nodes) clustered around one final product or service and linking firms, industries and communities to one another across the world economy’ (Gereffi, 1992; Gereffi & Korzeniewicz, 1994; ILO 1998a, 1998b). Commodity chains have four main dimensions:

- 1) An *input-output structure*, or sequence of interrelated value-adding activities including product design and engineering, manufacturing, logistics, marketing and sales,
- 2) A *governance structure*, or power relations that determine how economic surplus is distributed within the chain,
- 3) A *geographical configuration*, referring to the spatial dispersion or concentration of activities within and across locations,
- 4) A *social and institutional context*, formed by the norms, values, and regulatory frameworks of the various communities (at different scale levels) within which firms operate.

Before elaborating on the different aspects of GCCs analysis, we should first try to create some order in the terminological jungle that has characterised the literature related to the GCC concept. Table 2.1 gives an overview of the different terms and definitions found. It demonstrates that the different concepts and their definitions all to some extent overlap. For the current study we have chosen to use the terms (global) production networks and (global) commodity chains.

According to Gereffi, what makes the GCC useful as an analytical device is that it focuses on how international trade and production networks confer advantages to the leading group of firms that co-ordinate them and he continues to argue that the GCC differs in at least four respects from related concepts such as ‘production’ or ‘supply chain’ in that it:

- i. incorporates an explicit international dimension into the analysis;
- ii. focuses on the power exercised by the lead firms (i.e. governance) in different segments of the commodity chain and it illustrates how power shifts over time;

**Table 2.1 Networks and Chains: Terminology and Definitions**

| <b>Concept/term (synonyms)</b>  | <b>Definition</b>   | <b>Focus/what it highlights</b>  | <b>Reference</b>   |
|---|---|--|--|
| <b>Supply Chain</b>   | Generic label for input-output structure of value-adding activities, beginning with raw materials and ending with finished product  | ➤ input-output structure   | Gereffi et al, 2001  |
| <b>Porter's Value Chain</b>   | The different stages of the process of supply (inbound logistics, operations, out-bound logistics, marketing & sales, and after-sales) and the support services the firm marshals to accomplish this task | ➤ draws away attention from the physical transformation to where value is added in the process of bringing a product or service to the end-user<br>➤ gaining competitiveness through management of the value chain as a system   | Porter, 1990   |
| <b>Value System</b><br>(Commodity/Production Value Chain, (French) Filière <sup>1</sup> ) | A sequence of productive (i.e. value-adding) activities across industries (inter-industry linkages) leading to/supporting, end use  |  | Porter, 1990   |
| <b>Production Chain</b><br>(Commodity Chain Value System/Chain (French) Filière)          | A transactionally linked sequence of functions in which each stage adds value to the process of production of goods or services   | ➤ input-output structure<br>➤ co-ordination and regulation of chains<br>➤ geographical configuration   | Dicken, 1998   |
| <b>Commodity Chain</b><br>(Value System/Chain, (French) Filière, Production Chain)        | A network of labour and production processes whose end result is a finished commodity   | ➤ input-output structure;<br>➤ governance structure;   | Hopkins & Wallerstein, 1986  |
| <b>Value Chain</b><br>(Commodity/Production Chain, Value System (French) Filière)         | A sequence of productive (i.e. value added) activities often across industries (inter-industry linkages) leading to, and supporting, an end use (product or service)                                      | ➤ relative value of activities required to bring a product or service from conception through phases of production to end use & disposal<br>➤ value chains as repositories for rent<br>➤ governance/systemic efficiency required for effective functioning of chain  | Gereffi et al, 2001;<br>Sturgeon, 2001<br>Kaplinsky, 2000                          |
| <b>International/Global Production Network</b><br>(Supply Base)                           | A set of inter-firm relationships that bind a group of firms into a larger economic unit and in which actors co-ordinate activities across countries and even continents.                                 |  | Sturgeon, 2001   |
| <b>Global Commodity Chain</b><br>(Global Value Chain)                                     | A set of networks (nodes) clustered around one final product or service, linking firms, industries and communities to one another across the world economy  | ➤ geographical configuration, international dimension<br>➤ territorial embeddedness/social & institutional context<br>➤ networks as strategic assets<br>➤ distribution of wealth within chain is outcome of relative intensity of competition within different nodes; nodes rather than national economies are locus where surplus accrues | Gereffi & Korzeniewicz, 1994; Gereffi, 1997; Gereffi et al, 2001; Kaplinsky, 2000; |

<sup>1</sup> The French Filière approach is not so much centred around a distinct school of thought or a unified theoretical framework. Instead it is a loosely-knit set of studies with the common characteristics that they use the filière or chain of activities and exchanges as a tool and to delimit the scope of their analysis. It thus less a theory than a 'meso-level' of analysis (Raikes et al, 2000, p.14).

- iii. views the co-ordination of the entire chain as the key source of competitive advantage that requires using networks as a strategic asset;
- iv. looks at flows of information as one of the critical mechanisms by which firms try to improve or consolidate their positions within the chain (Gereffi, 1997a).

Dicken et al, argue that “Networks are neither purely organisational forms, nor structures. They are essentially *relational processes*, which, when realised empirically within distinct time- and space specific contexts, produce observable patterns in the global economy” (Dicken et al, 2001, p.91, original italics). Seeing networks as relational processes allows us to identify the actors in the networks, their ongoing relations and the structural outcomes of these. The shifts and changes taking place in networks are what shape the economic globalisation process. Looking at networks as relational processes thus stresses the importance of governance systems, relationships within the networks and information flows. In addition they argue that networks encompass a ‘multiplicity of spatial and organisational scale levels’ (Dicken et al, 2001, p.92) - stressing the international dimensions as well as the fact that networks are shaped by (f)actors at different levels - and have a distinct and ‘complex territorial embeddedness’ (ibid, p.92) - stressing the role of the social and institutional environment.

According to Kaplinsky (2000) the analytical power of GCCs<sup>2</sup> lies in the concepts of rents, governance and systemic efficiency, which again are closely related to the concepts introduced by Gereffi and Dicken et al.

Governance constitutes one of the factors determining the nature of the insertion of producers into the global division of labour. For, it is not just a matter of whether producers participate in the global economy, which determines their returns to production, but *how* and *on what terms* they do (Kaplinsky, 2000). Improving competitiveness within a GCC perspective would imply increasing ones capacity to exercise governance over other parts of the chain and thus create rents. This capacity or power (to exercise governance) exists in gradations and governance within a chain perspective may take on different forms (Raikes et al, 2000). Although lead firms may take on the critical governing roles, there are often intermediary governing roles, which may be performed by core producers (e.g. co-ordination of production in regional production networks by NIE producers), or specialist service providers in the chain. By positioning themselves strategically in the chains, firms can increase their capacity to exercise some form of governance over parts of the chain, enhancing their power, raising entry barriers and increasing economic rents, thus diminishing the relative intensity of competition in the nodes in which they operate. Often the rents thus generated are in part ‘relational rents’ (Gereffi, 2001), derived from trust relationships and strategic alliances with the main lead firms in the chains.

In terms of governance, a distinction is often made between *buyer-driven commodity chains (BDCC)* and *producer-driven commodity chain (PDCC)*. In the former, governance is exercised by large retailers or branded marketers and relationships between the different actors in the chain are horizontal and trade-based. These types of chains and networks are typical for consumer non-durable industries such as garment, footwear and toys. In PDCCs on the other hand governance is exercised by large producers and relationships between the different actors in the chain are vertical and investment-based. They are typical of consumer durable industries such as automobiles, computers and aircrafts (Gereffi & Korzeniewicz, 1994)<sup>3</sup>. Economic rents are derived from different types of barriers to entry in these two chains: in BDCCs rents are often relational, trade policy and brand name and derived from

economies of scope barriers to entry, whereas in PDCCs they are usually technology and organisational, derived from economies of scale barriers to entry<sup>4</sup>.

Given the nature of global production networks and chains, lead firms will have to put significant resources into trying to improve the efficiency throughout the chain, as they realise that the activities that they are directly responsible for in their internal operations account for only a small share of total production cost. Also, lead firms are often held responsible by end-users (consumers) for the quality and production circumstances of the products they market and sell, even if they are not involved directly in actual production. Lead firms therefore need to promote systemic integration by forging closer links within the chain, involving enhanced responsibilities for them as well as the growth of greater levels of trust between the different links. As value chains increasingly span national boundaries, governors are also forced to learn how to upgrade producers in low-income countries. It is in part due to this need for systemic integration that incorporation within global production networks and chains presents LDC producers with possibilities and sources for learning and upgrading.

It is these dimensions and concepts that provide the basis for the way GCC analysis has tended to conceptualise the link between incorporation into global networks and chains and local industry development and competitiveness, stressing particularly the possibilities for upgrading that such incorporation entails.

## **2.2 Global Networks and Chains, and Local Industry Development: a GCC Perspective**

The GCC (-related) literature suggests that one of the most viable roads to local industrial upgrading and development in LDCs is incorporation into GCCs through export-oriented industrialisation in the form of contract manufacturing for foreign lead firms or acting as host to TNC branches (ILO, 1998a, 1998b; Dicken et al, 2001; Gereffi & Kaplinsky, 2001). Contract manufacturing in BDCCs is seen to enable latecomer firms in LDCs to overcome the disadvantages of being far removed from lead-user markets and sources of technology as well as their relative shortage of specialised input resources (Wong, 1999). Achieving participation in global networks and chains, requires local firms and industries to engage in some form of initial upgrading of quality to meet the minimum conditions (international standards and minimum requirements) of lead firms. Meyer-stamer (2002) compares this to 'appearing on the radar screen' of those who co-ordinate the chains and argues that "In the pre-radar screen constellation upgrading means learning within local markets or elsewhere to improve competitiveness in order to appear on the radar screen of value chain scouts" (Meyer-stamer, 2002, p.15). Incorporation into GCCs is subsequently seen as putting firms in LDCs on a fast track to growth, upgrading and improvement of competitiveness as it provides access to resources, thus speeding up, and bringing down the cost of, learning processes.

Gereffi refers to industrial upgrading as involving "organizational learning to improve the position of firms or nations in international trade networks" (Gereffi, 1999, p.39) and even argues that, "participation in global commodity chains is a necessary step for industrial upgrading because it puts firms and economies on potentially dynamic learning curves" (ibid, p.39), although there is no standard learning curve for all enterprises to travel down. Upgrading is thus seen as requiring a conscious effort on the part of local firms in terms of 'linking, leveraging and learning' (UNIDO, 2002, p.95). Lead-firm producer links provide LDC producers, once incorporated, with the information sources and knowledge to engage in 'organizational succession' (Gereffi, 1999)

trajectories. Thus firms move to nodes and positions in the chains where they are capable of exercising some form of governance over other parts of the chain, i.e. a position where entry barriers are higher and the intensity of competition is less, allowing for the creation of new rents. Gereffi's view on the upgrading potential of GCCs is a rather optimistic one, stressing that opportunities are driven by the needs of lead firms. More recently, however, several authors have questioned the role of lead firms arguing that in some cases they may even limit upgrading (Schmitz & Knorringa, 1999; Humphrey & Schmitz, 2001).

The actual process of industrial upgrading is defined by Gereffi (1999) as an improvement of the ability of a firm or an economy to move to more profitable and/or technologically sophisticated capital- and skill-intensive economic niches.

At the local industry level Gereffi views upgrading mostly in terms of an increase of value chain activities performed locally and increased local forward and backward linkages, which he essentially extends to the regional level, where he views upgrading as a 'regionalisation of commodity chains' (Gereffi, 1997a).

Humphrey and Schmitz' (2001) definition of upgrading within factories (firms) or groups of firms, revolves around four different shifts: (1) *process upgrading*, transforming inputs to outputs more efficiently by re-organising the production system or introducing superior technology; (2) *product upgrading*, implying firms move into more sophisticated, higher unit value, product lines; (3) *functional upgrading*, implying firms acquire new functions or abandon existing functions so that they increase the overall skill content of their activities (e.g. complement production with design or marketing, or move out of low-value production activities altogether); and (4) *intersectoral upgrading*, where firms apply the competence acquired in a particular function of a chain to move into a new sector. Particularly functional and intersectoral upgrading are seen to possibly lead to a repositioning of firms and groups of firms in global markets (Humphrey & Schmitz, 2001, p.4). It has also been suggested that a fifth level of upgrading should be added, that is the *upgrading of marketing linkages*, or a shift to higher value added chains and lead firms (Gereffi, 1999).

Participation in GCCs is thus seen as a necessary, but not sufficient, condition for subordinate agents to upgrade. It provides LDC firms and industries the potential for learning. To actually profit from this potential, however, requires active steps of LDC firms in terms of meeting buyer requirements (a capability lead firms will take into account when selecting firms to participate in their production networks) and shifting to higher-end lead firms and segments. However, acceptance of terms defined by key agents is a condition for participating in the chain, and even more so for progressing to higher (technology, value-added) positions in the chain.

Therefore the GCC literature initially focused on the governance structure; the influence and power of lead firms were seen as the dominant drivers of local upgrading and development<sup>5</sup>. It remained somewhat one-dimensional and vague in providing an explanation of how exactly incorporation into global networks and chains would lead to local industry development or upgrading, i.e. the determinants of local firms and industries actually achieving upgrading and positive development. As Meyer-stamer argues, Gereffi's representation of industrial upgrading "is not a very useful typology since it says nothing about causalities: Did the firms upgrade because locational factors improved, or despite the fact that they stayed dismal?

What was more relevant: intra-firm effort, inter-firm collaboration, locational policy efforts, or overall macro-economic conditions?” (Meyer-stamer, 2002, p.8).

This issue has been addressed through attempts to further elaborate other key dimensions of the GCC framework, most notably the social and institutional environment<sup>6</sup>. This refers to the conditions under which control over market access and information are exercised on a global plane (Gibbon, 2000a) and includes the international regulatory environment (international trade agreements), the regional political economy (as in the case of trade blocs or regional free trade agreements), and the local industry environment. While the latter initially received limited attention, more recently several authors and bodies of literature that link to GCC analysis have tried to expand this aspect more explicitly, arguing that national institutional differences continue to exert a significant influence on the international structure of economic activities (Dicken et al, 2001; Appelbaum & Smith, 2001). The work of Whitley (1992, 1996, 1999) specifically has pointed to the importance of ‘national business systems’ that firms within a chain (both lead firms and dependent firms) operate in. Whitley defines these business systems as “distinctive configurations of hierarchy-market relations which become institutionalised as relatively successful ways of organising economic activities in different institutional contexts” (Whitley, 1992, p.10). He has argued for instance that “the sorts of firms that dominate GCCs often follow different strategies and develop different roles within them because of their idiosyncratic histories and institutional contexts” (Whitley, 1996, p.419). With respect to dependent firms (in LDCs) within the chain, the national business system is seen as a factor hindering or stimulating the acquisition of capabilities and competencies, through learning. This involves the role of supporting institutional arrangements, both government and private. Whether and how firms and industries in LDCs will participate in GCCs and how they develop will thus depend to a large extent on the national business system in which they operate. As Smith et al argue “Economic actors such as firms are always embedded in dense social and institutional networks of relations (...) at both national and local scale levels, and these relations impinge in important ways upon the variability of economic development outcomes across space” (Smith et al, 2002, p. 48). The fact that similar global processes have produced differential outcomes at the local level serves to underscore the importance of placing commodity chains in the wider context of the institutional environment and regional economy in which they are embedded (Dolan & Tewari, 2001).

In addition the national innovation systems literature (Freeman & Soete, 2000; Freeman, 1990; Nelson, 1993; Lundvall, 1992; Wong 1999), the work on organisational and institutional learning (see e.g. Malecki & Oinas, 1999) and the literature on small and medium local firm and institutional actor ensembles – often labelled as clusters - (Porter, 1990, 1998) explicitly stress the local environment as an important factor in local firm and industry development in a global economy. The cluster literature has more recently been extended to developing country industries looking to enter into the global economy, i.e. the possibilities for industry clusters in developing countries for collective incorporation into networks and chains (see e.g. Helmsing, 2000; Schmitz & Nadvi; 1999; Bell & Albu, 1999; Vargas, 2001; Dolan et al, 1999).

Linked to the bodies of literature referred to above, is the body of work emphasising the importance of policy networks (ILO, 1998a, 1998b). All these contributions have pointed in one way or another to the fact that there are forms of governance exercised by actors outside the chain, in the form of local governments, NGO’s, international regulatory bodies, etc. (Humphrey & Schmitz, 2000; Raikes et al, 2000; Dicken et al, 2001; Appelbaum & Smith, 2001). They have added to our understanding of local development under globalisation, stressing the *global-local* interaction, not just merely the global forces at work. Recognising the important role of the national business environment, the institutional context and national

business system as determinants for firm and industry development, they are explicitly incorporated in our conceptual framework, presented in the next chapter<sup>7</sup>.

All in all an impressive body of work has emerged, trying to analyse and explain the effects of incorporation into GCCs for LDC firms and industries and the learning and upgrading potential such incorporation presents. Equally important as the question of initial incorporation are the interrelated issues of longer-term development paths, sustaining connections to chains and networks, how the latter is achieved and what it means for local industry development. The literature suggests that for firms to stay connected to chains, they must engage in learning and upgrading (Gereffi, 1999; Kaplinsky, 2000), for which external linkages and the local business environment (and their interaction) may provide the incentives and opportunities. While local industry development under globalisation, usually revolves around the concept of (industrial) upgrading, a great deal of the literature fails to clearly explain or problematise this issue. There is some notion that upgrading is about ‘moving up’, that it involves learning – which in itself remains a vague and hard to measure concept – that it is induced by external linkages and that both firms, industries and locations/countries can upgrade. But this still doesn’t help much in explaining the meaning of operating in global chains for local industry development.

What exactly is upgrading, how should it be defined? Is it a cause or an outcome, a condition or a process? How is it achieved, is it externally driven or internally induced?

Once incorporated into global networks and chains, firms and industries in LDCs will have to operate in a highly dynamic external environment. Competitive threats, shifts in competitiveness of companies, countries and regions, and resultant changes in lead-firm strategies/selections necessitate constant competitive adjustment by firms and industries in LDCs. Such adjustments may take different forms and while some may lead to advancing of roles and positions in networks and chains, others will achieve mainly the sustaining of connections, while yet other may establish alternatives positions relative to chains.

These considerations warrant an approach to operating in global chains in relation to local industry development, that considers competitive adjustment strategies and the idea of *development paths*, rather than ‘upgrading’.

To clarify these matters further we will therefore take a brief look at the issue of sustaining connections and upgrading, followed by a discussion of firms competitive adjustment strategies. Together they will subsequently permit a conceptualisation of local firm and industry development trajectories after incorporation.

### **2.3 Sustaining Connections and Upgrading in a GCCs Perspective**

As was explained in the above, several problems stand out with regards to inter-firm networks in GCCs and upgrading. First, there seems to be an implicitly assumed automatic link between incorporation in global networks and chains and industrial upgrading. Yet, a great deal of the literature is limited to issues concerning meeting the conditions for entry into global network and chains, and alignment with the ‘right’ type of lead firms. The equally important questions of longer-term local firm and industry development related to sustaining connections to networks and chains, how this is achieved and what the implications are and particularly the opportunities for advancing to more rewarding roles within networks and chains, have thus remained poorly understood.

Second, more fundamentally there is the issue that upgrading is rarely well defined and, although the literature is reasonably clear on upgrading as a condition for entry into networks

and chains, no clear distinction seems to be made between the *process* of upgrading and upgrading as an *outcome*. For instance Humphrey and Schmitz' (2001) typology presented earlier is not entirely satisfying, as it defines *processes* of upgrading, which may not always lead to upgrading as an *outcome*. To understand its weaknesses, it is useful to refer to the argument developed by Porter (1996) that for many companies it has been extremely difficult to translate dramatic operational improvements into sustainable profitability gains. Behind this, Porter argues, is the problem that firms confuse operational effectiveness (performing similar activities *better* than rivals perform them) and strategy (p.62). "OE competition shifts the productivity frontier outward, effectively raising the bar for everyone. But although such competition produces absolute improvement in operational effectiveness, it leads to relative improvement for no one. (...) major productivity gains are captured by customers and equipment suppliers, not retained in superior profitability" (ibid, p.63). "The more benchmarking companies do, the more they look alike. The more rivals outsource activities to efficient third parties, often the same ones, the more generic those activities become. As rivals imitate one another's improvements in quality, cycle times, or supplier partnerships, strategies converge and competition becomes a series of races down identical paths that no one can win" (ibid, 64). The way out of this trap, according to Porter, is *strategy* - "choosing to perform activities differently or to perform different activities than rivals" (ibid.).

According to Meyer-stamer (2002) the principle of competition in globalised markets is "Running to stand still". A company, which is standing still, i.e. does not pursue some kind of upgrading all the time, has little chance of survival. A company which puts a lot of effort into upgrading does not necessarily improve its competitive position. For this reason *increasing skills content* is not adequate, as it is something firms have to do all the time to *maintain* their competitive position. This is, in the words of Porter, about operational effectiveness. It is about performing activities differently than they themselves did in the past, but not necessarily about performing activities differently than rivals. *Moving into market niches which have entry barriers* is more likely to be what Porter would recommend in terms of strategy, though it does not create a strategic difference vis-à-vis competitors if it just implies copying the activities of more sophisticated rivals. It is not rare to observe that several competitors try to move into the same market niches (Meyer-stamer, 2002). This also implies that upgrading is not a priori about a direction, such as 'moving up', as much of the literature seems to suggest. It is rather about productive rent-seeking (Kaplinsky 1998), which may be achieved in more than just one way. "Upgrading means to do things differently, and/or to do different things - not different compared to yesterday's practice in the same company, but compared to competitors" (Meyer-stamer, 2002, p.7).

The key to upgrading within a chain perspective is thus that of *competitive positioning* within networks and chains. Fleury & Fleury (2001) make a similar argument: one can speak of upgrading only if the development

of capabilities and competencies lead to a new situation where the firm has improved its position relative to its previous position, vis-à-vis other firms, is catching up to the best performers in the field and there is increased power regarding other firms in the chain - i.e. some capacity to exercise governance (Fleury & Fleury, 2001). They introduce the term 'routinised upgrading', which applies when "changes in the operational conditions of the firm are more a consequence of external pressures than of the efforts of the firm to improve their competitive position and by building their own competencies" (Fleury & Fleury, 2001, p.118). An example would be if a firm acquires new competencies, but does so just by following the requirements set by lead firms (thus the decision making processes are mainly in the hands of external parties). What appears to be upgrading at the surface will in fact do little to improve the firm's position vis-à-vis its competitors or its bargaining power vis-à-vis lead firms. The opposite of such 'routinised upgrading' (comparable to Porter's 'operational effectiveness') is what Fleury & Fleury call 'continuous and sustainable upgrading' (Fleury & Fleury, 2001, p.118).

In summary, gauging a firm, industry or region's success in the global economy requires looking beyond the processes of learning, capability development and improvement of competencies, at the *outcome* of these processes in terms of competitive positioning in GCCs. For the purpose of the current study upgrading in a chain perspective is defined as the improvement of a firm's competitive strength and positioning within networks and chains as a consequence of conscious competitive adjustment strategies and learning processes aimed at improving and broadening the firm's capabilities and competencies.

Without dismissing the definitions of upgrading given by e.g. Humphrey & Schmitz (2001), we should be aware of the different meanings of the concept in different context and at different scale levels. The process, product and functional upgrading that Humphrey and Schmitz describe, are in essence intra-firm upgrading processes, in which most firms will to some extent engage. Upgrading as an outcome, i.e. in terms of a development path, will usually involve one or more of these processes, yet the processes do not necessarily lead to an upgrading development trajectory as it is defined above.

Third, there often seems to be an implicit assumption that managing to 'sustain connections' can be equated with 'upgrading'. Having illustrated in the above that upgrading as an outcome is but one possible development path for firms and industries, this assumption is obviously too simplistic.

Fourth and qualifying the entire argument, in this thinking inclusion in chains is seen as the only viable route to (rapid) local industrial development, thus perhaps overemphasising the link between connections to global networks and possibilities for local development. In any case extra chain processes have been viewed mostly in a negative way and *extra-chain* possibilities for development have been neglected. The literature usually only points to the risk of exclusion from chains and consequently not having access to resources, markets and sources for upgrading (Gibbon, 2000a; Dolan & Tewari, 2001), as well as to the competencies gap between firms incorporated in global chains and those not (Keessing & Lall, 1992). Although such arguments are very legitimate and applicable to the cases studied in the work of these authors, it need not be the case that companies can only be successful if and when they become incorporated in GCCs and produce for exports. Examples can also be found of local and regional (brand) producers/retailers, which have been highly successful through developing competencies and capabilities for their domestic markets, providing the basis for subsequent expansion into international markets. To the extent that these types of firms have been considered, it is mostly in the idea of 'organisational succession' (Gereffi, 1999; Dolan & Tewari, 2001), where suppliers initially gain access to chains with less

demanding characteristics (domestic markets), prior to engaging in ‘more sophisticated’ export markets and becoming incorporated in GCCs as OEM suppliers. Although brand manufacturing and moving into marketing and retailing as a form of upgrading is often referred to in the GCC literature, it has been poorly conceptualised or studied outside the examples of a handful of Asian companies which followed the OEM-ODM-OBM route<sup>8</sup>.

#### *Upgrading at the industry level*

Although Gereffi (1999) also distinguishes upgrading at the industry level, in much of his work he subsequently fails to make a clear distinction between the firm and industry levels in particular when discussing upgrading. In fact, although Dicken et al (2001) point to the importance of distinguishing different scale levels, as with Gereffi’s work, a substantial amount of the literature fails to do so. This has resulted in the concept of upgrading at the industry level in particular being ill-defined, often merely as an extension of firm level upgrading. Although the two levels are obviously linked, they are not the same and for an analysis of incorporation into GCCs and specifically upgrading, a clear distinction is therefore necessary.

At the industry level Gereffi essentially views upgrading as a ‘regionalisation of commodity chains’ (Gereffi, 1997a) and the development of local/national clusters with horizontal and vertical linkages. This definition deserves some elaboration. At the local/national industry level upgrading essentially would imply that the outcomes of a number of different developments and processes (e.g. firm level upgrading, entry of new players in higher-value added activities, government policies) would lead to a changed situation where the location fulfils a different role and becomes a more crucial node. This new role need not be in production or be achieved by existing players. In general the activities performed locally should be higher value-added and could well be non-production. In addition the new role assumed by a national industry must be harder to copy by others, thus setting it apart from industries in other locations. Often in such cases synergy and clustering are indeed involved, although it appears vertical integration is not always necessary, rather the right kind of supportive activities need to be in place. A good example is Silicon Valley, where through clustering and synergy, a unique and highly competitive computer industry developed, focused primarily on product development and R&D, which functions as a crucial node and driver within the GCC.

The above discussion of the main aspects of GCC analysis, and most important issue surrounding upgrading in relation to connections to global networks and chains, provides important insights for the development of a more comprehensive approach to incorporation into global networks and chains and longer-term prospects for local industry development and global-local dynamics, by considering firm competitive adjustment strategies in LDCs, and development trajectories at both the firm and industry levels.

#### **2.4 LDC Firms within GCCs: Firm Strategies and Development Trajectories**

As initial conditions for incorporation into global networks and chains are in fact fairly easy to meet, and entry is usually at the lowest levels of the chain - the assembly and manufacturing of basic consumer goods - many LDCs, even some of the least developed ones, have by now become incorporated. However, this is no guarantee for longer-term development and, although "It makes sense for latecomers to become incorporated into GCCs and thus use all the resources they can acquire from the advanced world, in return for providing such services as low-cost manufacturing (...) the trade-off can be exploited to the advantage of the latecomer only if there is a strategic choice to gain knowledge – to learn”

(UNIDO, 2002, p.107). This remark points to the important notion of strategic choice on the part of firms in LDCs as an important factor in firm and industry development after incorporation. Therefore the approach in this study focuses on the range of *competitive adjustment strategies* firms may implement after incorporation in response to factors impinging on competitiveness, and considers whether and how they allow firms to benefit from the opportunities offered by linkages to lead-firms. As this concerns dynamic processes, which may result in different development paths and lead to different outcomes in terms of the competitive positioning of firms, the approach takes on a broader perspective than the usual focus on (industrial) upgrading alone, as this represents just one outcome. Instead the study considers different *firm development trajectories* as a result of competitive adjustment strategies and their outcomes in terms of firm roles and positioning within or relative to global networks and chains.

In this section we consider some of the existing theoretical notions and studies on these issues.

#### 2.4.1 *Imperatives and Determinants of Competitive Adjustment Strategies*

Firms that managed to get on the radar screen of global lead firms and thus have become incorporated in global networks and chains, often at some stage start to face increasing pressures on their initial low cost competitive advantage. These derive from rising local cost levels (as rapid growth of an export manufacturing sector puts upward pressures on wages and causes labour shortages) and from the entry of new low cost producer countries into the networks and chains. They are often exacerbated by macro-economic developments and policies, such as currency appreciation and national restructuring policies, as well as international developments such as trade regulations and market developments. After LDC firms and industries have become incorporated into global networks and chains, their changing competitiveness may lead to changes in selection (by lead firms) of producers included in the networks as well as their mode of incorporation. The outcomes of this selection and mode of incorporation – whether an improvement or a deterioration of a firm or industries position and role – are in part dependent on local firm behaviour in terms of capability development, competitive adjustment, the kind of strategies implemented, as well as on the support or impediment of the local business environment in which they operate. The responsibility for further firm and industry development after incorporation thus also lies with local producers and Governments, and doesn't solely depend on lead-firms.

By now a substantial literature has emerged on the subject of competitive adjustment and restructuring, both at the firm and industry levels. There is the literature on changing comparative advantage and the changing competitiveness of firms, industries and locations, ranging from Vernon's Product-Life-Cycle theory (Vernon, 1966) to Porter's work on competitive advantage (Porter, 1990, 1998). Linked to this is the work on international and national industrial restructuring (see e.g. Ruigrok & van Tulder, 1995; Dosi et al, 1988; Piore & Sable, 1984; Nelson & Winter, 1982), and firm level restructuring in specific sectors or industries (Taplin & Winterton, 1997). Although this work initially focused on restructuring in the old industrial cores in the West, more recently a rich literature has emerged on restructuring at the macro and micro levels in the Asian NIEs. This focuses on the important role of both firm strategies and industrial policies in encouraging such processes (see e.g. Kim, 1993; Chiu, Ho & Lui, 1997; Clark & Kim, 1995; Grunsvén, 1998; Masuyama et al, 2001; Rodan, 1989; Castells, 1992).

The restructuring literature often analyses industrial change in terms of the sources for restructuring strategies, the responses to these sources (i.e. the actual restructuring strategies) and their outcomes<sup>9</sup>. This literature is in many respects informative to our framework for competitive adjustment and advancement in GCCs, to be presented later. However, a major

limitation is its local orientation, not *explicitly* taking into account the role of transnational networks and firm and industry positioning in global chains (especially the governance exercised by lead firms in these chains). Heuristic models of restructuring like the one presented by Taplin and Winterton (1997, p.9) distinguish between so-called imperatives to restructure, factors that obligatory to take into account, and so-called options, factors that are discretionary. However, determinants of responses - i.e. factors influencing which strategies a firm will opt for given the options and imperatives<sup>10</sup> - are not (explicitly) identified. For the purpose of our research we have expanded the concept of the sources for restructuring by including international (or external) sources and adding the concept of determinants.

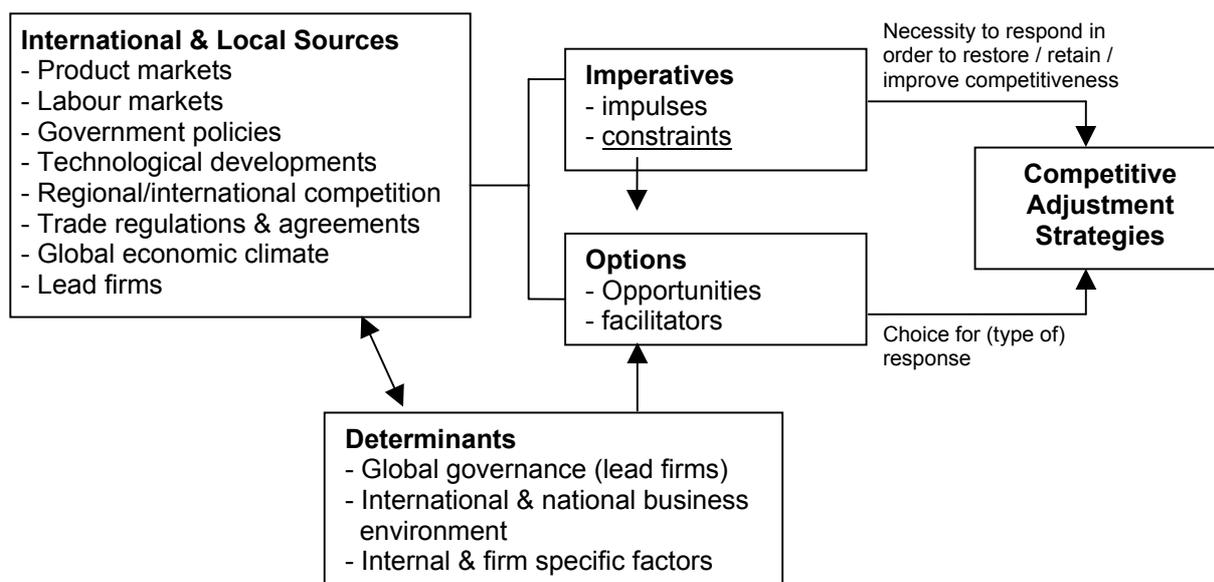
Imperatives may include rising production cost due to the rising price of production factors (labour, material inputs, land, etc.), taxes, cost of capital, transportation cost, etc.; entry of new (cheaper) competitors; increased demands of buyers with regards to quality, speed and reliability of delivery, etc.; changed international regulations (e.g. quota limitations or higher import duties for major markets) and changing macro-economic conditions (currency appreciation or exchange rate volatility). Certain sources take the form of options, which represent opportunities for change, favourable situations of which the parties may take advantage, and facilitators, the adoption of which make some aspects of restructuring easier or which enable certain strategies. For instance trade agreements could actually open up new business opportunities, and buyer requirements may also offer learning opportunities.

Determinants are what influence the actual strategy choices. We will elaborate on these in more detail in the next chapter. It is important to note, however, that imperatives, options and determinants often overlap or interact. Separation is done purely for analytical purposes.

Figure 2.1 gives a graphic illustration of the sources and determinants of competitive adjustment strategies.

Besides the changes to the restructuring model presented by Taplin & Winterton (1997), the concept of restructuring strategies has been broadened to competitive adjustment strategies. These will briefly be considered in the next section. The term restructuring strategy suffers from a reference to the area of the production process only. The term competitive adjustment strategies will therefore be used instead, as it better captures the idea that strategies are aimed at restoring, retaining or shifting the basis of competitiveness (or improving vis-à-vis competitors and/or other actors in the chains), may also be in anticipation of such factors and involve the entire spectrum of corporate activities.

**Figure 2.1 Sources and Determinants of Competitive Adjustment Strategies**



Source: Modified after Taplin & Winterton (1997)

#### 2.4.2 Firm Competitive Adjustment Strategies

In considerations of the interrelationship between competitive adjustment processes, strategies and connections to, as well as positions in, networks and chains, many of the existing analyses emphasise upgrading (product, process, functional) at the firm level. The literature suggests, however, that not all intra-firm processes lead to upgrading of a firm or location's positioning in chains.

Broadening the scope, two types of competitive adjustment strategies may be identified. These are defined by Porter as 'low-road' and 'high-road' (Porter, 1990) equivalent to what Freeman (1974) terms 'defensive' and 'offensive'. The former have a strong cost focus and are thus more retentive, while high-road or offensive strategies tend to have a capabilities and competencies focus and are thus more pro-active. A firm may apply both types of strategies simultaneously.

Secondly, and related to the concepts of retention and pro-active strategies, a distinction can be made between carefully chosen and *planned strategies* and *emergent strategies*. The former are often based on the identification of a corporate goal ('mission statement' in business literature) and a (set of) core competence(s) a firm wishes to further strengthen or develop. The latter are often re-active and ad-hoc responses to sudden changes in a firm's business environment and consequent increases in competitive pressures (e.g. sudden cost increases, the entry of a new competitor in the market, etc.). The already existing literature, dealing with restructuring at the firm and national levels (see e.g. Simon, 1995; Taplin & Winterton, 1997; Chiu, Ho & Lui, 1995; Clark & Kim, 1995), illustrates that firms show an array of responses in order to adjust to changing circumstances. Actions, both re-active and pro-active and including ad-hoc responses to immediate crises, may include decisions on new capital issues, mergers and acquisitions, product diversification, relocation and closures, investments in new technologies and measures to raise productivity, flexibility and quality (Taplin & Winterton, 1997). From the GCC perspective they also involve strategic choices regarding relationships within the chain, i.e. both with lead firms and other actors in the chain. These strategic choices and the implementation of different strategies will ultimately determine the capability and competencies development a firm will achieve and thus the development trajectory it may follow over time.

### 2.4.3 Firm Development Trajectory Models

In recent years there has been an impressive number of studies, all within the general framework of global networks and chains, giving a greater insight into the issue of technological catch-up by latecomer firms in late industrialising countries<sup>11</sup>. This work has tended to take a bottom-up approach in trying to understand local development implications of incorporation into global networks and chains, conceptualising such development in terms of firm strategies, local learning dynamics, and firm development trajectories over time. A large amount of this work has focused on examples of the East Asian NIEs.

#### *Gereffi's organisational succession model*

By far the simplest, and therefore perhaps also least satisfying, model is Gereffi's organisational succession model that suggests a trajectory of moving from assembly and CMT to OEM and eventually OBM. The model only implicitly deals with (producer) firm strategies by suggesting LDC firms use the expertise initially gained from links to, and alignments with, different types of lead firms to upgrade to full package and eventually OBM supply (Gereffi & Korzeniewicz, 1994; Gereffi, 1999). Actual dynamics remain vague though and no real insight is given into specific strategies of firms and governments in achieving such shifts.

Several other contributions have attempted a more comprehensive approach to firm strategies and development trajectories within a GCC perspective, by focusing on specific cases (sectors, industries and locations).

#### *Hobday's export-led learning model*

Similar to Gereffi's organisational succession model, but more elaborate in its dealing with the underlying dynamics of such trajectories, is Hobday's export-led learning model (see figure 2.2).

Based on his research on the development of the micro-electronics/IT industry in the Asian NIEs, he developed a model<sup>12</sup> illustrating the learning process and development path of latecomer firms in late industrialising countries catching up with the technology frontier (Hobday, 1995a, 1995b)

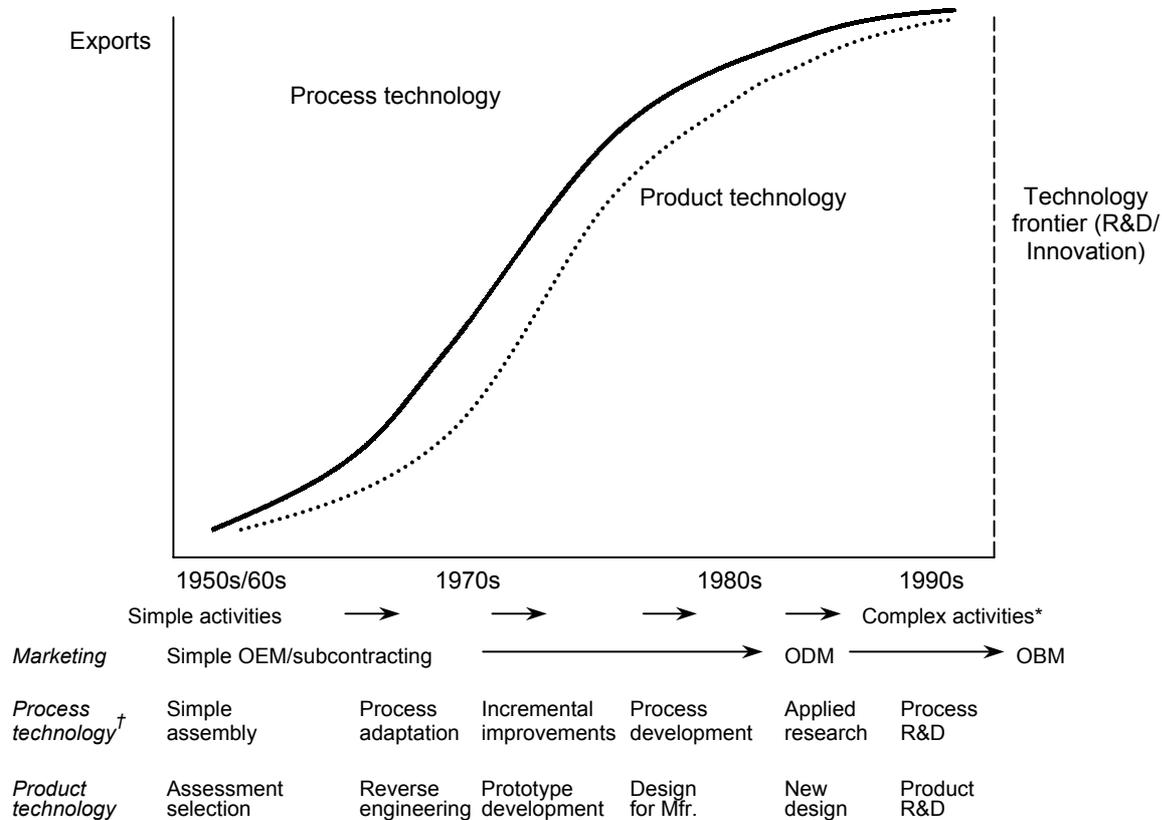
Firms start by mastering simple component subcontracting or contract assembly operations, typically on an OEM basis. They then move up to acquire product design capabilities and become ODM suppliers to end buyers. Some will subsequently attempt to enter into developing own product ideas (OIM) and/or selling under their own brand name (OBM). In essence this technology capability development trajectory involves starting with first developing process capabilities, followed by product design and finally new product creation/branding capabilities.

Depicting a reversal of the 'normal' sequence of value chain activities pursued by large, established high-tech firms in advanced countries (see e.g. Wong, 1999), Hobday's model provides a logic behind the organizational succession model presented by Gereffi and gives a better insight into how succession actually takes place.

Hobday stresses several points of his model vis-à-vis 'traditional' innovation or development models<sup>13</sup>. First although R&D may not be central to latecomer firm strategies, innovation is essential for catching up to occur. This is incremental and needs to be continuous and relatively fast so as to achieve catching up instead of just keeping up (compare to Meyerstamer's 'running to stand still'). Second latecomer innovation is triggered by profit opportunities provided by fast growing export markets. Channels such as OEM and subcontracting relay export market requirements directly to the latecomer firm (Hobday,

1995b). In other words, incorporation into GCCs is a necessary first step for innovation and catching up to occur.

**Figure 2.2 Latecomer firms – export-led learning from behind the technology frontier**



\* No stages or linearity implied, but a general tendency to catch up cumulatively, through time with capabilities building systematically upon each other.

† Although it is useful to distinguish between process and product technology for analytical purposes, in practice the two are often inextricably entwined

Source: Hobday (1995b)

Third, “as the absorptive capacity of the economy increases new start-ups may by-pass earlier phases. Spin-offs from older firms, diversifications from other sectors, and new experimental start-ups will constitute the growing industrial base” (Hobday, 1995b, p.1186). This implies that changes at the industry level are not necessarily an aggregate of *existing* firms’ development trajectories, but also involve new entrants, a point we will return to in more detail when discussing industry development trajectories.

Finally Hobday stresses that there is “no automatic process by which technology accumulation occurs. On the contrary, firms learn to innovate by their own efforts and investments in technology. Purposeful learning efforts are needed to assimilate foreign technology, build up new competencies and catch up with market leaders” (Hobday, 1995b, p.1186).

#### *Mathews and Cho’s leverage path*

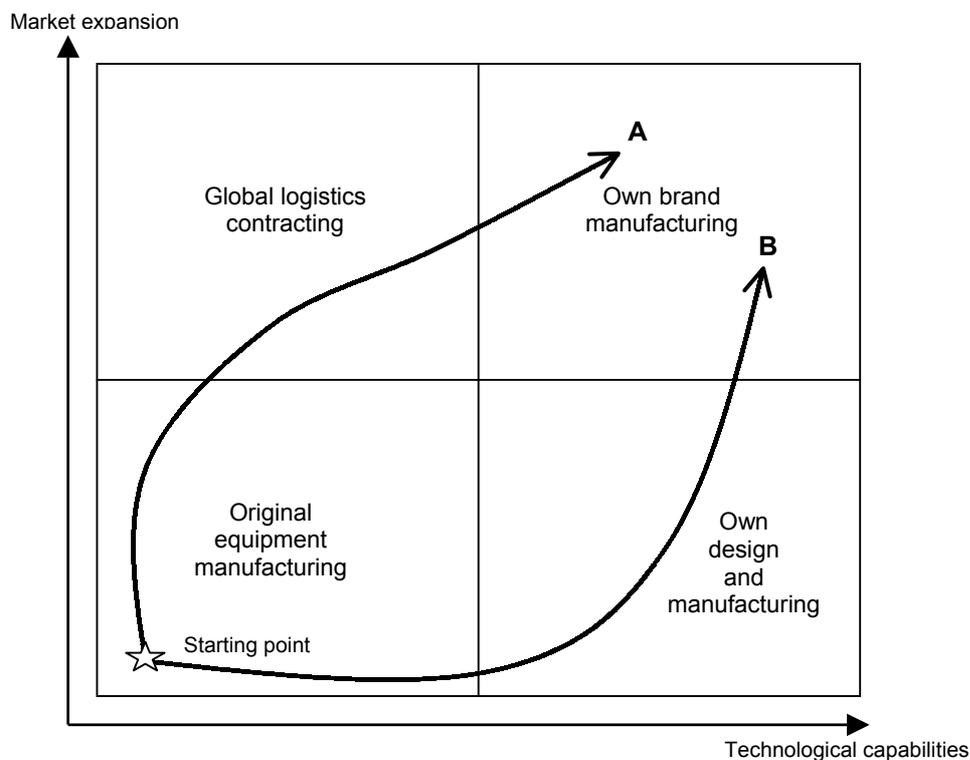
According to Mathews and Cho (2000) innovation within global value chains moves along two dimensions of leverage strategies: market expansion and technological capabilities. OBM, usually the most profitable segment of a global value chain, requires both market and

technological competencies. These two dimensions are illustrated in figure 2.3 in terms of trajectories or paths. Both paths start out from OEM supply roles. The model is based on a study of the apparel industry.

Path A represents a trajectory whereby from an initial OEM position capability enhancement revolves around mastering the complex of logistical functions required when sourcing and combining inputs from a number of different producers and locations. Implicitly assumed in this model is thus the outsourcing or relocation of actual production.

Path B, by contrast focuses on capability enhancement through expanding functional responsibilities from OEM to including some responsibilities for design, leading the firm to then market its own design under its own brand (UNIDO, 2002). Although in essence also suggesting a form of the OEM-ODM-OBM trajectory, it is presented in a less linear way, and discerns different possible paths or trajectories.

**Figure 2.3 Leverage Paths within Two Dimensions**



Source: Mathews & Cho (2000); UNIDO (2002)

*UNIDO Industrial Development Report 2002/2003*

The work of Gereffi, Hobday and Mathews & Cho has been incorporated into the UNIDO Industrial Development Report 2002/2003, along with other models dealing with enterprise innovation and learning, and the different features of these processes (UNIDO, 2002, p.98). Although impressive in bringing together and consolidation of much of the work on industrial development in LDCs under globalisation, it is essentially a summary of the mainstream discourse with some inherent weaknesses. All models suggest that local firm and industry evolution follows an almost linear path *upwards*, equating development with upgrading (and equating upgrading with a move towards OBM). For instance, although Mathews recognises a path towards global logistics management, he still sees this as ultimately leading to OBM. The problematic nature of this has already been discussed, suggesting the need to recognise a

range of development trajectories and define upgrading as just one of these. By focusing only on upgrading trajectories, too little attention is given to alternative development trajectories after incorporation, such as steady trajectories, *failure* to capitalise on insertion into the global economy, or moving out of networks tied to global lead-firms and following an independent course.

The work of both Wong (1999) and Meyer-stamer (2002) does take such trajectories in consideration and form important contributions to a more comprehensive framework.

#### *Meyer-stamer's types of product upgrading*

Criticising the general conceptualisation of upgrading in the literature, Meyer-stamer (2002) presents several types of product upgrading, the essence of which is that upgrading may take *different* directions and is not a priori about a single direction such as moving up, which is the conventional view of upgrading. There are alternative views, however, such as upgrading through 'lateral differentiation', implying the creation of a whole new segment in the market, or 'polarisation', whereby a firm simultaneously upgrades and downgrades (i.e. moves into higher markets, but also produces for lower-end markets) (Meyer-stamer, 2002, p.6-7). The confusing part of Meyer-stamer's discussion and typology is that he uses the term 'upgrading' for all trajectories, while it might be more appropriate to reserve the term for only specific trajectories. However, his work is interesting in the sense that it actually identifies alternative trajectories that do not always fit the logic of conventional 'upgrading' thinking.

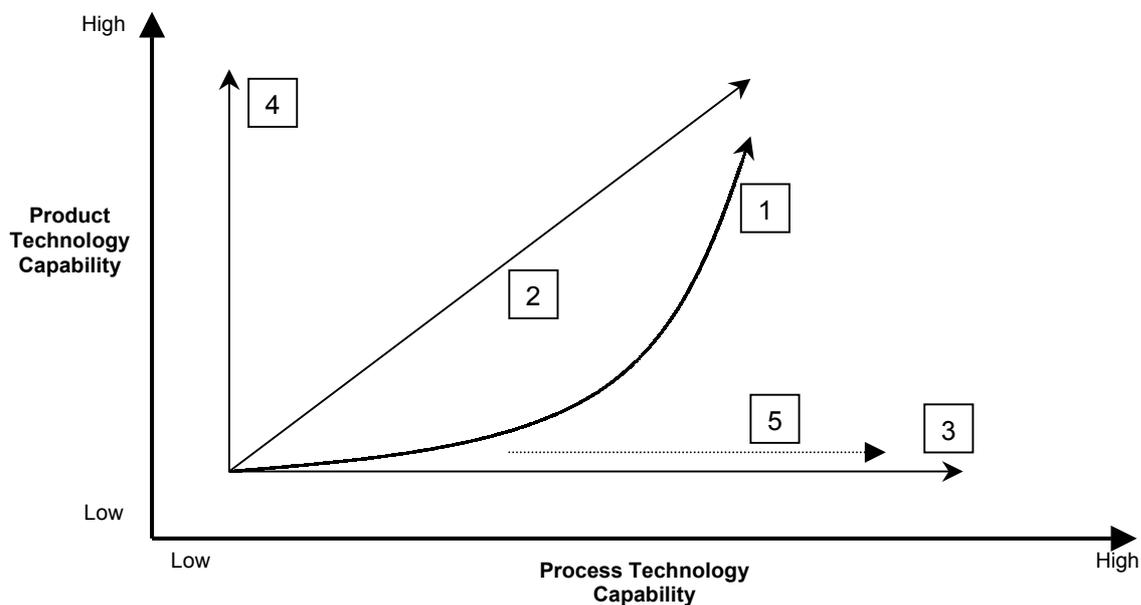
#### *Wong's generic evolutionary paths framework for rapid technological catch up by late-industrialising countries*

Wong (1999) has developed perhaps the most insightful framework for the analysis of local firm strategies and consequent development trajectories. He arrives at his model through careful consideration of the technological catch-up strategies in three Asian NIEs (South Korea, Taiwan and Singapore) while integrating several theoretical perspectives: the resource based view of the firm, the network interaction perspective on the technological learning process and the institutional economics perspective on the contexts of late industrialisation (Wong, 1999, p.1). He argues that different national innovation systems<sup>14</sup> in the three countries have produced distinctly different industrial development trajectories, as they have shaped the strategic choices of firms from these countries. He emphasises that the key to a firm's achievement of superior performance is its choice to pursue a strategy that best exploits its unique resource position. A strategic choice will take this resource position into account and focus on either of two strategic dimensions: product technological capabilities or process technological capabilities, although a choice for one often involves learning more about the other as well. He then proceeds to conceptualise the strategic focus of technological capability development as either enhancing an existing core competence or an attempt to build new core competence.

He finally identifies 5 different strategic choices and their consequent routes for technological catch-up. These are (1) the "Reverse Value Chain" route (from OEM to ODM to OIM or OBM); (2) the "Reverse Product Life-Cycle" innovation route (from late follower to fast follower); (3) the Process Capability Specialist route (dedicated manufacturing specialist in the service of product developers); (4) the Product Technology Pioneering route (product innovator in the global market) and (5) the Applications Pioneering route (innovator in the application of existing technologies in new innovative ways). Figure 2.4 illustrates these five generic routes for rapid technological catch up by latecomer firms from late industrialising countries.

The model is rather uni-dimensional in that it only illustrates technological capability development, which – as Wong indicates himself – merely represents one competing use of a firm resources versus others such as investment in marketing, distribution channels, production capacities or diversification away from the core business. However, it could be extended to include such strategic choices and consequent development trajectories. Strengths of Wong’s model are a dynamic view of firm strategies and their outcomes, recognition that a number of alternative trajectories may be identified, while stressing that these need not be smooth, but may take the form of ‘punctuated equilibria’ of consolidating particular core competencies versus significant leaps into new competencies (Wong, 1999, p.7).

**Figure 2.4 Generic Technological Capability Development Strategies of Latecomer Firms from Late Industrialising Economies**



Source: Wong (1999)

The model incorporates the models presented by Gereffi and Hobday, but presents these as just one possible trajectory.

The models presented in the previous all provide useful insights for our own framework. They draw attention to firm strategies and present dynamic pictures of firm and industry development within a network and GCC perspective. All seem to stress that both external linkages and local dynamics (purposeful strategies of local firms, national innovation systems, etc.) play an important role in the choices for strategies and the ensuing trajectories. The more elaborate ones, such as Meyer-stamer’s and Wong’s models, moreover illustrate the idea of alternative development trajectories, thus recognising implicitly the limited applicability of the concept of upgrading that is so prominent in many existing analyses.

## 2.5 Industry Development Trajectories in a GCC Perspective

A large part of the conceptualisations referred to above, claim to deal with the firm level but are implicitly - and sometimes even explicitly - extended to the industry level. Although firm level dynamics are obviously at the base of industry level changes, simply extrapolating the

firm level to the industry level provides a limited insight into the dynamics at both these levels.

In the current study a clear distinction has been made between these two organisational levels to include both explicitly in our analysis, without dismissing the obvious connections that do exist.

Industry development trajectories should be seen as a result of how the profile of an industry locally changes over time. This change essentially results from the development of *new sources of growth and diversification*, often related to new/other activities in the value chain, performed either by existing firms or (more often) by new entrants.

A range of trajectories can in principle be identified including ones that cause a change in the mix of value chain activities being performed locally and consequent changes of a location's overall role (within the specific industry's context) in regional and/or global production networks and chains. A changing mix of value chain activities performed locally is essentially a sum of development trajectories of existing firms, and the possible insertion of new entrants performing activities in different segments of the value chain. Government and other local institutions may play an important role in determining the actual direction of the local industry trajectory, both in terms of strategies of existing firms and entry of new firms (see e.g. Wong, 1999; Hobday, 1995b).

As local firms restructure their operations in response to competitive pressures, they may change the function of their organisation locally, leading to a different set of value chain activities being performed locally by these firms. This could either be because they have changed the functioning of their organisation as a whole (and thus have repositioned in the GCC), or because they have shifted lower value added activities abroad to cheaper cost locations, while still performing higher value added activities locally. Often it is a combination of both.

Local industries may also change and upgrade through the entry of new players and segments involved in different value chain activities (higher value added) (Hobday, 1995b), often encouraged, or even envisioned by local governments (Grunsven & Smakman, 2002). This effect is even more pronounced when existing producers fail to upgrade to the extent of becoming locked-in or even opt for exiting the local industry.

It has also been argued that "industrial clustering" may enhance the competitiveness of local industries through innovation diffusion (see e.g. Porter, 1990, 1998; Maskell & Malmberg, 1999; Bell & Albu, 1999; Schmitz & Nadvi, 1999). Such clustering is achieved through the development of linkages (both horizontal and vertical) and strengthened by the quantity and quality of a set of local factors, which enhance the competitiveness of the local industry. By enhancing domestic linkages between firms down- and upstream in the production chain, the advantage of industrial clustering is seen to be twofold. On the one hand the increased competitiveness of local industries resulting from it makes these firms and industries more capable of competing on a global scale (something firms individually may not be able to achieve) and more attractive to lead firms in chains. On the other hand, the advantages of connections to GCCs (access to markets, information, technology etc.) are likely to reach a larger number of firms locally, not just the (core) producers directly linked to global buyers<sup>15</sup>. Recognition of these advantages has led a number of governments in LDCs to actively promote and become involved in industrial clustering, offering support, promoting co-operation and developing and improving the linkage potential.

## Conclusion

In this chapter the main issues surrounding upgrading and the central question of the longer-term development prospects of being incorporated in networks and chains, were considered. An overview of existing literature and models revealed both useful insights and perspectives,

as well as some distinct conceptual gaps, which are mostly due to the fact that focus seems to be on specific organisational or geographical scale levels, while a comprehensive framework for analysis linking these different levels and relevant to a specific industry like the garment industry, is lacking. In addition key concepts, most notably the concept of upgrading, are rarely problematised or clearly defined.

The insights gained from the literature in this chapter, will be integrated with some of the findings from chapter 1 and additional literature, providing the basis for the conceptualisation and analytical framework of the research, with specific reference to the garment industry, to be presented in the following chapter.

## Notes

<sup>1</sup> The Institute for Development Studies (IDS) at the University of Sussex, and the Institute for Development and Peace (INEP) in Germany.

<sup>2</sup> The global commodity chain concept as elaborated by Gereffi & Korzeniewicz (1994), is in fact seen by Kaplinsky (2000) to 'suffer' from the word 'commodity' as it is argued it presents an inherent contradiction in that GCCs explicitly *do not* deal with *commodities*, which are probably the only goods still traded on markets in the traditional sense of the word and *not* through production networks and chains. However, the term global value chain gives the impression of focusing solely on the adding of value. As our study does explicitly deal with a physical product, we use the term GCC to stress this

<sup>3</sup> In more recent work, however, Gereffi argues that a third type of chain may be emerging, based on the internet as a main source and channel of information (see Gereffi, 2001)

<sup>4</sup> For a further elaboration of the different characteristics of these two types of chains, see Gereffi, 2001, p.1622

<sup>5</sup> Cramer (1999) even goes so far as to state that "GCC analysis ('reflecting intellectual roots in structuralist development economics') is especially 'fatalistic' concerning the limits of economic activity in LDCs, considering these to be determined in their entirety by 'economic structures and behaviour in OECD countries' on the one hand and the 'rigidly exploitative terms' set by multinational companies (MNCs) on the other" (op. cit., p. 1248, 1252, 1260).

<sup>6</sup> The other dimensions have been somewhat neglected and poorly conceptualised in favour of the governance structure. Thus the input-output dimension is perceived as an essentially linear process (Dicken et al, 2001) and as such remains rather descriptive (Gibbon, 2000a, Raikes et al 2000), while the geographical dimension of GCCs is dealt with at a very high level of spatial aggregation. Moreover, much of the GCC and GCC related literature seems to switch continuously between geographical as well as organisational scale levels (firm level, industry level and country level), without making a clear distinction between these very different levels of analysis. This often makes for a rather confusing analysis.

<sup>7</sup> Although these bodies of literature are all in some way connected to the current study, they aren't all explicitly incorporated into our analytical framework, due to the choice of specific focus and approach taken for this research (explained briefly in the introduction and in more detail in chapter 3).

<sup>8</sup> Gereffi (1997a) does argue that 'production and trade networks in the apparel commodity chain are becoming increasingly concentrated in Asia' and that 'a general restructuring that is leading to parallel processes of regionalization of the apparel commodity chain within Asia, North America and Europe'. These processes suggest developments of separate chains in these different regions, possibly led by regional buyers (regional commodity chains). This observation is, however, not really further explored in his subsequent work, which has tended to focus on *global* commodity chains, with the exception perhaps of his work on the Mexican garment industry. Whether this is because such regionalised chains haven't emerged (yet), or because it was a conscious choice to focus primarily on global chains is not clear.

<sup>9</sup> For a general overview of garment industry restructuring in high-wage countries see Taplin & Winterton (1997)

<sup>10</sup> In addition, while the restructuring literature analyses the outcomes of restructuring processes in terms of the changed organisation and functions of firms and industries, it doesn't evaluate outcomes in terms of a (changed) positioning of firms and industries in networks and chains as a consequence of changed organisation and functions, as a network centred analysis would.

<sup>11</sup> Besides the literature and models treated in this section, see also Ernst, Ganiatsos & Mytelka (1998) and Choung et al (2000).

<sup>12</sup> Wong (1999) argues that because of the sector specific focus of Hobday's work there is a tendency to prescribe too much commonality than exists (the OEM-ODM-OBM migration route as a common route for most Asian firms). However, as Hobday himself points out "The model (...) should not be seen as a generalizable

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model of innovation, but rather a specific model which attempts to capture the historical catching up of East Asian latecomer firms in electronics” (Hobday, 1995b, p.1186)

<sup>13</sup> Often industry development trajectories are related to technological innovations (moving from low tech to high tech), which is why the terms innovation, innovation models or innovation systems are often used (see e.g. Hobday, 1995a, 1995b; Mathews and Cho, 2000; Wong, 1999)

<sup>14</sup> A national innovation system is seen to involve a (location specific) mix of firm strategies, innovation network structure and state intervention roles (Wong, 1999, p.3)

<sup>15</sup> For a detailed overview of industrial clusters in LDCs and their incorporation into GCCs (or the interaction between local and global governance systems) see Bell & Albu (1999), Schmitz & Nadvi (1999) and Vargas (2001)

### **3 Firm Strategies and Development Trajectories in the Garment Industry: Towards a Conceptual Framework**

#### **Introduction**

The GCC (related) literature discussed, and models presented in the previous chapter provide useful insights and conceptualisations towards a conceptual framework for the analysis of local firm and industry development trajectories under globalisation. However application to the case of the garment industry requires some adaptations and fine-tuning. In the current chapter therefore some of the more specific literature on the garment industry and the experiences of the garment industry in the East Asian NIEs, will be considered. These are integrated with the theoretical and analytical perspectives and concepts discussed in the previous chapter, to form the basis for our own conceptual framework, presented in this chapter.

Section 3.1 first presents a consideration of specific characteristics of the garment value chain and how they influence the scope for strategy formulation and implementation by garment producers, while in section 3.2 the East Asian experiences - on which a rich literature and many interesting studies already exist - will be considered as antecedents for developments in other countries and regions.

Section 3.3 further elaborates on firm strategies and development trajectories, combining the insights from the previous chapters, with the considerations made in the first two sections of this chapter to arrive at a typology of firm strategies and development trajectories in garment production. Section 3.4 extends the discussion to the industry level, presenting a typology of industry development trajectories.

In sections 3.5 and 3.6 finally, a model or framework conceptualising firm and industry development trajectories in the garment industry, and a contemplation of the possible determinants of the different types of trajectories identified, are presented. The framework helps identify and characterise local firm and industry development trajectories in LDCs, taking into account (the role of actors at) different scale levels and focusing on the outcomes of firm strategies (both of producer firms and lead firms) and local government/institutional action.

#### **3.1 Competitive Adjustment Strategies in Garment Production**

Garment production has been associated with low capital intensity, high labour intensity, medium material cost and simple technology (Dicken, 1998). These characteristics complicate the meaning of concepts such as upgrading and productivity in the context of the industry. Therefore we need to evaluate competitive adjustment strategies of garment firms in LDCs against the background of these specific characteristics.

##### *3.1.1 Production Cost*

The problem with the above given description of garment production is that it is a generalised one (and as such appropriate). In reality the industry is highly diverse in terms of products and production complexity. Consequently labour intensity, cost structures and capital intensity vary considerably. Very basic garments such as round-knit t-shirts are a lot less labour intensive than children's wear or ski-wear, and garment products that are knit to shape (such as certain knit sweaters and socks) can be more easily automated than products that need to be assembled from pieces of fabric. The more pieces of fabric and accessories required for of a single item, the more labour is spent on each individual product.

“The cost structure for clothing production differs strongly per type of garment (relative complexity). For instance total cost of production of a simple t-shirt may break down into 70% fabric cost and only 10% labour cost, whereas total cost of manufacturing children’s wear may break down into 40-45% fabric cost and a much higher share of labour cost in total cost, maybe around 40% of total cost” (- *Interview with garment producer Singapore, February 1999*).

Obviously the complexity of the product - determining the amount of handling - as well as the type (hence cost) of fabrics used plays an important role in the breakdown of cost. Table 3.1 for instance, gives the break-down of production cost for a men’s satin jacket. As can be seen, the cost of material inputs for such an item is relatively high. This has implications for firm strategies. Often it is suggested that to retain competitiveness when a firm’s cost levels rise due to for instance higher wages, the firm should move into more sophisticated and complex products, as the price-point for such products are higher, thus offsetting higher cost. The irony is, that such products often involve more handling (i.e. labour), often causing productivity to drop and labour cost to increase, to the extent that it may even offset the higher price point advantage. This appears to be somewhat of a catch 22. Often, therefore, competitive adjustment strategies aimed at upgrading may involve moving to brand names and higher-end buyers, offering higher price points, but not to more sophisticated or complex products (see chapter 1).

**Table 3.1** *Example of Cost Breakdown for Men’s Satin Jacket*

| Input                               | Cost<br>(in US\$) | % of total |  |
|-------------------------------------|-------------------|------------|--|
| Fabric                              | 9.63              | 60.8       | Material inputs =<br>76.4% of total cost |
| Trims                               | 2.38              | 15.0       |  |
| Artwork (embroidery,<br>etc.)       | 0.10              | 0.6        |  |
| Labour & overhead (incl.<br>profit) | 3.75              | 23.7       | Labour = less than<br>24% of total cost  |
| Total                               | 15.85             | 100.1      |  |

*Source: Interview with garment producer, Malaysia (2000)*

Evaluating development trajectories of garment firms and how these should be judged in terms of their determinants, should thus take into account such specific characteristics. This also becomes clear if we look at the use of technology in the industry.

### 3.1.2 *Technology and Technological changes*

Technological innovations in the area of garment production have been rather limited. This is due mainly to the nature of the product. Because fabric is limp and delicate, it is difficult to automate its manufacture into garments. Consequently, rationalisation of garment assembly through increased automation has been limited (Taplin, 1996). With the exception of the simplest articles, the manufacture of garments remains a complex of related manual operations (Dicken, 1998) and the principle of one machine one worker still holds true in the assembly (i.e. sewing) stages of production. Technological changes in garment production, including those based on micro-electronics, have therefore concerned mostly pre-assembly and handling processes (Taplin & Winterton, 1997). Examples include:

- Computer aided design (including marking and grading) or CAD systems;
- Computerised- or laser-cutting;
- Computer aided manufacturing (CAM);

- Conveyor belt or hanger systems (e.g. the unit production system, UPS) for more efficient transportation of components from one production unit to the next (reducing work-in-progress);
- Attachment technologies, allowing for more efficient use of sewing machines for specific activities or products and quick change-over between different products.

Although several of these technologies, such as CAD, can be easily adopted by a wide range of different producers, others (e.g. laser cutting and hanger systems) are not so easy to adopt for certain products, or by certain producers, as they require substantial initial capital investments, are most efficient with large-scale production of relatively standardised goods, or are only suitable for certain types of fabrics and textiles. Since the industry generally consists of small and medium sized enterprises with limited access to capital, such investments are beyond the reach of most firms.

Many of the (technological) innovations that are being implemented are of a small and incremental nature and often involve changes in the organisation of the production process, to reduce handling time. These types of innovations are relatively cheap and usually achieved through industrial engineering and the upgrading or adjustment of existing machinery.

In recent years, more emphasis is placed on improvement of information and communication flow, within firms (e.g. internal management systems, warehouse management, etc.); between different actors in the chain, and between actors within and outside the chain (e.g. relevant government institutions etc.). Often this is required by buyers striving for systemic integration. It is facilitated by more general micro-electronics technology and IT developments. Improvement of information and communication flows enhances process efficiency, tracking capacity and supply chain and logistics management. The use of e-mail and the internet to communicate with buyers and suppliers, to advertise and gather information, and the introduction of management information or resource planning systems are becoming more common. One of the most advanced technology in this area is the so-called Quick Response (QR) system, linking producers directly to warehouses or even point of sales of buyers, enabling the latter to re-stock rapidly. This system, however, is only viable for large (scale) producers working with large retailers (e.g. the TAP group, a Hong Kong based global garment producer with JC Penney, a large US department store), or within vertically integrated companies (e.g. Benetton).

Another characteristic of the garment value chain is the sharp divide between design, marketing and retailing on the one hand and production on the other hand. These two seem to overlap only in the process of distribution and (global) production organisation. Put differently, design capabilities are not, or hardly embodied in equipment or technology (UNIDO, 2002). Because the technology used in the garment production process is relatively simple, the learning requirements for these technologies aren't very high and the breadth of skills and knowledge involved is also not very extensive. On the other hand design and branding involve not so much technological innovation in terms of the production process, as they do marketing skills and the capacity to predict and create trends and styles, be innovative with the use of new materials and accessories, etc. Many of the leading retailers, branded marketers and designers were never involved in production and did not develop their capabilities from production (as is the case in many, more technologically intensive, industries). The shift from production to (internationally competitive) design, marketing and retailing is thus not a logical step as in some other industries and it is difficult and risky.

Overall, the characteristics referred to in the above, have meant some of the most commonly implemented competitive adjustment strategies by garment producers are in the area of the

production process. They are aimed at reducing production cost, speeding up the process and reducing handling time/cutting the need for labour.

### 3.1.3 Typology of competitive adjustment strategies in garment production

Related to the specific characteristics of the garment industry and based on literature dealing with restructuring and adjustment strategies as a response to factors impinging on the (initial) comparative and competitive advantages of firms, table 3.2 gives an overview of the most important, and typical competitive adjustment strategies found in the context of garment production.

**Table 3.2 Typical Competitive Adjustment Strategies in Garment Production<sup>1</sup>**

| Focus of strategy              | Examples   | Aim/Possible outcomes  |
|--------------------------------|--|--|
| <b>Labour</b>                  | <ul style="list-style-type: none"> <li>- incentives to increase productivity</li> <li>- overtime</li> <li>- part-time workers</li> <li>- use of foreign workers, illegal workers, cheaper sources of labour (e.g. women)</li> <li>- develop skills workers</li> </ul>                    | <ul style="list-style-type: none"> <li>➤ Reduce cost</li> <li>➤ Increase productivity</li> <li>➤ Speed up process/meet delivery times</li> <li>➤ Solve labour shortages</li> <li>➤ Produce more complex products</li> </ul>  |
| <b>Location</b>                | <ul style="list-style-type: none"> <li>- relocate (lower-end) production to cheaper cost location through FDI or subcontracting</li> <li>- set up certain departments in different locations (e.g. merchandising/sales &amp; marketing department closer to suppliers/buyers)</li> </ul> | <ul style="list-style-type: none"> <li>➤ Lower production cost</li> <li>➤ Circumvent quota barriers</li> <li>➤ Reduce lead times</li> <li>➤ Increase services to buyer</li> </ul>  |
| <b>Outsourcing</b>             | <ul style="list-style-type: none"> <li>- capacity subcontracting</li> <li>- specialisation subcontracting</li> </ul>   | <ul style="list-style-type: none"> <li>➤ Reduce cost</li> <li>➤ Increase flexibility</li> </ul>  |
| <b>Production organisation</b> | <ul style="list-style-type: none"> <li>- Industrial engineering</li> <li>- supply chain management</li> </ul>  | <ul style="list-style-type: none"> <li>➤ Increase productivity/efficiency</li> <li>➤ Speed up process/reduce lead times</li> <li>➤ Improve quality</li> </ul>  |
| <b>Technology</b>              | <ul style="list-style-type: none"> <li>- Introduction of more advanced and/or labour saving technologies</li> <li>- Introduction of information and communication technologies (management information systems, IT, ERP systems, etc.)</li> </ul>  | <ul style="list-style-type: none"> <li>➤ Increase productivity/efficiency</li> <li>➤ Improve quality</li> <li>➤ Cut labour (cost)</li> <li>➤ Improve monitoring/tracking capacity</li> <li>➤ Improve speed of communication with suppliers/buyers, reducing lead times and improving services</li> </ul> |
| <b>Product</b>                 | <ul style="list-style-type: none"> <li>- improve product quality/produce more sophisticated products</li> <li>- increase product range</li> <li>- branding</li> <li>- move to more standardised (less labour intensive) products</li> </ul>  | <ul style="list-style-type: none"> <li>➤ Increase price-point for products</li> <li>➤ Increase services to buyers</li> <li>➤ Increase margins</li> <li>➤ Reduce dependence</li> <li>➤ Reduce labour cost/labour dependence</li> </ul>  |
| <b>Markets/ Clients</b>        | <ul style="list-style-type: none"> <li>- diversify into new geographical markets</li> <li>- diversify into new market segments</li> <li>- change client base (move to higher value added clients/buyers)</li> </ul>  | <ul style="list-style-type: none"> <li>➤ Increase market</li> <li>➤ Avoid quota</li> <li>➤ Increase margins</li> <li>➤ Decrease competition</li> </ul>   |
| <b>Function</b>                | <ul style="list-style-type: none"> <li>- move within production, e.g. from CMT to OEM or OEM to ODM/OIM/OBM</li> <li>- diversify or integrate down or upstream in the value chain (possibly move out of</li> </ul>   | <ul style="list-style-type: none"> <li>➤ Improve services to buyers</li> <li>➤ Improve chain position/reduce dependency</li> <li>➤ Increase margins</li> </ul>   |

*Sources: Clark & Kim (1995); Taplin (1996); Taplin & Winterton (1997); Dicken (1998); Dicken & Hassler (1999); Gibbon (2000b); Gunsven & Smakman (2001)*

The table gives an idea of the commonly applied strategies and the aim with which they are implemented. Which (combinations of) strategies will be implemented by a specific firm, depends on a number of determinants internal and external to the firm. We will discuss these in more detail in the last part of this chapter.

Strategies often overlap and they usually have several outcomes, some of which may have been unintended. Thus a strategy aimed at improving supply chain management may involve investments in information and communication technologies, branding may be part of a functional strategy, and a technology strategy aimed at cutting labour (cost) may also have the effect of improving the quality of products/processes.

Some of the strategies are obviously of a highly exploitative nature. Especially labour strategies such as having workers work overtime, 'importing' foreign workers or using illegal workers and cheaper sources of labour, subcontracting and use of homeworkers are in fact the kind of strategies that have given the garment industry its dubious reputation. In some cases they are the initial responses and adjustment strategies firms turn to, and may eventually be replaced by more constructive strategies aimed at improving quality, positioning in the chain and upgrading jobs in the local industry. When the switch from defensive/low road strategies to offensive/high road strategies is not made, this may eventually lead to immiserisation.

Most of the strategies listed in the table have been implemented by firms in the East Asian NIEs, albeit in different degrees, combinations and phases. These firm level strategies as well the insertion of new segments into the industry locally, have consequently led to distinctly different industry development paths in each of these countries.

### **3.2 The East Asian Antecedents<sup>2</sup>**

Japan and the East Asian NIEs, played an important role in the onset of the globalisation of the garment industry. With US- and Europe-based buyers as drivers of the internationalisation of the commodity chain, contract manufacturing of garments fuelled their export drive from the 1970s onwards (Bonacich et al. 1994, Dicken 1998).

As was already explained in chapter one, despite the recent decline of the East Asian NIEs share in world garment trade, their role in the GACC remains significant, although no longer in terms of production output and direct exports. Although firm closures and diversification into other activities have occurred, competitive pressures haven't implied an *en masse* exit of NIE firms from the industry, as these have managed to continuously adjust and redefine their roles in the GACC, through successful competitive adjustment strategies (Simon, 1995; Taplin & Winterton, 1997). Some have developed into higher end or specialised activities, whereas others have developed intricate regional production networks and moved to a co-ordinating role (Lau & Chan, 1994). In many cases these types of strategies have been applied simultaneously. At the industry level upgrading and repositioning has been achieved through insertion and development of new segments and activities, often not directly related to garment production.

Thus, as the comparative advantages of the East Asian NIEs changed, production in these locations has dwindled. Despite this decline in production, however, the industry has shown remarkable resilience, as new activities, changing the profile of the industry, have developed. For instance regional trading and sourcing hub, (Hong Kong) brought about by both upgrading and outsourcing of existing producers, *and* infusion of new higher-end segments;

fashion, design and own brands development (Hong Kong) marketed not just regionally, but even internationally (e.g. Giordano and Hang Ten).

Another option, has been development as a high-end supplier of both material inputs and machinery. This route was followed by Japan, which is currently one of the main suppliers of machinery (especially sewing machines) to the rest of the region and even the world.

Yet another route has been specialisation in flexible production, through networks of small-scale producers and suppliers, enhanced by the development of a strong local supply industry (specialised fabrics and accessories) and extension of networks overseas (Taiwan) (Gereffi & Pan, 1994).

As to the relationship between GCCs and local industry development, the East Asian NIE experiences paint a rather positive picture. The garment companies in these countries were able to learn from their buyers and subsequently develop competencies in the areas of design, specialised inputs and logistics. Key to their success was the relationships they managed to forge with their buyers, so that long after they lost their comparative cost advantage, they still managed to remain connected to GCCs and more importantly had managed to secure more advanced positions within the chain (co-ordinating roles, specialised roles, design roles) with higher barriers to entry and the possibility for generating rents.

It is no coincidence that most of Gereffi's work on GCCs and the GACC – which also paints a rather positive picture as to the possibilities for industrial upgrading after incorporation into GCCs – is based on the examples of the East Asian NIEs.

This of course raises questions as to whether these positive experiences are emulated in other countries/regions that have become incorporated into the GACC.

### **3.3 Typology of Firm Strategies and Development Trajectories in the GACC**

By combining the insights from the trajectory models presented in the previous chapter, the specific characteristics of the garment industry, the implications for competitive adjustment strategies in the industry, as well as the East Asian antecedents, a typology of firm strategies and development trajectories was developed. This typology is presented in tables 3.3a - 3.3c and forms an integral part of the conceptual framework.

The type of strategies a firm will implement depend on the general aim a company may have for its business (getting out of the industry, just staying in business and trying to evade major changes, keeping up with the general trends and direct competitors, or moving ahead of competitors), and the way it responds to imperatives impinging on its competitiveness. Subsequently a firm will align the competitive advantage it wants to focus on (cost or capabilities/competencies) with the core competency it has identified and wishes to develop (e.g. process, product or functional capabilities) (Wong, 1999; Fleury & Fleury, 2001) to come to a choice for specific strategies.

Table 3.3a depicts the strategic options available to garment firms given their focus on either retention or pro-active strategies.

It must be noted that not all firms will have a clear idea of their core competencies, or a clearly defined corporate strategy. Firm strategies should therefore be seen as lying on a continuum between on the one extreme without specific focus or identification of core competencies and on the other extreme based on a clear understanding of a firm's core competencies and a perfect alignment of the two. Especially those firms that just aim to stay in the business and keep doing what they have always done, are unlikely to have identified core competencies and chosen a strategic focus for their company. In addition there may be a group of companies who lets their strategies be completely guided by their customers (a situation likely to be found in production sharing or subcontracting arrangements). Finally, while some strategies may stem from a particular strategic focus (i.e. planned strategies),

others may be implemented as an ad-hoc response to (sudden) changes in the firms competitive environment (i.e. emergent strategies).

**Table 3.3a** *Typology of Strategies of Garment Producers in the GACC*

| Producer strategy (as response to imperatives and guided by determinants) <sup>1</sup>  | Strategic options  | Effect(s) of strategies (firm level)  | Determinants (see section 3.6)   |
|---|--|---|--|
| <b><u>1) Surrender response/exit strategies</u></b>   | <p><b>Cost Focus</b></p> <ul style="list-style-type: none"> <li>• move into other industry/sector (e.g. real estate, property development, trading)</li> <li>• closure of business locally (incl. complete relocation of investments of foreign companies)</li> <li>• abandon production</li> <li>• operate outside the chain (stop working for international buyer but produce brand for local market)</li> </ul>   | <ul style="list-style-type: none"> <li>✓ No more garment production in this location</li> <li>✓ Shift to other parts of/activities in the value chain (trading, wholesaling), but not increased control or power in the GACC</li> <li>✓ Disconnection from GACC</li> </ul>  | <p><u>External factors</u></p> <ul style="list-style-type: none"> <li>➤ Chain type &amp; market segment</li> <li>➤ International business environment including buyer requirements and strategies, international regulatory framework, etc.</li> <li>➤ National business environment including national institutional context &amp; business system</li> </ul> |
| <b><u>2) Defensive/retention strategies</u></b>   | <ul style="list-style-type: none"> <li>• labour strategies</li> <li>• subcontracting</li> <li>• relocation of production (FDI/subcontracting)</li> </ul>   | <ul style="list-style-type: none"> <li>✓ Change in core activities of local establishment (less labour intensive/costly)</li> <li>✓ Saving labour cost</li> <li>✓ Solving labour shortage and/or turnover</li> <li>✓ Lowering or maintaining overall cost</li> <li>✓ Increased flexibility</li> <li>✓ Better market access (quota)</li> <li>✓ Changed function of local establishment (management &amp; control, HQ-function etc.)</li> </ul>   |  |
| <p><b><u>3) Offensive/pro-active strategies</u></b></p> <p><b>a. within production (OEM/ODM/OIM)</b></p> <p><b>b. beyond production (OBM/marketing/retailing)</b></p> | <p><b>Capability development focus</b></p> <ul style="list-style-type: none"> <li>• human resource development</li> <li>• technological upgrading</li> </ul> <p><i>Process technology capability (operational excellence)</i></p> <ul style="list-style-type: none"> <li>• process specialist strategy</li> <li>• application pioneering strategy</li> </ul> <p><i>Product technology capability (product innovation)</i></p> <ul style="list-style-type: none"> <li>• diversification (within apparel) of products and markets</li> <li>• development of design capabilities</li> <li>• own brand development</li> </ul> <p><i>Functional capabilities</i></p> <ul style="list-style-type: none"> <li>• integration/diversification into other parts of chain (e.g. textiles)</li> <li>• development/marketing of own brand(s)</li> <li>• diversification into marketing/retailing (own brand)</li> </ul> | <ul style="list-style-type: none"> <li>✓ Increased efficiency, productivity and/or flexibility</li> <li>✓ Increased skill content of products and processes</li> <li>✓ Better market access (non-quota items)</li> <li>✓ Increased quality/reliability/speed of production &amp; delivery (increased services to buyers)</li> <li>✓ Increasing value of products (higher price-points)</li> <li>✓ production for higher-end, more sophisticated market segments</li> <li>✓ higher value added activities/less dependent positions in the chain</li> <li>✓ increased command and control over own production and distribution</li> </ul> | <p><u>Internal factors</u></p> <ul style="list-style-type: none"> <li>➤ Management's strategic vision/ strategic intent</li> <li>➤ Size</li> <li>➤ History</li> </ul> <p><u>(Enabling factors)</u></p> <ul style="list-style-type: none"> <li>➤ Technological developments/innovations</li> <li>➤ Market trends</li> <li>➤ Trade agreements</li> </ul>         |

<sup>1</sup> NB. Any categorisation of strategies is by default arbitrary and debatable, as both aims and outcomes of the strategies may be multiple and overlapping. For instance new technologies (technological upgrading) may simultaneously have the effect of reducing the need for labour and saving cost *and* enhancing product and process capabilities, as part of an overall upgrading effort. In addition relocation may be part of an offensive strategy aimed at changing functional capabilities.

As becomes clear from the second column in table 3.3a, surrender and retention strategies tend to have a cost focus, whereas offensive strategies focus more on the development of (new) capabilities and competencies.

Obviously the latter are the strategies a firm looking to move ahead and reposition in the chain must opt for, however, in most cases even the most pro-active firms will probably also apply some retention strategies, such as subcontracting and relocation<sup>3</sup>.

In the third column an idea is given of the effects the different strategies may have. These may have been intended, although in many cases more than one effect will result from a particular strategy, and not all may have been anticipated at the moment of implementation.

The determinants of choices for particular firm strategies and hence trajectories are listed in the last column. We will elaborate on these in more detail below. These determinants are not the same as the imperatives that may force firms to respond, rather they play a role in the kind of strategies a firm will choose for as a response.

The outcomes of firm competitive adjustment strategies in terms of the capabilities, functions and competitive positioning in networks and chains may be mapped over time as firm development trajectories. A typology is presented in table 3.3b.

Within the identified so-called generic development trajectories (table 3.3b, column 1) it is possible to identify specific trajectories, as shown in column 2. At the base of each trajectory are usually a number of different combinations of strategies. Generally speaking at the base of upgrading trajectories are mostly (though not exclusively) pro-active strategies aimed at moving ahead, creating a niche and developing a unique competitive advantage. These specific trajectories are just examples and other trajectories are imaginable. The last column finally gives an assessment of what the different type of trajectories may imply for a firm's position within the global production network(s) and chain(s) in which it operates.

A few notes should be added to this table, as it may appear to present a rather linear and one-sided approach to firm level development within a GCC perspective.

First firms may actually downgrade. There are indeed examples - as found in the Mauritian garment industry by Gibbon (2000b) and in the Brenta footwear cluster (Italy) by Rabellotti (2001) - of companies that actively pursued ODM/OBM roles, only to abandon these in a later stage in favour of returning to a more dependent position again. The companies found they couldn't compete in the ODM/OBM segment and thus opted for returning to an OEM role. In addition there companies going back from OEM positions to becoming subcontractors or simultaneously applying both upgrading and downgrading strategies for different markets (e.g. ODM for local markets and OEM for export markets). This is for instance what Meyer-stamer, Maggi & Seibel (2001) found in the ceramic tile industry.

These examples just serve to illustrate that the development trajectories followed by firms may not always be smooth or moving up.

Second there are several 'ambiguous' positions and development trajectories identifiable as well. Consider for instance the firm that moves from production and marketing of its own brand in local markets to OEM supply to an overseas buyer (i.e. becomes incorporated in a global chain). Gereffi (1999) considers this to be upgrading in the sense of organisational succession<sup>4</sup>. However, if independence (and the power to exercise governance) is a measure to go by, such a development could be seen as downgrading, especially since it may well be that profit *margins* are actually higher for own brand production and sales in the local market. Often production for export offers greater profitability in terms of total profits (due to scale) but does not do much for profit margins.

**Table 3.3b** *Typology of Development Trajectories of Garment Firms in the GACC*

| Generic Trajectories                     | Examples of Specific Trajectories   | Positioning in the GACC   |
|--|---|---|
| <b>Exit trajectory</b>                   | <ul style="list-style-type: none"> <li>➤ Going out of business (locally)</li> <li>➤ <b>Extra-chain trajectory</b></li> </ul>  | <b>N.A. (position outside of chain)</b>   |
| <b>Partial exit trajectory</b>           | <ul style="list-style-type: none"> <li>➤ <b>Production to wholesaling/trading</b> → Redefining main functions</li> <li>➤ <b>Diversification trajectory</b> → extending business into other sectors (e.g. real estate), gradually decreasing importance of garment production</li> </ul>   | <b>Alternative positioning/side-stepping</b>  |
| <b>Reactionary adjustment trajectory</b> | <ul style="list-style-type: none"> <li>➤ <b>Exploitation trajectory</b> → Drawing on illegal workers, overtime work, underage workers, homeworkers, etc. to retain/cut cost</li> <li>➤ <b>Diversification trajectory</b> → extending business into other sectors (e.g. real estate), without decreasing importance of garment production (making up for decreased profitability of garment production with profits in other sector)</li> <li>➤ <b>Retention trajectory</b> → Retaining core activities and functions by adjusting production and production organisation to changing circumstances (e.g. importing foreign workers, (overseas) subcontracting, part time and temporary workers, etc.) but not changing basis of competitive advantage (i.e. still try to compete on low cost comparative advantage, no fundamental changes to products or processes)</li> </ul> | <b>Retain positioning</b><br><i>Unsustainable</i> in long run, firm will either have to (partially) exit industry or revert to (adjustment) upgrading trajectory  |
| <b>Adjustment upgrading trajectories</b> | <ul style="list-style-type: none"> <li>➤ <b>CMT to OEM</b> → Moving from function as subcontractor or CMT producer to becoming full package producer (OEM)</li> <li>➤ <b>OEM trajectory</b> → Specialisation as a full-package producer taking on increasing responsibilities in terms of design and distribution within the chain. Possibly moving to higher value-added buyers (e.g. branded buyers), but essentially retaining role as OEM supplier involved primarily in production and production organisation.</li> <li>➤ <b>OEM+ / Operational excellence and internationalisation trajectory</b> → Becoming core/main producer to large retailer (responsible for large portion of its products); world-wide production and advanced communication and co-ordination system with buyer (e.g. QR system); world class manufacturing, lean production, etc.</li> </ul>    | <b>Absolute repositioning</b> within production networks and chains (producing better and faster than before and meeting increased buyer requirements). Risk of OEM lock-in in longer run, competitiveness based on operational effectiveness |
| <b>Upgrading trajectories</b>            | <ul style="list-style-type: none"> <li>➤ <b>Specialised agent trajectory</b> → client intimacy, development of specific (global) solutions and marketing services to clients</li> <li>➤ <b>Product innovation trajectory</b> (mostly through fabric or accessorising)</li> <li>➤ <b>OBM trajectory</b> → Become independent from buyers, develop, design &amp; produce own brand</li> <li>➤ <b>Marketing trajectory</b> → Besides developing own brand, also take care of marketing and distribution of this brand, possibly even function as buyer in own right and moving away from production altogether (eventually become branded marketer)</li> </ul>   | <b>Relative repositioning</b> within the commodity chain, improved positioning vis-à-vis competitors & buyers, competitive advantage based on uniqueness  |

Source: Grunsven & Smakman (2001)

Third, OBM trajectories are often hard to define, as OBM in itself is a somewhat ambivalent concept. East Asian experiences illustrate that there are examples of OEM producers, who also carry their own brand(s). However, it is hard to label these firms as OBM suppliers if (1) their own brands aren't exactly based on truly 'original designs' but rather basic designs, which are easily copied and for which no sophisticated design capabilities are required; (2) they are marketed through regional or international wholesalers or local/regional department stores in the low- to medium-end segments of the market; and (3) they don't form the main focus of the company, but are part of a diversification strategy to spread risk. Especially if the firm has no intention of abandoning OEM production in favour of own brand production, it may be more apt to speak of 'own label' manufacturing, as part of a product/market diversification strategy.

Finally, as Wong (1999) suggests "the sequencing of strategic emphasis (of a firm) may change over time, i.e. focus of technological capability development may shift from one strategic dimension to another over time (e.g. from process capabilities to product capabilities, or vice versa)" (Wong, 1999, p.7)<sup>5</sup>. Thus firm development may not always follow a smooth trajectory, but firms may 'switch' over time. It is also imaginable that firms following a retention trajectory may reach a certain point/threshold at which such a trajectory is no longer sustainable and the firm is forced to either re-focus on more offensive strategies or exit the industry. Likewise, development trajectories need not all have the same 'starting point'. There are indeed examples of firms starting out as OBM producers, without gaining expertise as OEM producers first. Starting out in local markets, they may eventually expand into local and even international markets.

**Table 3.3c Outcomes of Firm Development Trajectories from a GACC Perspective**

| Business Approach/Aim | Strategies<br>(table 3.3a) | Development<br>Trajectory (table<br>3.3b) | OUTCOMES |
|-----------------------|----------------------------|---|----------|
|-----------------------|----------------------------|---|----------|

|   |  |   |  |
|---|--|---|--|
| <b>Exit</b><br>Give in to competitive pressures and close shop or voluntarily exit the chain  | (Partial) Exit strategy  | Exit trajectory<br>Extra-chain trajectory             | <b>Disconnection from GACC</b>   |
| <b>Evasion</b><br>Recreate initial advantages and conditions; adjustments, but only to avoid actual or more pro-found change in operations  | Retention/defensive strategies                                     | Reactionary/<br>exploitative<br>adjustment trajectory | <b>Immiserisation; loss of competitiveness, lock-in &amp; exclusion</b>  |
| <b>Keeping up</b><br>Improvement of a firm's capabilities and competencies and reduction of cost to meet requirements imposed by external pressures/factors (strategies based on standardised procedures defined elsewhere) | Retention/defensive as well as some proactive/offensive strategies | Adjustment upgrading trajectory                       | <b>Operational effectiveness; running to stand still; increasing skills content; keeping up, retaining competitiveness, risk of lock-in and possibly exclusion in long run</b> |
| <b>Moving ahead</b><br>Improvement of a firm's capabilities and competencies to increase competitive strength and improve positioning within networks and chains  | Pro-active/offensive strategies                                    | Upgrading trajectory                                  | <b>Improved competitive positioning; moving into market niches with entry barriers; strategic intent; repositioning, enhancing competitiveness</b>                             |

Table 3.3c finally gives a summary of the previous two tables, with types of strategies and generic development trajectories at the firm level. It adds the general business approach or aim of firms (column 1), which further influences their strategic choices, on one end, and the final outcomes from a GACC perspective - i.e. what the development trajectories imply for a firm's positioning within the chain - on the other end.

All in all the development trajectories individual firms may follow are manifold and possibly complex. Mapping and understanding them requires taking an in-depth look at the strategies firms apply and the imperatives and determinants behind them.

### 3.4 Local Industry Development Trajectories from a GACC Perspective: Changes in the Profile of the Local Garment Industry

As noted earlier, industry development trajectories pertain to the profile of an industry locally over time, which may take the form of a changing mix of value chain activities performed locally. Trajectories are established through both strategies and development trajectories of existing firms, and the value chain activities of new entrants. Both are clearly observable in the cases of the East Asian NIEs. Government and other local institutions have proven to be important factors in determining the actual direction of local industry trajectories, both in terms of existing firms and new entrants in these countries (see e.g. Wong, 1999).

At the industry level, several generic development trajectories can be distinguished, ranging from demise to steady and reconstitution trajectories (see table 3.4). In addition it is possible an industry 'moves' upstream, by focusing on specialised input supplies. This is for instance the trajectory the Japanese and Taiwanese garment industries seem to have followed.

**Table 3.4 Typology of Local Industry Development Trajectories in the GACC**

| Industry Development Trajectories   | Factors contributing to changing profile of the industry  |
|---|---|
| <b>A. Sunset trajectory (industry demise)</b>   | <ul style="list-style-type: none"> <li>• Firm closures and relocations without replacement by new/other segments</li> <li>• Reactionary adjustment trajectories of local firms (immiserisation)</li> </ul>  |
| <b>B. Upstream trajectory</b>   | <ul style="list-style-type: none"> <li>• Garment production moving out</li> <li>• Development of (specialised) textile/fabric industry and/or other (specialised) material inputs</li> <li>• Development of specialised (specific for garment production) machine tools industry (technology development)</li> </ul>  |
| <b>C. Steady trajectory</b>   | <ul style="list-style-type: none"> <li>• Garment production retained through restructuring and competitive adjustment of existing firms; OEM firm trajectories; operational effectiveness. Unsustainable in long run; industry will have to either reconstitute through new entrants/upgrading of existing producers, or eventually face demise.</li> </ul>   |
| <b>D. Reconstitution trajectory:</b><br>From production location to regional co-ordination & control/ trading & sourcing centre           | <ul style="list-style-type: none"> <li>• Location of regional buying/sourcing offices &amp; agents (international/local)</li> <li>• Location of marketing/sales offices of regional producers (sellers)</li> <li>• Location of core producers, co-ordinating regional production networks (HQ functions, R&amp;D etc.)</li> <li>• Advanced physical and information infrastructure</li> <li>• Well developed regional sourcing base</li> <li>• Location of input suppliers or their representative offices</li> <li>• Location of supporting and complementary (services) industries</li> </ul> |
| <b>E. Reconstitution trajectory:</b><br>From production on OEM basis to OBM/ fashion & design centre (possibly regionalisation of GACC?!) | <ul style="list-style-type: none"> <li>• Development of local fashion industry/OBM based industry               <ol style="list-style-type: none"> <li>a) development of existing producers into OBM producers</li> <li>b) establishment of new companies in this segment</li> </ol> </li> <li>• Location of (international) design and fashion houses</li> <li>• Location of fashion and design schools</li> <li>• Location of supporting and complementary industries</li> <li>• Critical and creative attitude</li> </ul>  |

Source: Grunsven & Smakman (2001)

Reconstitution trajectories imply a changing profile of the industry in terms of the mix of value chain activities, moving towards higher value-added activities locally as a consequence of both firm level upgrading, new entrants operating in higher value added parts of the chain. Such trajectories imply a repositioning of the industry as a whole and thus a changing role of the location within the GACC.

A steady trajectory at the industry level may involve a changing profile of the industry locally as well, but without fundamentally changing the mix of value chains activities i.e. the functions or positioning of the industry in a global context. This would be the case if existing producers, as well as new entrants were all following a basic OEM trajectory.

An industry demise trajectory is closely tied to reactionary adjustment of existing firms or what Kaplinsky refers to as 'a race to the bottom' (Kaplinsky, 2000, p.32). It implies the industry in time succumbs to competitive pressures.

Although it would be hard to denote clustering as a trajectory perse, it is interesting to see that in East Asia a regional cluster is developing, with inputs (fabrics, machinery, accessories) from Taiwan and Japan, manufacturing in China, trading in Hong Kong and Japan as a final market and a fashion and design centre. For the region as a whole this implies a development trajectory towards a less dependent and more regionally oriented commodity chain, or what Gereffi has referred to as regionalisation of the GACC (Gereffi, 1996)

### **3.5 The Conceptual Framework: Local Firm Strategies and Firm and Industry Development Trajectories in the GACC**

Based on the foregoing, local firm and industry development for garments within GCCs has been conceptualised in two related frameworks for analysis.

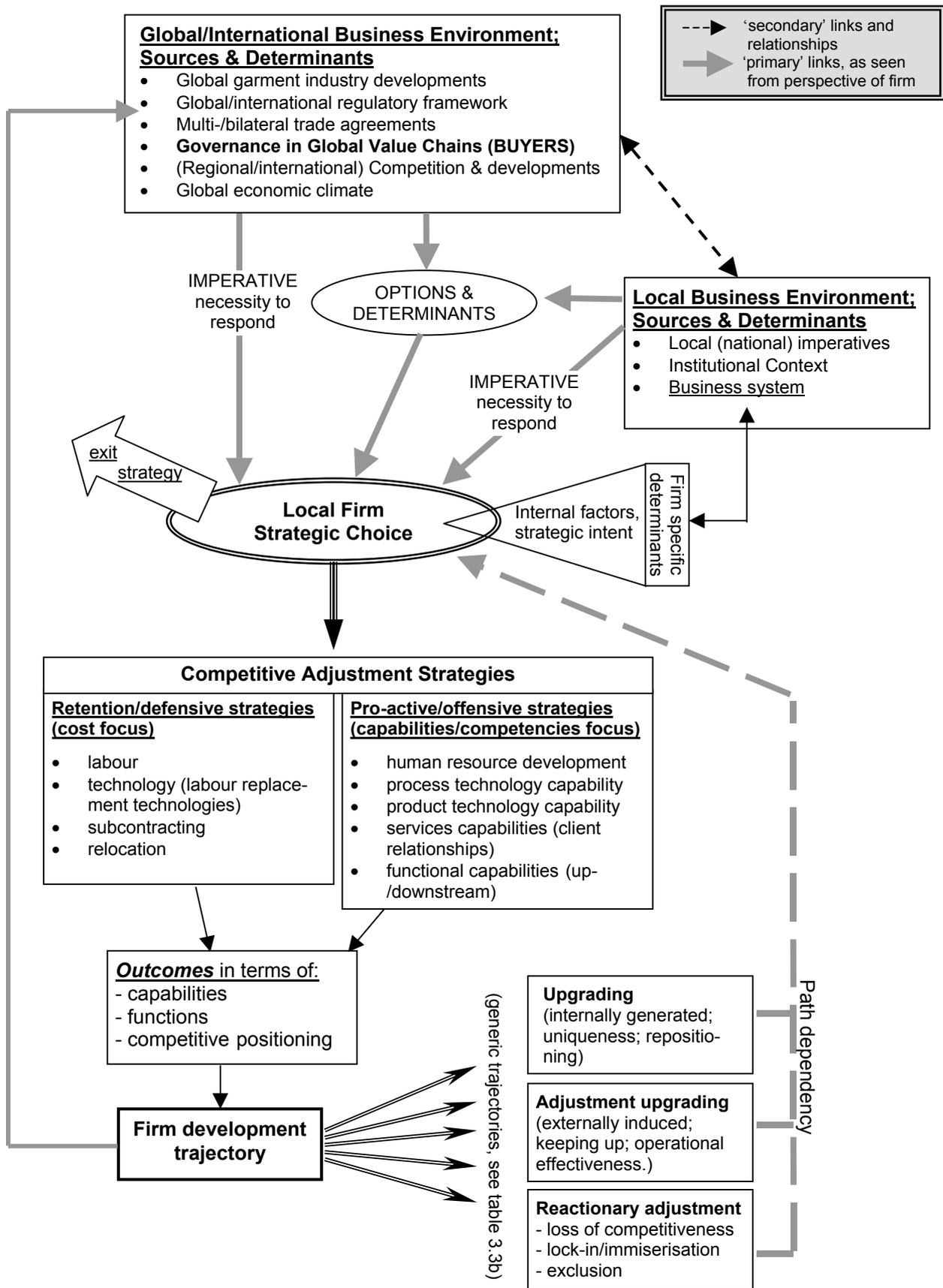
The first framework, presented in figure 3.1, conceptualises local firm strategies and development trajectories and the main determinants of these strategies and trajectories.

It is centred on firm competitive strategies, which form the focus (and starting point) for the conceptualisation of the research as elaborated in the following chapters.

The upper section of the figure illustrates the firm environment at multiple scale levels, containing the sources and determinants of firm competitive adjustment strategies. The sources, both in the form of imperatives as well as options/opportunities for specific (types of) strategies, have been discussed in the previous chapter. In the next section we will discuss determinants in the case of the garment industry in more detail.

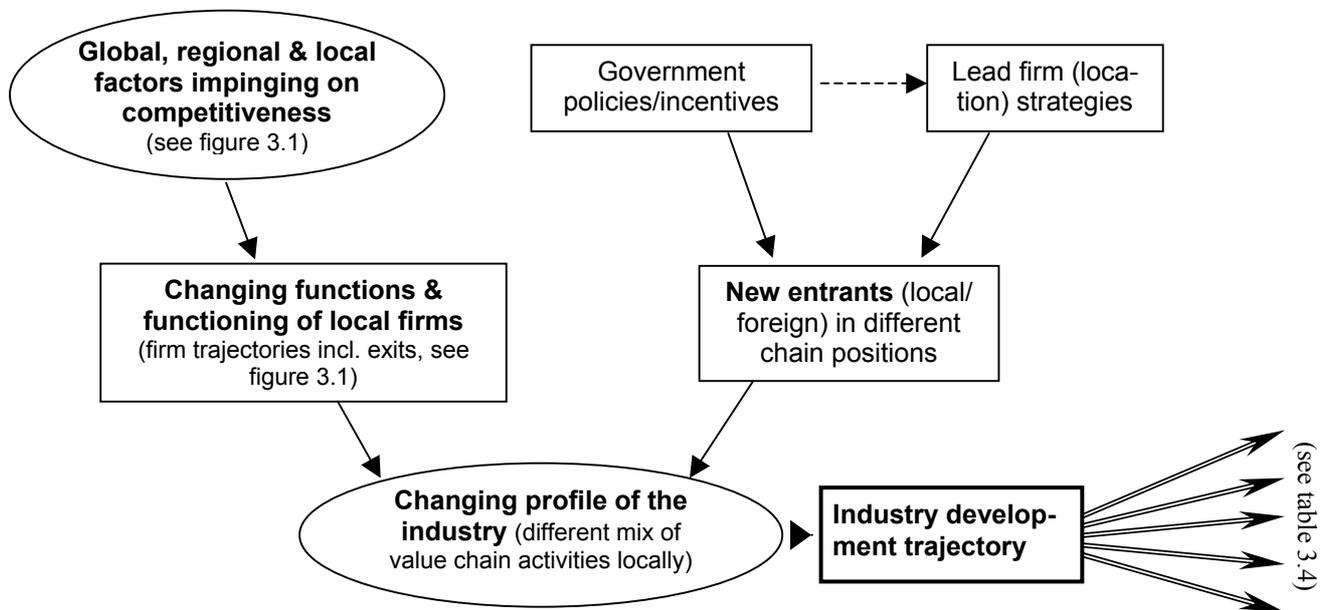
The lower part of the figure depicts the strategies firms may implement and the outcomes of these strategies in terms of capabilities, functions and positioning within chains and ultimately in terms of development trajectories. This lower part essentially incorporates the typologies of firm strategies and development trajectories presented in tables 3.3a through 3.3c

Figure 3.1 Conceptual Framework I: Local Firm Strategies and Development Trajectories



Extending the framework to the industry level, figure 3.2 presents a framework for the conceptualisation of industry level development trajectories and incorporates table 3.4.

**Figure 3.2 Conceptual Framework II: Changing Profile of Local Industry and Industry Development Trajectories**



### 3.6 Sources and Determinants of Firm and Industry Development Trajectories

Merely describing possible strategies and trajectories gives little in-depth understanding of the dynamics or causalities behind them. It is therefore important to look at the sources and determinants behind them. Under which circumstances, under which pressures and through which kinds of encouragement will firms and locations engage in certain strategies and embark on certain types of trajectories? Only by looking closer at these forces is it possible to understand how local firms and communities can gain from globalisation or why they don't.

In this section we will take a closer look at some of the determinants at both the firm and industry levels of the strategies and trajectories identified earlier. This discussion is not exhaustive, but attempts to give some conceptualisation of possible causalities, which will then be further explored in the empirical chapters.

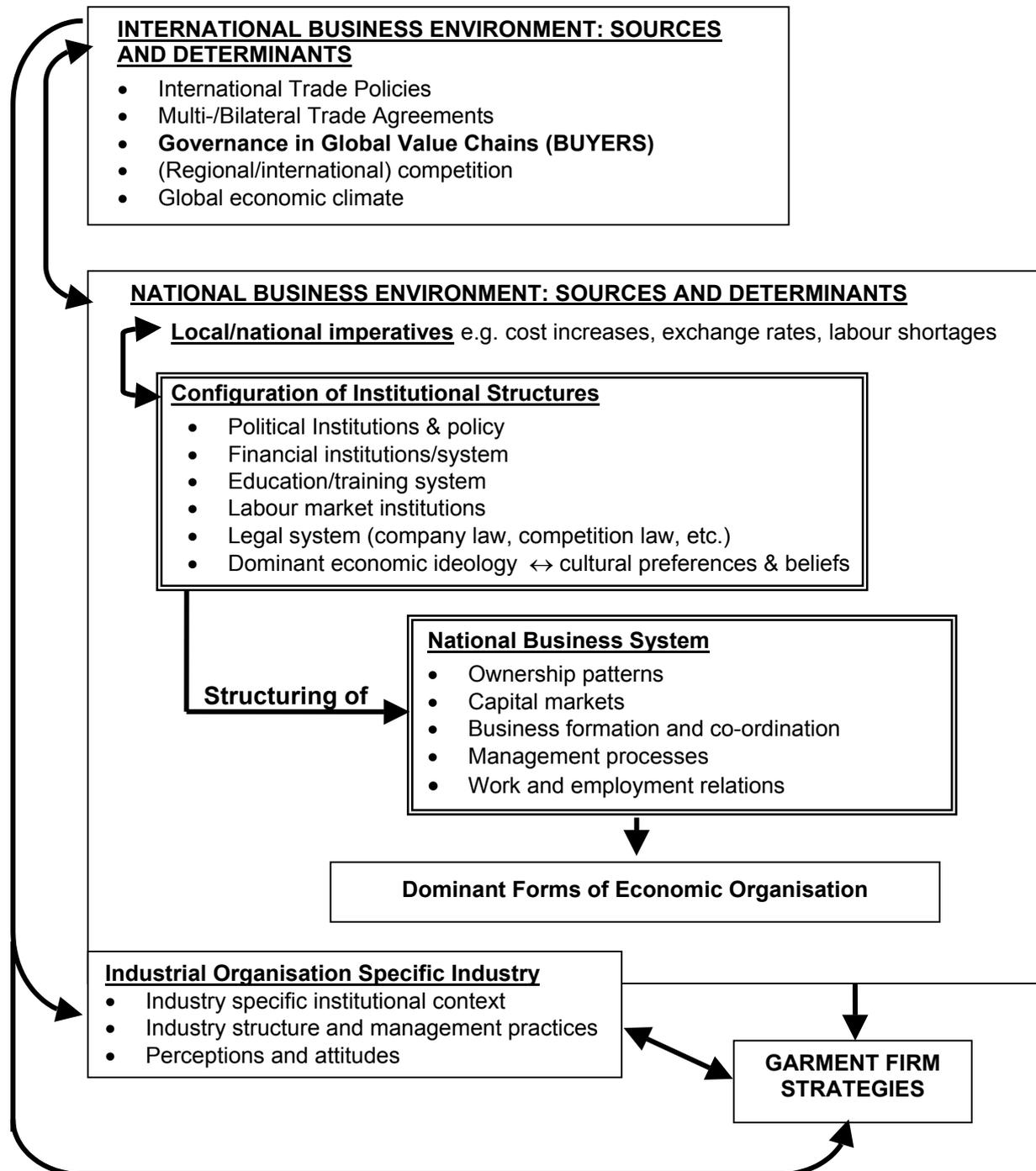
#### 3.6.1 Sources and Determinants of Firm Competitive Adjustment Strategies and Development Trajectories

The last column of figure 3.3b sums up the most important factors behind the actual choice of strategy by firms that were subsequently integrated in the upper part of figure 3.1. They include both external and internal (or firm specific) determinants.

##### *External determinants: International business environment*

Figure 3.3 gives a graphic illustration of the external determinants and their influence on local firm competitive adjustment strategies in the GACC.

*Figure 3.3 External Sources and Determinants of Firm Competitive Adjustment Strategies*



*Sources: Based on Whitley (1992) and Yeung (2002)*

External sources and determinants are found in the international and national business environment in which a firm operates<sup>6</sup>. Those in the international business environment include most notably the chain type in which a firm is incorporated and the market segment

for which it produces, buyer requirements and strategies and the international regulatory framework. Those in the national business environment include the national institutional context, the national business system and the industry specific context.

Although figure 3.3 gives a comprehensive overview, not all elements will affect garment the strategic choices of garment firms to the same degree and some may even have little impact at all. In the context of our study, therefore, the focus will only be on the elements with the most explicit effect on strategic choices of garment firms. Here we consider a few briefly.

The *governance exercised by lead firms* in the GACC influences the decisions and development trajectories of dependent firms in the chains in many ways, both directly and indirectly<sup>7</sup>. The extent of their influence will however differ substantially per type of buyer and per type of chain. In other words, the potential for learning from buyers and through linkages in the chain differ (see chapter 1). It is argued that lower-end (non-branded) buyers, operating in the price driven segments, will be less involved (and interested) in teaching producers and more inclined to constantly shift sourcing networks to the cheapest locations. Trying to hang on to such buyers (sustain connections) will most likely lead to defensive strategies and reactionary adjustment trajectories (hence immiserisation). On the other hand, linking to, and trying to sustain connections with, higher-end buyers in quality driven segments will force dependent producers to adopt more pro-active strategies involving constant product and process upgrading.

It has also been argued that although buyers may encourage certain types of learning processes and strategies, they may limit others. As Schmitz & Knorringa concluded in their research on the footwear industry, buyers are actively involved in, and even drive, upgrading within production (OEM or even ODM trajectories), but do not stimulate upgrading beyond production. Assistance with OBM would go against buyers' own interests as it essentially encroaches on their core competency (Schmitz & Knorringa, 1999). Thus firms that attempt to sustain connections as OEM producers, and aim at becoming world class suppliers, will most likely not engage in branding strategies, as it would imply competing with clients.

Different buyers also exercise different 'degrees' of control. Some buyers may prohibit or limit further subcontracting, or require producers to buy their inputs from specified suppliers.

Finally, buyers from different origins may apply different global sourcing strategies and exert different degrees of control over chains (see also chapter 1).

*International trade policies* include most notably the quota system. Quota may encourage relocation and outsourcing to other countries (with less or no restrictions), or may encourage firms to shift to higher value added products (quota go by volume, not value) (O'Connor, 1993), or export to different countries (that do not impose quota restrictions). On the other hand, quota may actually protect industries in certain countries<sup>8</sup>, allowing firms to not make the profound competitive adjustments they would otherwise have been forced to make.

#### *External determinants: national business environment*

The national or local business environment contains within it several other important – often interrelated – sources and determinants, most notably the *institutional context*, the *national business system*, *dominant forms of economic organisation* and the *industry specific local*

*context*, although the effects of particularly the national business system and dominant forms of economic organisations are mostly indirect.

The institutional context, or what Yeung (2002, p.74) refers to as the 'pre-existing configurations of institutional structures and state-society relations', consists chiefly of (i) political institutions, most notably government and government institutions and their policies; (ii) economic institutions, such as labour market institutions, capital markets and banks; and (iii) the dominant economic ideology or the accepted conventions, values, views, practices and so-called 'rules of the game' in economic decision making and market processes. The dominant economic ideology is often related to long existing cultural values and beliefs.

Government and its policies can be very influential. It may both discourage certain (types of) strategies and activities through regulations and pressures and encourage others through incentives, subsidies, information, etc. Generally, 'high-road' policies will probably be more successful in eliciting high road strategies (competing on product quality and customer service rather than costs) and encouraging upgrading trajectories. Conversely, a continued emphasis on minimising labour costs and on 'traditional' comparative advantage factors (i.e. 'low-road') will also encourage firm defensive and 'low-road' strategies. Thus it may actually hinder or slow down a shift to upgrading.

Government policies relevant to economic organisation, industries and firms include (i) international economic policy (e.g. negotiation of trade agreements, trade policies etc.); (ii) national economic policies and plans (e.g. macro-economic and labour market policies concerning standards, foreign workers, wages, etc.); (iii) sectoral policies, towards manufacturing sector, services, incentives for specific sectors, etc. (iv) industry specific policies, incentives and programs; and finally (v) firm specific policies or programs. It must be noted that the impact and outcomes of government policies may be very different at different organisational levels and results may therefore sometimes be contradictory.

Government is just one of the elements of the institutional context and often other institutions, government related or private (e.g. business associations), financial institutions (e.g. capital markets and banks), labour market institutions (e.g. labour unions), etc., will play a role in the choice of firm strategies (see e.g. Chiu, Ho & Lui, 1997; Yeung, 2002).

Labour market institutions and the local labour relations system, may be an important factor in the possibilities and limitations for firms to apply certain labour or location strategies. A strong labour union will most likely decrease flexibility in terms of hiring and especially retrenching workers on short notice, without having to pay or provide some form of compensation. Where the dominant economic ideology is pervasive in all these institutional arrangements, the result is often a very distinct national business system (Whitley, 1992).

Thus, besides directly influencing firm competitive adjustment strategies, the institutional context also indirectly influences firms, through its role in structuring the *national business system* in which dominant forms of economic organisation endure for a relatively long period of time (Yeung, 2002; Whitley, 1992) and certain business attitudes tend to prevail.

The diverse structuring of the business system is evident in the variations of its main elements: ownership patterns, capital markets, business formation and co-ordination, management processes and work and employment relations. In the context of Asia, a rich literature already exists on the distinct business systems in Japan, Korea, Taiwan and Hong Kong (see e.g. Whitley, 1992, Castells, 1992; Yeung, 2000b). In the latter cases reference is often made to the ethnic Chinese business system (Yeung, 2002; Gomez & Hsiao, 2001), at the core of which is the so-called Chinese family business (CFB).

In their own forms of organisation, strategic choices and general business attitudes and approaches, individual companies are likely to follow the patterns of the national business

system and dominant forms of economic organisation. Thus the behaviour of firms may be logical and efficient in its specific national business environment, yet not be effective in other contexts, where important institutions operate quite differently (Whitley, 1992)<sup>9</sup>.

Finally, the *industry specific local context* of a firm will often influence the strategies implemented by firms and more generally speaking their perceptions and attitudes. Often one will find these to be more similar within industries than between industries. The industry specific context encompasses prevailing business attitudes (often strongly influenced by the national business system), but also industry specific institutions and policies.

Industry specific institutions are usually the industry associations, which may function on the one hand as important intermediaries between the government, other institutions and businesses, and on the other hand directly stimulate learning and upgrading processes in an industry through information gathering and dissemination, encouragement of information sharing and trust building, training, etc. Several empirical studies (see e.g. Crewe, 1996; Bennett, 1998a, 1998b) have pointed to the potential and capacity of these institutions to promote a sense of shared group identity and strengthen the voice of local firms (Yeung, 2000a) and to encourage certain types of firm strategies.

#### *Internal, firm specific determinants*

Factors internal to the firm are size, organisation structure, history and business/management attitudes. Large companies will be able to make other choices and decisions as they usually have easier access to capital than smaller companies do. On the other hand, a company that is part of a larger corporation or group, may be limited in its ability to formulate and implement new strategies independently.

Previous choices and strategies (a firm's history) may also influence current choices and strategies, as it is often a lot easier to go further down a path already chosen than to take a completely new direction. This is what is commonly referred to as path dependency and can be found on many levels, not just the company level. The attitude and vision of management, the specific management style present in a company, will also determine strategic choices. After all, it is a firm's initial decision to align itself with certain buyers or to stay with them, which in turn may determine learning and upgrading possibilities.

As Humphrey & Schmitz (2000) assert "successful upgrading (...) appears to require a combination of human resource and industrial development policies at the national level, local institutional support, *and firms with strategic intent* using a variety of ways to acquire knowledge for upgrading" (Humphrey & Schmitz, 2000, p.30, emphasis added). This strategic intent, or general business approach plays an important role in the aim of subsequent strategic choices and is reflected in the first column of table 3.3c.

Management attitudes towards risk, production organisation, investment, R&D and especially concerning trust among industry members, and towards government, can be seen as both related to firm culture and management's unique style and characteristics, *and* to general business attitudes in the industry, in turn often influenced by the national business system and cultural preferences and beliefs. Such attitudes may thus be socially and historically embedded and can be quite resistant to change<sup>10</sup>.

#### *3.6.2 Determinants of industry development trajectories*

As explained in section 3.4, at the industry level, the determinants of change essentially are the development trajectories of existing firms and new entrants. However, the institutional environment can be seen as influencing such developments on so many levels, that it also deserves mention as one of the main determinants behind industry level trajectories.

At the national level governments may develop general economic and industrial policies aimed at restructuring local industries and the general industrial structure, encouraging certain industries or value chain activities and discouraging others. These policies may both affect existing firms and encourage newcomers in certain sectors or value chain activities. In some cases this encouragement may be quite direct through incentives to foreign investors to set up certain types of activities, or support or even protection for local newcomer firms. In addition, a government may envision a different function for the country as a whole within the global economy, say becoming a regional trading hub or a fashion centre and subsequently deploy policies aimed at achieving such a changed function through a host of different programs, incentives and/or regulations. In other cases policies may have indirect effects, e.g. those aimed at increasing wage levels will encourage the shifting out of (lower value added) labour intensive activities in industries, changing the profile of the industry locally.

Obviously there is a host of factors behind the strategies and trajectories of individual firms and industries as a whole, and usually many are operating simultaneously, enhancing or nullifying one another. An analysis of local firm and industry development trajectories should therefore not only try to identify the most important determinants and their differential effects, but also their interactions.

## Conclusion

The conceptual framework presented in this chapter will form the framework for analysis of the empirical data presented in the remainder of this study.

Before turning to survey results and their analysis in chapters 6 and 7, however, in the following two chapters the general development of the garment industry in Singapore and Malaysia will be considered in more detail, with specific attention for the distinct local business environments in which they have evolved and operate. An integral part of the conceptual framework presented in this chapter, the local business environment is seen as an important force behind developments at the firm and industry levels, both directly and indirectly.

## Notes

<sup>1</sup> The strategies included in the table all concern the product, process or function within the chain. Not included are financial strategies, such as raising capital through IPOs, as these are primarily intended to allow for investments in any of the strategies listed in the table.

<sup>2</sup> This section is largely based on existing literature. As has already been noted, the firm and industry level are often used interchangeably in this literature. This is therefore also reflected in this section.

<sup>3</sup> Deavers (1997) even argues that outsourcing may be part of a corporate competitiveness strategy, as opposed to a search for low wages, which is often implied. In such cases outsourcing involves specialist subcontracting.

<sup>4</sup> This again illustrates the sort of automatic link assumed between incorporation into GCCs and upgrading.

<sup>5</sup> Much of the National Innovation Systems literature also essentially asserts that firm strategies are not monolithic and that trajectories may thus take different forms and directions.

<sup>6</sup> The discussion could be linked here to the national innovation systems discourse and the relationship between organisational and institutional learning. However, the choice for the current study to explicitly take the global network perspective and the upgrading discourse as a starting point, has implied the focus of this study is on the micro-level, i.e. firms operating in global networks and chains. Moreover, the emphasis is on strategies and their outcomes in terms of competitive positioning relative to these networks and chains, and not on learning processes per se. Without dismissing the relevance and importance of these discourses, they are beyond the scope of the current study and would have required a completely different set-up and approach. Hence they have not been considered in depth.

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<sup>7</sup> Buyers may invest and actively engage in teaching by sending technical engineers to visit the producers and offer support and specific know-how (Schmitz & Knorringa, 1999). Indirectly, producers may learn from buyers 'by doing', i.e. by following their requirements and specifications, which keep them up to date on fashion, quality and technological standards

<sup>8</sup> Consider for instance a certain product, which is produced in both country A and country B (similar quality, delivery times, etc.). Country B is the cheaper production location of the two, but country is restricted in its exports to country C by quota limitations, while country A does not have such limitations. Without quota limitations, buyers from country C would source all of this product from country B, but because of the quota limitations, country B cannot fulfil the entire demand and part of it is therefore deferred to country A.

<sup>9</sup> Whitley's work on national business systems is, however, very general, and can't be directly tested for the understanding of individual firm strategies or developments within a specific industry, the way the work of Gereffi, or that of authors in the National Innovation Systems tradition can. It is therefore considered as an element of the business environment in which specific firms and industries operate and through its direct and indirect links to the institutional and industry specific context it can prove useful in understanding some of the underlying motives of company behaviour.

<sup>10</sup> However, the very incorporation of local producers in global implies that local producers must in some cases 'surpass' their direct business environment and comply with internationally set standards and 'rules of the game'. The growing cross-national inter-dependence of firms and markets, as they become integrated into global production networks and commodity chains, thus inevitably affects local business environments and attitudes. In other words the business environment must be viewed as dynamic, influencing local business attitudes and learning processes, yet at the same time being influenced by the strategies of key local firms integrated into global networks (Yeung, 2000a, 2002).

## **4 Evolution of the Singapore Garment Industry in Local Context**

### **Introduction**

The current chapter presents a general overview of the development of Singapore garment industry, and a consideration of the local business environment, which was identified as an important factors influencing local firm and industry development. Thus we try to provide some initial insights into the relationship between the development of the industry and (changes in) its local context.

As we will demonstrate in section 4.1, official statistics seem to indicate decline of the industry (or rather the production segment), which is not surprising given the pressures (or imperatives) in the industry's international and local business environment. However, a brief review of the literature and a look beyond the apparent facts in sections 4.2 and 4.3, already suggests that designating the industry as 'sunset' merely on the basis of official statistics may not give an accurate picture of the complex dynamics of industry change. Rather, understanding these requires an in-depth look at changes in the national business environment, as these are also more complex than the initial review of imperatives suggests. This will be done in sections 4.4 and 4.5.

The industry specific context will subsequently be considered briefly in section 4.6, after which a contemplation of the (possible) implications of the local business environment for the garment industry, given its specific characteristics, concludes the chapter (section 4.7).

### **4.1 Incorporation and Development of the Singapore Garment Industry**

During Singapore's first export oriented industrialisation (EOI) phases in the 1960s and 1970s, the garment industry became incorporated in international production networks and chains of US and European buyers, mainly fulfilling a role of contract manufacturing on a CMT and (more often) full-package (OEM) basis. While the industry consisted predominantly of local firms, manufacturers from the East Asian NIEs, most notably Hong Kong and Taiwan, also set up branch plants and subsidiaries in Singapore. Already looking to avoid quota restrictions, they were attracted to Singapore because it didn't (yet) have these. In addition Singapore had preferential access to commonwealth countries and a generally favourable investment climate with generous tax and export incentives, low labour cost, supportive labour policy, inexpensive building sites and excellent port facilities (Douglas et al, 1994). Such favourable circumstances plus the ability of local producers to supply on an OEM basis also made Singapore a popular sourcing location for especially US buyers.

#### *4.1.1 Growth and Development: The Statistics*

The labour intensive garment industry contributed significantly to the initial objectives of the state economic planners in this first phase of EOI development of the Singapore economy, contributing to labour absorption and export earnings. The industry group accounted for only 6.3 percent of increased value added and 5.3 percent of increased manufacturing output, yet provided 14.8 percent of Singapore's new employment by sector and an export ratio of 56 percent in 1969 (Douglas et al, 1994). Table 4.1 presents some key statistics on the garment industry, providing a rough overview of its development after this incorporation. The industry experienced rapid growth throughout the 1970s, fuelled mostly by exports, as its high percentage in total output indicates. This has been a discerning feature through all phases of the industry's development. The main destination region for Singapore's garment exports was the North American region (USA and Canada), which has become increasingly important over the years, accounting for 58 percent of domestic exports in 1983, almost 70 percent of domestic exports in 1992 and more than 73 percent of domestic exports in 1998. The

European market was the second largest market for Singapore garment exports, although value of exports to Europe was only a quarter of that destined for North America in 1998. More recently Asia has become an important export destination, taking up a third position. However, by comparison this market is still very small, with exports only constituting 10 to 15 percent of value of exports to the North American market in 1998 (DOS, International trade statistics, various years).

Despite rapid growth of the industry in the 1970s, its share of total manufacturing output, value added, workers and domestic exports grew only marginally.

**Table 4.1 Key Indicators of the Singapore Garment Manufacturing Industry, 1970-1998**

|                            | 1970  | 1975   | 1980   | 1985    | 1990    | 1995    | 1998    |
|----------------------------|-------|--------|--------|---------|---------|---------|---------|
| Establishments             | 162   | 252    | 374    | 370     | 370     | 231     | 169     |
| % of total                 | 9.3   | 10.6   | 11.2   | 10.6    | 10.0    | 5.7     | 3.9     |
| Output (S\$ Mln)           | 86.0  | 269.1  | 848.4  | 1,035.4 | 1,729.8 | 973.7   | 773     |
| % of total                 | 2.2   | 2.9    | 2.7    | 2.7     | 2.4     | 0.9     | 0.6     |
| Value added (S\$ Mln)      | 23.8  | 92.2   | 266.4  | 345.7   | 532.8   | 220.1   | 224     |
| % of total                 | 2.2   | 2.7    | 3.9    | 4.4     | 3.2     | 0.8     | 0.58    |
| Workers                    | 9,987 | 17,966 | 27,188 | 24,782  | 27,694  | 14,684  | 8,144   |
| % of total                 | 8.3   | 9.4    | 9.5    | 9.8     | 7.9     | 4.0     | 2.2     |
| Total Exports (S\$ Mln)    | -     | -      | 912    | 1,176.5 | 2,867.2 | 2,074.9 | 2,386.9 |
| Domestic Exports (S\$ Mln) | 65.5  | 236.2  | 752.8  | 877     | 1,600   | 831     | 620     |
| % of total                 | 3.6   | 3.1    | -      | 2.7     | 2.8     | 0.8     | 0.7     |
| Exports/output %           | 76.2  | 87.8   | 88.7   | 84.7    | 92.5    | 82.6    | 80.2    |

\* More recent statistical data were not included as the survey was concluded at the end of 1998 and the statistics presented here serve as a contextualisation of survey outcomes (see chapter 5)

Source: DOS Census of Industrial Production, various years

Growth of the industry slowed down in the early 1980s, which was consistent with a general slowdown of economic growth during this period and the 1985 recession. The improved economic climate in the latter part of the 1980s combined with newly implemented cost cutting policies by the government helped the industry recuperate in this period and once again achieve rapid growth. By this time, however, the first signs of the declining importance of garment production became apparent, as the industry's share of total manufacturing output, value added, workers and domestic exports decreased. The early 1990s witnessed a first real turning point, with an absolute decline in local manufacturing establishments, output and employment that has persisted throughout the 1990s. Not only locally did Singapore's garment production decline, its global export position deteriorated as well.

**Table 4.2 Singapore Apparel Exports and Global Export Position 1980-1999<sup>1</sup>**

|   | 1980 | 1985 <sup>2</sup> | 1990  | 1995  | 1999  |
|---|------|-------------------|-------|-------|-------|
| Value total apparel exports (mln. US\$) | 426  | 535               | 1,588 | 1,464 | 1,603 |
| Domestic exports                        | 354  | 399               | 996   | 587   | 471   |
| Re-exports                              | 72   | 136               | 592   | 877   | 1,132 |
| Share in world apparel exports (%)      | 1.0  | -                 | 1.5   | 0.9   | 0.9   |
| Global export position Singapore (rank) | 19   | -                 | 20    | 26    | 28    |

<sup>1</sup> These WTO statistics are in US\$, whereas the export statistics given by the Department of Statistics (DOS) in Singapore are in S\$ (see table 4.1); WTO statistics make international comparison easier.

<sup>2</sup> Numbers for 1985 are calculated from DOS statistics

Source: WTO (2000); DOS Census of Industrial Statistics, various years.

As demonstrated in table 4.2, Singapore went from being the 19<sup>th</sup> biggest apparel exporter in the world, to being the 28<sup>th</sup> biggest exporter in 1999<sup>1</sup>. It dropped six places between 1990 and 1995 alone. Despite total export increases for most of the 1980-1999 period, this growth lagged behind global growth in exports. Moreover, this position is based on total export figures, i.e. including re-exports. From the early 1990s onwards, however, the share of domestic exports in total exports has been declining (see tables 4.1 and 4.2), and Singapore would be ranked 38<sup>th</sup> in 1999 if based on domestic exports only.

The above points towards industry decline, or in GCC terms an industry that has not been capable of sustaining its connection to the GACC. Such decline would also seem logical if one considers the imperatives in the global, regional and local business environment, that have impinged on firms' competitiveness after their incorporation into global production networks and chains. A brief look at these imperatives and their effects on the garment industry may help explain the apparent decline of garment manufacturing in Singapore<sup>2</sup>.

#### *4.1.2 International imperatives*

##### *International trade restrictions (MFA)*

Although Singapore was initially not as severely limited by quota restrictions as for instance the East Asian NIEs were (after all, many East Asian garment firms initially set up branch plants in Singapore because there were still quota available), by the late 1980s two quota categories – knitted shirts and polo shirts – were completely 'filled'. This affected the industry, as these categories were precisely Singapore's two main garment export products. On the one hand quota limitations restricted existing companies in expansion of their production (of those particular items) and new companies from entering export markets for these products, on the other hand it may have been a factor in the (very modest) shift towards Asian markets and towards other product categories. Moreover, as was observed in the East Asian cases, quota restrictions may also be important drivers behind production relocation.

##### *Regional and international competition*

During the 1980s firms in countries such as Malaysia, Thailand, the Philippines and Indonesia managed to develop the capabilities and competencies for incorporation into the GACC as well, yet they produced at a substantially lower price. These low-cost competitors initially just took on the lowest value added and lowest skilled activities, often on a CMT basis, but eventually managed to develop OEM capabilities as well. Not only did they thus attract investments by East Asian NIEs away from Singapore (divesting from Singapore and investing in these new countries), they also became direct sourcing locations for US and European buyers looking for full-package deals.

More recently other countries in Southeast Asia, such as Vietnam and Cambodia, countries in South Asia, such as Sri Lanka, India and Bangladesh, and particularly China in East Asia, have become important players in regional and global garment production networks, while the East Asian NIEs have evolved their roles and strengthened their positions in higher-end products and activities (see chapter 1 and 3). In all segments of production therefore, regional competition within Asia has increased significantly, putting tremendous pressures on Singapore producers, who operate in a relatively high cost environment.

Added to these regional pressures are pressures resorting from competitors closer to the final markets or under favourable trade agreements with the USA or EU, in Eastern Europe, North Africa and Latin America, which has also further encouraged the development of full package supply in these regions.

*Developments in the global garment industry and increased buyer requirements*

As elaborated in chapter 1, developments in consumer demand and markets caused responses from buyers, which in turn affected their suppliers. Increased requirements regarding quality, design capabilities, delivery times, batch sizes, flexibility, etc. put added pressures on suppliers. This was felt in Singapore as well. However, considering Singapore's loss of *cost* competitiveness vis-à-vis new entrants, this was the kind of area – less price-driven and more quality driven segments – where higher cost producers such as the ones in Singapore would need to excel in order to avoid becoming excluded altogether from the GACC. The shift from lower value added cost driven products to higher value added, quality driven products and improvement of services to buyers was what enabled many producers in the East Asian NIEs to maintain their connections to the GACC and even improve their positions within them. Meeting and preferably exceeding buyer requirements thus is a strong imperative, especially to producers faced with rising local cost of production, while at the same time linking to higher-end buyers may also provide learning opportunities.

*4.1.3 Local imperatives*

*Cost increases*

Increased competition from other countries was not just the result of their cheaper cost, but also of Singapore's increased cost, widening the gap even further. Especially from the late 1970s onwards, cost increases were steep. During the 1980-1984 period Singapore's unit labour cost for the manufacturing sector increased on average 38 percent per annum and 43 percent for the whole economy. The unit business cost for the same period increased by 16 percent per annum (Okposin, 1999) (see table 4.3).

**Table 4.3 Indices of Unit Business Cost and Unit Labour Cost (1980-1998) (1988 = 100)**

| Period               | Unit Business Cost of Manufacturing |                  |               |                         | Unit Labour Cost of Overall Economy |
|----------------------|-------------------------------------|------------------|---------------|-------------------------|-------------------------------------|
|                      | Total                               | Unit Labour Cost | Services Cost | Government Fees & Rates |                                     |
| Weights <sup>1</sup> | 100.0                               | 49.9             | 48.3          | 2.3                     |                                     |
| 1980                 | 98.4                                | 81.3             | -             | -                       | 78.7                                |
| 1982                 | 110.8                               | 101.3            | -             | -                       | 100.4                               |
| 1984                 | 114.6                               | 112.2            | 115.0         | 150.4                   | 112.4                               |
| 1986                 | 100.4                               | 101.7            | 99.4          | 95.4                    | 100.8                               |
| 1988                 | 100.0                               | 100.0            | 100.0         | 100.0                   | 100.0                               |
| 1990                 | 114.8                               | 122.3            | 106.5         | 129.0                   | 118.1                               |
| 1992                 | 125.2                               | 140.3            | 108.2         | 159.5                   | 129.6                               |
| 1994                 | 120.1                               | 126.0            | 112.2         | 161.5                   | 130.0                               |
| 1996                 | 125.0                               | 126.7            | 119.9         | 196.2                   | 141.8                               |
| 1998                 | 124.8                               | 127.3            | 121.4         | 144.1                   | 140.3                               |

<sup>1</sup> The weights are based on the 1988 inputs structure and are used in the compilation of the indices from 1988 onwards

Source: DOS, *Yearbook of Statistics, 1991, 1993* & DOS, *Monthly Digest of Statistics, December 1998*

In fact manufacturing wages in terms of remuneration per worker increased more than 66 percent over the whole period. To make matters worse, labour cost increases could not be matched by labour productivity increases (Okposin, 1999) (see table 4.4). Although these

were all more or less general trends their effects seemed to be even more pronounced in the garment industry, due to the very nature and characteristics of the industry.

For instance, although wages (remuneration per worker) in the garment industry increased substantially less than manufacturing wages in general between 1988 and 1993 (see table 4.4), productivity in the industry in this period also increased less than the national average (only 11% in the garment industry as opposed to a national increase of 42%), as automation and introduction of labour saving technologies were less viable options to increase productivity. With productivity increases lagging, garment companies simply couldn't afford following the general wage increases.

**Table 4.4 Change in output per worker and remuneration per worker for the manufacturing sector and garment industry in Singapore (1980-1995)<sup>1</sup>**

|                            | Output/ Worker |             | Remuneration/ Worker |             | Garment Industry <sup>2</sup> Output/Worker |             | Garment Industry Re-muneration/Worker |             |
|----------------------------|----------------|-------------|----------------------|-------------|---|-------------|---------------------------------------|-------------|
|                            | average annual |             | average annual       |             | average annual                              |             | average annual                        |             |
| <b>1980-84</b>             | 34.9%          | 7.9%        | 66.3%                | 13.6%       | 35.2%                                       | 8.2%        | 66.2%                                 | 13.6%       |
| <b>1985-87<sup>3</sup></b> | 9.8%           | 3.8%        | -5.5%                | 1.0%        | 34.9%                                       | 10.5%       | 0.5%                                  | 0.0%        |
| <b>1988-93</b>             | 41.9%          | 6.8%        | 61.9%                | 8.9%        | 10.6%                                       | 2.2%        | 37.8%                                 | 6.7%        |
| <b>1994-99</b>             | 43.2%          | 8.2%        | 22.5%                | 4.6%        | 48.0%                                       | 7.9%        | 26.7%                                 | 5.4%        |
| <b>1980-99</b>             | <b>255.2%</b>  | <b>7.0%</b> | <b>271.6%</b>        | <b>7.3%</b> | <b>215.3%</b>                               | <b>6.6%</b> | <b>232.5%</b>                         | <b>6.7%</b> |

<sup>1</sup> As numbers were taken from publications from various years, output and remuneration are in current prices.

<sup>2</sup> Because of the crisis in the early 1980's and the fact that wage increases surpassed productivity increases, the NWC advised wage retentions between 1985-1987, which the majority of companies followed.

<sup>3</sup> Industrial code 322: wearing apparel except footwear

Source: DOS Census of Industrial Production, various years

### Labour shortages

One of the factors that continued to pose a constraint on especially the manufacturing sector since the early 1970s was the shortage of labour. Although the take-off of export-led manufacturing initially concentrated on labour intensive industries, given Singapore's limited population size, full-employment was soon reached. In addition, the local population became higher educated and higher skilled over time, causing labour shortages to be most acute in low-skilled manufacturing and services jobs and construction. The solution was to import foreign labour from neighbouring countries and eventually even from countries elsewhere in the Asian region. Foreign workers therefore contributed significantly to the growth rate of the total workforce in Singapore as seen in table 4.5.

**Table 4.5 Singapore: Percentage Growth Rate of Total Workforce, 1973-2000**

| Period          | Average growth rate (%) | Contribution from      |                     |
|-----------------|-------------------------|------------------------|---------------------|
|                 |                         | Indigenous workers (%) | Foreign workers (%) |
| 1974-1978       | 4.1                     | 3.0                    | 1.1                 |
| 1979-1984       | 3.5                     | 1.6                    | 1.9                 |
| 1985-1990       | 2.6                     | 1.8                    | 0.8                 |
| 1990-1995       | 1.5                     | 0.7                    | 0.8                 |
| <b>Forecast</b> |                         |                        |                     |
| 1996-2000       | 1.4                     | 0.5                    | 0.7                 |

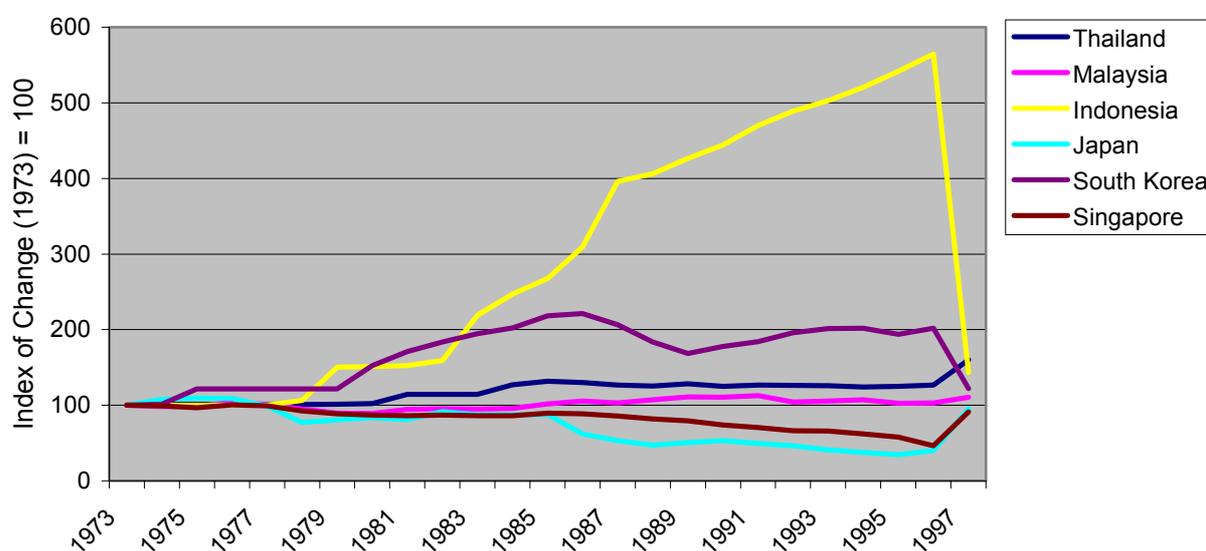
Source: Okposin, 1999

The effect of labour shortages was worse for the garment industry because of the labour intensive nature of the industry and especially the fact that wages were generally lower in the garment industry than in other manufacturing industries. Thus the industry had a hard time competing with other industries (e.g. electronics) for labour. The share of foreign workers in the industry (approximately 40%) accordingly is well above the national average share of the total workforce, which is around 18%. Individual firms in the industry often employ up till the maximum allowed number of foreign workers (50% of the total number of workers).

#### *Currency appreciation*

The loss in comparative advantage vis-à-vis particularly the other Asian countries was aggravated by the appreciating Singapore dollar. In US dollar (US\$) terms this appreciation was much higher than that of other regional currencies, with the exception of Japan (see figure 4.1).

**Figure 4.1 Index of Exchange Rate Movements in Selected East and Southeast Asian Economies 1973-1997 (national currency unit per US\$; 1973 = 100)**

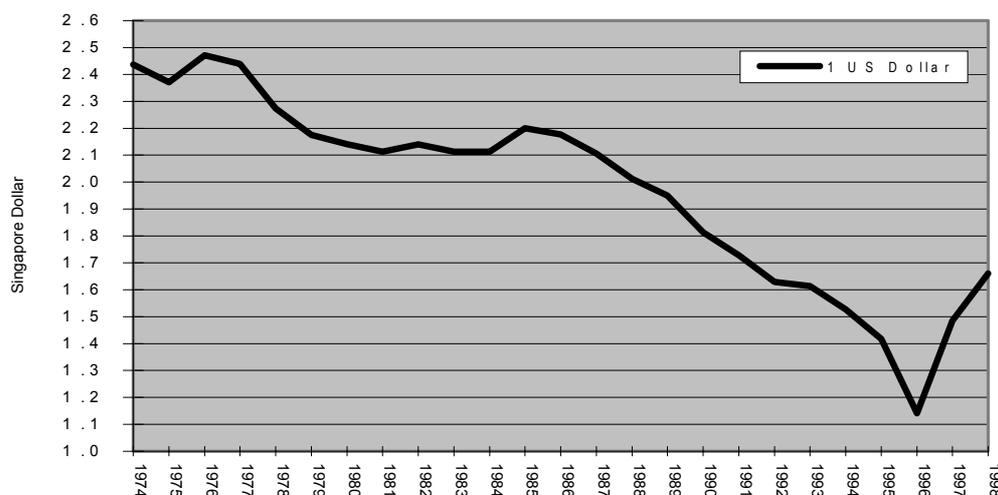


Source: Jomo (2001)

The strong Singapore dollar challenged the country's export competitiveness in manufacturing, especially in the late 1980s and early 1990s. Between 1986 and 1991 the exchange rate appreciated about 25% and between 1991 and 1996 a little over 14% (see figure 4.2). Thus in US dollars terms, currency appreciation *alone* made Singapore products 25% more expensive in a period of just 5 years and 35% more expensive in a period of 10 years. Especially in industries with such a strong emphasis on cost as the garment industry, such appreciation can be very harmful to export performance.

Some of these local imperatives were exacerbated by government policies. For instance, wage increases were encouraged as a way to discourage low value added and labour intensive industries and production activities (Rodan, 1989). We will return to the role of government and government policies in more detail in section 4.4.

**Figure 4.2** Exchange Rate of the Singapore Dollar (1974-1998, S\$/US\$)



Source: Jomo, 2001

#### *Limited size of local market*

Finally, although not directly affecting export competitiveness, the limited size of the Singapore market has prohibited local manufacturers from expanding production for this market as a means to compensate for falling export demand. In addition, up until more recently, the amount of affluent local consumers was even more limited. Import duties being very low in general and local industries hardly receiving protection from cheap imports (free trade was seen as one of the main conditions for Singapore's growth and development), this meant local producers also had to compete with cheap imports from e.g. China on the local markets. The (small) segment of highly affluent consumers that did evolve moreover seemed to have a strong preference for Western brands and designer labels. The local market was thus rather unattractive for local producers and most continue to be dependent on exports.

Given the statistics on garment production and exports, and considering the numerous pressures facing the industry, industry decline seems plausible and its designation as a 'sunset' industry perhaps justified. However, a review of some of the existing literature already gives some indication that developments in the industry might be more complex and we shouldn't jump to conclusions as to its fate.

## **4.2 Review of the Literature**

Overall, the garment industry's role in the manufacturing sector (in terms of output, value added and exports) has been rather modest as compared to for instance the East Asian NIEs. In addition it quickly became overshadowed by the electronics industry, which was incorporated into GCCs around the same time as the garment industry, during the first EOI phases. The mode of incorporation of the electronics industry differed somewhat from that of the garment industry, as this industry consisted mainly of branch-plant operations of TNCs. Thus there is not an abundance of studies on the industry, but insightful work has been done as part of industrial restructuring research. Before considering the resulting literature, we should also mention the work of Finnerty (1991) and Douglas et al (1994).

Finnerty's study (1991) was conducted as part of a special report for the Economist Intelligence Unit (EIU). The purpose of this report – titled "Textiles and Clothing in Southeast Asia: Competitive threat or Investment Opportunity?" – was essentially to give an overview of the development of the garment industry in a number of Southeast Asian

countries, and specifically the general economic development and investment climate in these countries. The EIU provides business intelligence and the report was thus intended for firms interested in investing in these countries. It therefore remains essentially a very descriptive and numerical study, without a particular analytical perspective as to (causal) relationships and explanations. In addition it is of course a rather dated study. However, it pays attention to a few interesting developments outside of production, such as the development and promotion of a fashion segment and the establishment of so-called buying offices of major lead firms in Singapore. In addition a number of cases and interviews are presented in the study, which give some insights into specific firm strategies, such as outward investments, moves towards higher value added production and reduction of dependence on buyers. Unfortunately these examples and cases remain rather anecdotal, and it therefore is not clear how pervasive these developments are and how representative the selected cases are.

The work of Douglas et al (1994) is also a rather general and somewhat superficial overview of the industry's development, but it is interesting as it is more explicitly set within a GCC perspective and deliberately tries to look beyond just production and producers at industry wide developments. These include for instance the establishment of buying offices and Singapore's role as a sourcing centre, the role of local fashion designers, etc. Little factual information is presented though. In addition, as even the authors admit, "The actions and interests of investors, managers and workers – not to mention customers – in the garment industry receive secondary attention in this study: the role of the state is paramount. It is possible that a different method, especially a more microanalytic perspective, would reveal more autonomous and influential initiatives coming from within the industry" (Douglas et al, 1994, p.211). In other words, the authors acknowledge need for a firm level approach to gain more insight into the actual developments and dynamics at work.

This is essentially the approach of the work of Ho Kong Chong, in Clark & Kim (eds.) (1995) and in Chiu, Ho & Lui (1997).

His work takes a comparative perspective at industrial restructuring and corporate strategy between two industries – garment and electronics – and between two countries – Hong Kong and Singapore. Ho Kong Chong's contribution in both these works on the Singapore garment industry was given form through an extensive survey among garment firms, focusing on restructuring strategies, specifically the ones used to control labour cost and encourage labour flexibility<sup>3</sup>. The survey and Ho Kong Chong's subsequent analysis of its results reveal on the one hand the imperatives and pressures in the business environment of garment firms, and on the other hand their responses in terms of labour, location and technology strategies (Ho Kong Chong, 1995).

Not surprisingly Ho Kong Chong found the imperatives experienced as most pressing were labour availability, cost and turnover, greater competition and high export price because of the strong Singapore dollar and he summarises the position of the industry in the international context as follows "(...) rapidly industrializing countries in Southeast Asia have been able to compete effectively in low-cost, labour intensive industries. Within this particular type of industry environment, Singaporean firms are therefore feeling the growing competition from below in terms of cost, unable to match the competition from developed countries in terms of quality and design and without the advantage of being close to major consumer markets" (ibid. p.125).

However, he argues that to understand actual responses and firm strategies one must consider not just the imperatives. Rather one should take into account the interplay between on the one hand this locational logic (production in Singapore), which provides both opportunities and cost (or pressures), and on the other hand a "wider industry logic, where the organisation and evolution of the industry defines for individual firms the nature of supply linkages and the boundaries for markets" (ibid. p.124). Ho characterises the industry as being dominated by

local capital, and oriented towards domestic markets<sup>4</sup>, as having low, stable technology and a relatively small workforce (all as opposed to the electronics industry).

Thus survey results demonstrated that cost and labour constraints (the location logic) were an important factor in the choice to invest overseas (which indeed almost a third of the firms in the survey had done), yet smaller size (i.e. capital constraints), lower involvement of foreign capital and a local market orientation (the industry logic) continue to keep garment manufacturers from investing extensively overseas. Industry logic in the electronics industry was for instance much more inductive of overseas investments, to an extent that with the same local pressures (or location logic), the electronics industry (surveyed in a simultaneous project) had a higher share of companies that had invested overseas.

Other interesting survey results included the observation of the fact that garment firms, as labour intensive and lower value added manufacturers facing increasing competition from low wage countries, have generally had a hard time adjusting to the problem of higher cost. Due to their relatively small size and local ownership, they were more likely to remain in Singapore despite higher cost, while small scale and the nature of garment production also constrain the use of technology. Thus of the three types of strategies garment firms were more likely to vary the use of labour (i.e. subcontracting, overtime work and foreign workers) as a response to industrial restructuring pressures.

Finally Ho identifies two other important factors that have played a role in the industry's development. On the one hand he observes that the industry has been a victim of government's industrial policies, specifically the encouragement of electronics and other capital and skill intensive industries, and the lack of support for others such as the garment industry.

On the other hand he notes that the quota limitations mean that expansion or increase in profits can only occur by moving into less restrictive categories in the MFA or into new export markets. However, experimentation with new product lines was more difficult to realize because of the small domestic market and forays into new markets seemed to be limited to neighbouring countries (ibid. p.133).

All in all Ho Kong Chong's analysis is very insightful, as it demonstrates that looking at the imperatives alone will not suffice to explain the strategies adopted by individual firms. For this one needs to have a more in-depth understanding of the industry's own logic and its interaction with the business environment (locational logic, policies, markets, etc.).

However, some limitations of the study should be mentioned. First it focuses predominantly on production and production restructuring and on the local context. Thus it seems to neglect alternative strategies, which take into account for instance chain positioning and relationships with buyers. Second it does not really look beyond existing firms, at other garment firms, perhaps not directly involved in production. As a result of these two limitations developments in the garment industry are essentially equated to developments of the garment production segment.

While not entirely avoiding the common 'sunset industry' reasoning, the literature does indeed paint a more nuanced picture than that of just decline painted in the first section of this chapter. A further nuancing of the official data, emerges from our own initial inventory of the industry and 'deeper' look at some of the statistics.

### **4.3 Decline and Disconnection from Global Chains?**

At the onset of our research an inventory was made of the garment industry in Singapore, which would serve as a database from which companies could be selected to approach for participation in our survey. In addition this database, which was compiled from various published sources (e.g. business directories) and validated through phonecalls, served to give

us an initial insight into the structure of the industry in terms of number and size (employment) of firms present in Singapore. During the short phone conversations we also asked firms about their general set-up or production organisation. The results of this inventory and background check are presented in table 4.6. It immediately becomes clear that the number of firms found that were still in operation (369) is much higher than the official number. The official statistics thus seem to underestimate the size of the industry in terms of number of firms.

This is due in part to the size of firms included in the Census: only firms with more than 10 employees are included. But it is probably also a consequence of the fact that a number of companies we found did not have formal production operations in their Singapore establishment, because all of it was relocated overseas or subcontracted. It may even be that some of these companies never were involved in production, but started out with a set-up where all production was outsourced. To which extent this is indeed the case and the scope, nature and effects of these developments are hard to gauge from our own inventory as well though, as these data give little indication as to what this implies for the function of the Singapore establishment.

**Table 4.6 Inventory of Garment Firms in Singapore (1998)**

|   | No. of Establishments | Number of employees |
|---|-----------------------|---------------------|
| <b>Total number of firms in database</b>        | <b>491</b>            | -                   |
| Total establishments producing in Singapore     | 232                   | 10,679              |
| → Establishments ≥ 10 employees                 | 170                   |                     |
| → Establishments < 10 employees                 | 62                    |                     |
| Total est. not/no longer producing in Singapore | 137                   | 2,045               |
| → fully relocated production                    | 53                    | 834                 |
| → fully subcontracted production                | 84                    | 1,211               |
| <b>Total number of firms still in operation</b> | <b>369</b>            | <b>12,724</b>       |
| <b>Firms closed/unconfirmed status</b>          | <b>122</b>            | -                   |

*Source: UU Research '98/'99*

As Finnerty (1991) and Douglas et al (1994) already indicated, an overview of a specific industry's dynamics should take into account national trends of a shift to higher value added activities within the value chain and non-production activities as well. Douglas for instance point to the fact that Singapore has been promoted, and has indeed become, a regional shopping centre, specifically for high-end garments, with international brands and fashion houses setting up retail outlets and boutiques in Singapore. The strong retailing function has in turn stimulated local designers and labels (Douglas et al, 1994). In addition both studies indicate that lead firms and buying agents were setting up regional buying and sourcing offices in Singapore. However, neither gives actual numbers.

Therefore, and because a complementary survey among these local buying and sourcing offices was to be conducted, a second database was compiled, again from various published sources. The compilation of this database allowed us a brief inventory of this segment as well, which is presented in table 4.7.

As becomes clear there are indeed a number of these offices located in Singapore and perhaps this is indicative of a trend as can be found in Hong Kong as well. Here the location of buying and sourcing offices can be seen as part of the country's changing function within the GACC, with a shift of focus away from manufacturing and towards becoming a trading, sourcing and production co-ordination centre.

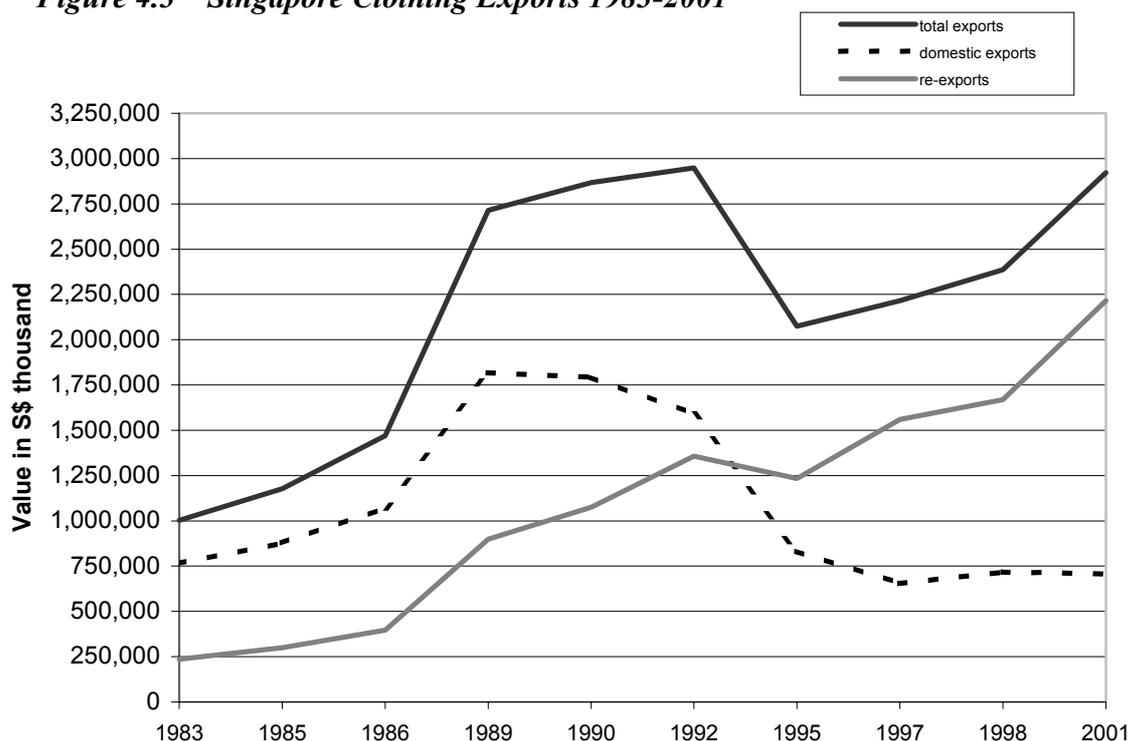
**Table 4.7 Buyers in Singapore**

| Buyer type  | No. in Singapore |
|---|------------------|
| Regional buying house/sourcing office of int'l buyer (branded, retailer, catalogue company, etc.)   | 15               |
| Int'l buyers that used to have office in Sing. but closed down/dormant/moved/changed function, etc. | 8                |
| International buying agents (part of multinational buying agencies)                                 | 13               |
| Local buying agents <sup>1</sup>  | 18               |
| <b>Total</b>  | <b>54</b>        |

<sup>1</sup> It is likely that this group is much bigger, as they are usually hard to trace

Source: UU Research '98/'99

Export statistics finally – when broken down into domestic exports and re-exports – may further support these findings of a shift towards trading and production co-ordination as an important feature of the industry's development. As figure 4.2 illustrates for instance, although domestic exports have decreased steadily since 1985, re-exports have actually increased since the mid-1980s.

**Figure 4.3 Singapore Clothing Exports 1983-2001**

Source: DOS, Yearbook of International Trade Statistics, various years

This may correspond with two trends suggested above: First, part of these re-exports may be products manufactured by overseas subsidiaries or subcontractors of Singapore firms. Second, they may be indicative of Singapore's evolving role as a regional trading and sourcing hub.

Finally, a first inventory indicated that some 60 to 70 local designers were selling their brand labels locally and in some case even regionally through their own outlets or through concessions in departmental stores. Although some of these have been around for quite a while, recent years have seen an increase in the number of these local designers/labels, as is also demonstrated by the annual Singapore Fashion Week, which has grown substantially in terms of number of events, number of participants and (local and international) media attention (<http://www.singaporefashionweek.com.sg>; <http://www.bharattextile.com>). Gaining further insight into these more complex dynamics requires probing deeper into firm level dynamics, which we will do in chapter 6.

However, it also requires a more in-depth look at the (changing) local business environment in which the garment industry operates, looking beyond just the imperatives resorting from this local business environment and instead focusing on the more complex dynamics of the institutional context, the local business system and the resulting dominant forms of economic organisation and what this has implied for the garment industry. The last sections of this chapter will therefore further elaborate on these issues, starting with the local institutional context, or what has also been described as the “configuration of institutional structures” (Yeung, 2002, p.19)

#### **4.4 Local Business Environment I: The Institutional Context**

In the previous chapter we outlined the elements that are usually considered to be part of the institutional structures in a specific country, such as the political institutions, economic institutions and dominant economic ideology (see figure 3.3). We won't elaborate in detail on all of them here, but will focus mainly on the role of the state in Singapore as its influence has been so dominant, that it has pervaded virtually all other elements of Singapore's institutional context.

##### *4.4.1 The Developmental, Corporatist State*

There is general agreement over the highly important and interventionist role of the state in Singapore's economic and industrial development, refuting earlier made assertions (by e.g. Milton Friedman) that Singapore's success could be attributed to economic liberalism and the free market (Lim, 1983, quoted in Rodan, 1989). Some have therefore dubbed the Singapore State as essentially being a ‘developmental state’ (Castells, 1992; Chiu, Ho & Lui, 1997; Perry & Yeoh, 1997) others have used the term ‘corporatist state’ (Deyo, 1981; Rodan, 1989). Ho Kong Chong (1995) defines these terms as follows:

“... the developmental state does not just take a background role as regulator and provider of public goods, but actively intervenes to circumvent various problems in the developmental process instead of relying on market adjustments. The developmental state can also be a corporatist arrangement, where the state acts as a broker to foster co-operative relations between capital and labour” (Ho Kong Chong, 1995, p.138/39)

To understand the power of the State one must first understand the political economy of the country's development since the Second World War and particularly the role of the People's Action Party (PAP). After a turbulent period from 1959 (when Singapore gained self rule from British colonisation) to 1965 (when Singapore finally became independent) – in which the country briefly joined the Malay Federation, was expelled from it again and struggled with internal conflict – the PAP managed to firmly establish itself as the strongest and hegemonic political party in Singapore. Its enduring, and virtual monopoly of, political power has created a stable (albeit repressive) political environment and enabled the PAP to structure and guide Singapore's economic progress. To an extent the “PAP has become the state” (Yeung, 2002, p.73). National economic development has been the primary goal of the PAP

government for the past 30 years. The institutional structuring and government-led economic development of Singapore has inspired the use of the corporate metaphor ‘Singapore Incorporated’ (Haley, Low & Toh, 1996, p.17). This refers to the strategic alliances between government and key stakeholders (considered in more detail below) to promote business.

Through various social programs in public housing, health and education and the achievement of rapid economic growth (hence jobs), the PAP gained, and has managed to retain, popular support. Opposition is virtually absent, even today. Through a number of laws implemented in the late 1960s<sup>5</sup>, organised labour was regulated and effectively eradicated. The National Trade Union Congress (NTUC) was established and tightly controlled by the PAP. Radical unions were suppressed. Thus labour union essentially became a state affair and an intricate part of the corporate structure of the Singapore state, functioning as an instrument of government rather than a negotiating partner. A highly disciplined and depoliticised labour force as well as a stable political environment were important elements of one of the main strategies adopted by the Singapore government to achieve its goal of economic development, namely the attraction of FDI. These two elements of Singapore’s development – the crucial role of government intervention and of FDI – can be traced in practically all stages of industrial development as is illustrated in table 4.8.

Government policies and strategies were instrumental in both Singapore’s incorporation into the global economy and its subsequent development and advancement, transforming the economy from an entrepot economy to a ‘low-tech’ manufacturing and trading economy during the 1960s and 1970s and from a manufacturing and trading economy to a ‘high-tech’ manufacturing and financial and business services economy over the past decade and a half.

To support government’s aim of rapid economic growth and to help attract FDI, an elite economic bureaucracy was established to guide the market. These institutions have played an important and enduring role in Singapore’s industrial development and have been instrumental in giving form to some of the main tenets in Singapore’s political economy and economic strategy.

#### 4.4.2 *Strong Economic Bureaucracy*

Under the Ministry of Trade and Industry (MTI) a number of statutory boards were set up. These were semi-independent agencies, carrying out specific plans and policies of MITI.

In 1961 the Economic Development Board (EDB) was established as an investment promotion agency to assist foreign firms in their operations in Singapore. The main concern of the EDB was to attract foreign firms to invest in Singapore. To this end for instance, EDB branches were set up in Hong Kong and New York to promote Singapore as an investment location and by 1990 EDB had opened as many as sixteen such overseas centres worldwide ([www.sedb.com](http://www.sedb.com)). The EDB is also directly in Singapore’s general economic development planning. As the PAP’s most important economic development instrument and think-tank, it became a relatively autonomous body – or as some would claim a State within a State – with a highly technocratic attitude.

**Table 4.8 Phases in Government Economic Planning and Development in Singapore**

| Period    | Local Environment: Competitive pressures & Competitiveness base   | Generic Economic and Industrial Policies (government objectives)   |
|-----------|---|--|
| 1966-1973 | Low cost comparative advantage  | <ul style="list-style-type: none"> <li>➤ Integration in the NIDL through an <b>export oriented industrialisation (EOI) strategy</b>.</li> <li>➤ <b>Attraction of FDI</b> to jumpstart industrial development (incentives, trade liberalisation, etc.)</li> <li>➤ Initially entrepot trade and heavy industry, soon expanded with consumer goods manufacturing industries.</li> </ul> <p>Singapore as an offshore production base for international capital, with emphasis on low value added labour intensive production activities.</p>             |
| 1974-1977 | Rising oil prices   | <ul style="list-style-type: none"> <li>➤ Promotion of more skill intensive and sophisticated manufacturing activities, less dependence on entrepot trade and heavy industry, especially oil industry</li> </ul>  |
| 1978-1984 | Cost increases, initial growth, but eventually loss of competitiveness also due to global recession                                   | <ul style="list-style-type: none"> <li>➤ <b>Second Industrial Revolution.</b></li> </ul> <p>Start of industrial restructuring, shift towards higher value added industrial activities which were more capital and skill intensive. High wage/high cost policy designed to force industry to invest in high value added areas. Introduction of <b>Corrective Wage Policy</b> in 1979 (Rodan, 1989; NWC, 1992),</p>  |
| 1985      | Economic recession, contraction of the economy  |  |
| 1986-1988 | Lower cost & restoration of competitiveness   | <ul style="list-style-type: none"> <li>➤ Cuts in employer and employee taxes<sup>6</sup>, wage restraint measures and cuts in corporate taxes and utility charges to lower labour cost in real terms for producers</li> <li>➤ <b>Total Business Centre Strategy</b></li> </ul> <p>More emphasis on the service sector and non-production activities in the value chain of foreign industrial enterprises operating in Singapore and elsewhere in the Asian region; diversification of the economy, Singapore as a financial and business centre.</p> |
| 1988-...  | Gradually increasing cost; relocation of low value added/labour intensive activities  | <ul style="list-style-type: none"> <li>➤ Extension of Total Business Centre Strategy, development of Singapore as core of <b>Economic Growth Triangle</b>.</li> </ul> <p>Regionalisation of the economy<sup>7</sup> and a shift of Singapore's position in the international division of labour.</p>   |
| 1991      | Higher value added manufacturing, non-production corporate activities and global services enhancement; regionalisation of the economy | <ul style="list-style-type: none"> <li>➤ <b>Strategic Economic Plan</b></li> </ul> <p>Deepening of the industrial restructuring process, with an emphasis on:</p> <ul style="list-style-type: none"> <li>• building of industry clusters in high value-added manufacturing branches</li> <li>• non-production corporate activities, i.e. R&amp;D and Operational Headquarters (OHQ)<sup>8</sup></li> <li>• attracting globalising service sector activities</li> <li>• export of services</li> </ul>   |

|      |   |   |
|------|---|---|
|      |   | <ul style="list-style-type: none"> <li>• further regional relocation of low value-added labour intensive production</li> <li>• support of promising local enterprises, grooming them into industry leaders and foreign investors</li> </ul>   |
| 1995 | Internationalisation of the economy and the achievement of developed country status   | <p>➤ <b>'External Wing'</b><br/>Promotion of, and assistance with FDI by Singapore based companies elsewhere in the region, both in SIJORI growth triangle and in flagship regional industrial parks in e.g. China (set-up by Singapore government) as well as in strategic markets (marketing FDI)</p>   |
| 1997 | Economic recession and Asian financial and economic crisis  |   |
| 1998 | High cost environment with emphasis on technology, knowledge and innovation. Targeting of specific industries and activities to be nurtured and developed, shift towards promotion of local firms and product specialisation/innovation | <p>➤ <b>Report of Committee on Singapore's Competitiveness</b><br/>Vision: a competitive, knowledge-based economy (moving from capital intensive to knowledge intensive economy), emphasis on intellectual capital. Strategies:</p> <ul style="list-style-type: none"> <li>◦ Manufacturing and Services as Twin Engines of Growth</li> <li>◦ Strengthening the External Wing</li> <li>◦ Building World-class Companies</li> <li>◦ Strengthening the Base of Small and Medium Local Enterprises</li> <li>◦ Human and Intellectual Capital as Key Competitive Edge</li> <li>◦ Leveraging on Science, Technology and Innovation</li> <li>◦ Optimising Resource management</li> <li>◦ Government as Business Facilitator</li> </ul> |

Source: Finnerty (1991); Grunsven & Westen (1997); Grunsven, (2000)

As such the EDB has been behind some of the core tenets in Singapore's economic development and has played a major part in the development of economic visions and strategies, as well as monitoring and implementation of these strategies.

The technocratic nature of the institution is most clearly seen in its general modus operandi. Heavy involvement of not just politicians, but more importantly of technocrats such as scholars and leaders of the business community, implies strategies are almost exclusively economic rather than politically inspired and heavily favour business and capital.

Although the scope of EDB's activities and influence became much broader, the fact that it was initially set up to promote Singapore as an investment location and attract FDI, meant foreign capital and its favouring has continued to permeate almost all EDB's strategies and programs. Thus virtually all committees formed under EDB for the formulation of economic policy and strategy (e.g. the Committee on Singapore's Competitiveness) include several CEOs of major TNCs located in Singapore. Other examples of EDB's almost absolute focus on foreign capital include its involvement in industrial manpower training through its own training institutes, which were essentially set-up to meet the manpower needs of TNCs.

Only from the late 1980s onward was local capital and entrepreneurship more explicitly considered as potential contributors to economic development and were they included in EDB strategies and programs. However, this was often still done selectively, i.e. local capital that was somehow linked to foreign capital (e.g. supporting and supplying industries), and high tech start-ups in specific sectors were encouraged in particular.

In the 1990s the EDB became directly involved in investment projects, through its investment arm and subsidiary, the EDB Investments Pte Ltd (EDBI) (<http://www.edbi.com>).

A second important statutory board, has been the Trade Development Board (TDB), recently renamed International Enterprise Singapore (IE Singapore). TDB was set up to promote trade and initially focused primarily on trade (import/export). While it continues to promote trade, the key focus of the newly named IE Singapore shifted towards helping enterprises grow and internationalise successfully. As such it has become an important instrument in implementing the External Wing policy (see table 4.8).

Finally two other institutions that spun off the EDB in the early phases of Singapore's industrial development have played an important role in the country's economic development and planning: the Jurong Town Corporation (JTC), which is also overseen by MTI and the Development Bank of Singapore (DBS), which by now has become to a large extent privatised, although government does still hold a substantial share in the bank.

The JTC was primarily responsible for the construction and management of industrial estates, the first of which was located in the Jurong area (Yeung, 2002).

The DBS was established as an industrial bank to provide long-term financing for the nascent industrial sector. There was, and still is, a high degree of integration between the financial sector and the manufacturing sector, which helped spawn the sizeable supporting industry for TNCs. However, credit has been selective to an extent, as certain sectors were favoured and the specific sectors that were favoured changed over time – in accordance with the general development strategy of the government (see below).

Finally, an important role in Singapore's economic development strategy has been played by the Central Provident Fund (CPF), established in 1955 as a social security scheme, but extended to become a macro-economic stabilization tool. Through the CPF, Singaporeans increased their stake in the economy and the PAP's goal of national economic development became a goal for virtually all Singaporeans. As Haley, Low & Toh (1996) argue:

"Policies in public housing, education, health and wealth accumulation have made home-owners and asset owners, shareholders, owners of corporations and others who depend on Singapore's prosperity and progress into Singapore Incorporated stakeholders (Haley, Low & Toh, 1996, p.22)

The CPF, which was in effect a compulsory individual saving scheme, enabled the

government to channel a large share of capital from the private sector to the CPF Board (i.e. the public sector). This capital is used to finance development schemes and stabilise the economy when necessary. It has been argued though that this large share of potential investment capital for private entrepreneurs flowing to the state has limited private entrepreneurs' in obtaining capital for expansion and thus has led to a crowding out of local entrepreneurship (Yeung, 2002)

The strong state bureaucracy and institutional arrangements that were put in place all served to support the state's main economic development strategies and policy initiatives, most notably the attraction of FDI.

#### 4.4.3 Foreign Direct Investment

After Singapore's independence in 1965, the new Singapore government quickly realised that local development would have to be externally induced, as the country lacked natural resources and didn't really have a local market. Indigenous entrepreneurship was not considered strong enough to achieve industrialisation, as local businessmen still operated mostly as traders (part of the colonial legacy) and weren't considered to have the competencies needed for industrial entrepreneurship and development. In addition, Yeung (2002) has argued "... the PAP-ruled state was suspicious of indigenous capitalists for fear of their pro-communist and pro-China attitudes (and)... for social, political and economic reasons Lee Kuan Yew [leader of PAP and Prime Minister] deliberately neglected and even distrusted the developmental capacity of local Chinese entrepreneurs" (Yeung, 2002, p.71-72; see also Chan & Ng, 2001).

Therefore, in the 1960s, the government embarked on a strategy of encouraging FDI on its shores to jump-start the economy. By providing tax and investment incentives, cheap and non-unionised labour, freeing up trade and extending and upgrading port facilities and other infrastructure, TNCs were successfully encouraged to set up manufacturing branch plants for export in Singapore. Thus Singapore became inserted into the global economy as a typical branch-plant economy.

Initially this FDI involved mostly simple assembly operations in low value-added labour intensive industries. The strategy proved successful and Singapore became one of the main destinations for FDI from the USA and Europe in Asia and also received substantial investments from Japan. The influx of FDI in Singapore rose steadily until the mid 1970s and rapidly throughout the 1980s. By the 1990s the ratio of FDI to GDP was more than 80% (see table 4.9). The nature of FDI changed over the years, with non-manufacturing FDI increasing its share. This was consistent with policy changes and the changes in the nature of FDI attracted, as we shall explain in more detail in the following section.

**Table 4.9 Foreign Equity Investments in Singapore (1965-1998, S\$ million)<sup>9</sup>**

|  | 1965  | 1970  | 1974   | 1980     | 1985     | 1990     | 1995     | 1998                   |
|--|-------|-------|--------|----------|----------|----------|----------|------------------------|
| Total FDI                                      | 157.0 | 995.0 | 3054.0 | 13,002.4 | 25,502.7 | 57,935.2 | 99,215.7 | 138,960.6 <sup>1</sup> |
| FDI Net Inflows (% of GDP)                     | -     | -     | 6.6    | 10.5     | 5.9      | 15.2     | 10.5     | 7.6                    |
| FDI Net Inflows (% of gross capital formation) | -     | -     | 14.52  | 22.76    | 13.92    | 41.5     | 30.48    | 23.6                   |
| % in non-manufacturing sectors                 | 0.0   | 0.0   | 0.0    | 46.7     | 53.3     | 60.9     | 62.8     | 63.4 <sup>1</sup>      |

<sup>1</sup> 1997

Sources: Yeung (2002); World Bank Institute (2002)

This TNC led approach and government's focus on foreign rather than local firms has been criticised as stunting the growth of local firms. It has been argued that the large number of foreign firms not only squeezes out local firms, but also undermines potential local talents that would have otherwise gone into risk taking entrepreneurial ventures (Rodan, 1989; Okposin, 1999). However, there is also research evidence that shows these TNCs have actually spawned a large supporting industry in Singapore and induced substantial technological capability development among local subcontracting and contract manufacturing firms. These firms followed what Wong (1999) refers to as a 'manufacturing process specialist' route, focusing on process technological capability development and essentially remaining OEM suppliers, albeit it while continuously improving process capabilities<sup>10</sup>. In later stages the Singapore government more actively promoted and facilitated this TNC induced technological learning by local firms and started paying more attention to local firms.

#### 4.4.4 *Economic Development Strategy: Inducing Industrial Restructuring and Upgrading*

Ever since the late 1970s, the main themes of the government's industrial and economic development strategy have been industrial restructuring and upgrading. It was believed this should be actively induced through incentives, pressures and investments, so as to reinforce and accelerate the processes set in motion by the market. Government thus coerced firms into adequately responding to pressures impinging on competitiveness, and, rather than awaiting (the effects of) increasing competitive pressures, anticipating and staying ahead of them by following high-road strategies to competitiveness.

Despite the initial successful insertion into the global economy in the 1960s – through labour intensive export oriented industrialisation – the Singapore government quickly realised the vulnerability and undesirability of competing on the basis of a comparative cost advantage and in labour intensive industries. Government therefore started promoting a move towards higher value added activities and industries and became more selective in terms of the type of TNCs it encouraged to invest in Singapore, aiming for those using more capital intensive modes of production. In 1979, the Government embarked on an ambitious plan to radically restructure its economy, hoping to turn Singapore into a centre of excellence for technology, manufacturing and services. The phase following this policy shift became known as the Second Industrial Revolution (see table 4.8). This period marked a first deliberate push by the Singapore government to force industries to invest in higher value-added areas, or to force certain activities to move out of Singapore altogether, through the active manipulation of competitiveness factors in the local business environment. The government pursued a so-called *high wage/high cost policy*, intensifying already existing cost pressures and intended to accelerate the process of adjustment and restructuring. This was mirrored by policies aimed at directly encouraging diversification and upgrading of the economic structure. The more general philosophy behind such policies was that of 'creative destruction', seen as necessary to free up resources and to attract and encourage the kind of FDI that could be leveraged for more sophisticated local development, i.e. involving more technology, higher skills and more value-added (Lim, 1980).

The high wage/high cost strategy was reflected most clearly in labour policies. The Corrective Wage Policy introduced in 1979 (Haley, Low & Toh, 1996) for instance caused a substantial increase in wage levels (see table 4.4). In addition government adjusted its foreign worker policies (see table 4.10). By 1980, the share of foreign workers made up more than 11% (Chan & Abdullah, 1999) of the total workforce, a share considered undesirably high as it was seen as delaying necessary restructuring and upgrading because firms could turn to

these alternative cheap sources of labour<sup>11</sup>. More restrictive foreign worker policies were therefore initiated to ensure employers would not resort to these (cheaper) sources of labour to circumvent wage pressures.

Initially the idea was to phase out foreign labour all together, but it soon became clear that even with higher cost this could not be achieved – the share of foreign workers actually jumped to more than 18% in 1992 (Chan & Abdullah, 1999). The policy objective therefore changed towards retaining a controlled pool of foreign workers on short-term work permits, serving as buffer against cyclical economic swings. To ensure only the minimum amount of foreign workers would be brought in, however, a two tier levy system was introduced which meant the more foreign workers a company used, the higher the cost of this labour became.

**Table 4.10 Foreign Worker Policies in Singapore (1960s-1990s)**

| Period         | Policy   |
|----------------|--|
| 1960s - 1970s  | <b>Regulation by country of origin:</b> extension of work permits to Malaysian workers on basis of renewable two (unskilled) or three (skilled) year work permits. Expanded in late 1970s to include workers from non-traditional sources (NTS) such as Thailand, Sri Lanka, India, Bangladesh, Philippines & Indonesia  |
| 1980s          | <b>Foreign worker levy scheme:</b> pricing mechanism to moderate inflow of foreign workers, initially flat rate, only for non-Malaysian construction workers.  |
| 1982           | In tandem with government <b>objective of phasing out foreign labour by 1991</b> (in line with broader objective of discouraging labour intensive industries, promoting skill-intensive and high value-added industries and the subsequent high cost/high wage policy) <b>extension of levy scheme:</b> All employers of NTS workers and Malaysian construction workers to pay levy of 30% of worker's salaries; CPF <sup>12</sup> as a social security restricted to skilled foreign workers  |
| Late 1980s     | Realisation that totally local labour force by 1991 was not feasible, necessity of retaining <b>controlled pool of foreign workers on short term work permits</b> (i.e. only one extension of permit possible), serving as buffer against cyclical economic swings   |
| 1987           | <b>Introduction of dependency ratio:</b> Not more than 50% of a firm's work force allowed to consist of foreign workers. Levy scheme extended to all work-permit holders (including Malaysians)  |
| 1990 - present | <b>Two tier foreign levy system:</b> Two dependency ceilings for foreign workers, in which levy for first tier dependency ceiling is lower than for the next dependency ceiling (e.g. levy of \$330,- per worker up to ceiling of 35% of workforce and a higher second tier levy of \$450,- for additional foreign workers up to 50% of the workforce). Hence firms that are more dependent on foreign labour pay a higher levy. Over the years this system has basically remained in place, although adjustments have been made in terms of the height of the dependency ceilings and expansion of the system to different sectors/industries |

Source: SILS (1995)

The specific foreign worker policies have particularly affected certain sectors and industries, as foreign workers tend to be overwhelmingly concentrated in a few: (labour intensive) manufacturing, construction and domestic services (maids).

Simultaneously with the high wage/high cost policies, from the 1980s onwards efforts continued to diversify the economy, pushing for a higher value added industrial base and shift to non-production activities and services. These efforts were given a boost in the second half of the 1980s with the implementation of the so-called Total Business Centre Strategy (see table 4.8). Tax changes introduced in the 1988 budget aimed to promote the service industries, overseas investments and the development of Singapore as a financial and

business centre (Finnerty, 1991). In addition, tax incentives promoting technological upgrading, pioneering industries, investment, export, FDI, etc. were expanded and improved. Subsequent policies, such as the Strategic Economic Plan (SEP) and the External Wing program implemented in the early 1990s (see table 4.8), reiterated the overall vision, strategies and instruments of earlier initiatives. New directions for the Singapore economy were formulated as well though, addressing what by then was perceived as a pressing issue related to two decades of industrialisation and economic development under globalisation through the leveraging of FDI, namely the rather unintegrated production or industry structures (Grunsven, 2000). One of the strategic thrusts of the SEP therefore emphasised the building of industry clusters in high value added manufacturing branches and developing local linkages within industries (both vertical and horizontal as well as institutional). Many specific strategic programs were linked to this SEP, aimed to elaborate on the different thrusts, such as manufacturing, international business hub, regionalisation, etc.

In the second half of the 1990s a new review of Singapore's competitiveness was undertaken, resulting in yet another reformulation of strategic directions for the future. The Report of the Committee on Singapore's Competitiveness (CSC) published at the end of 1998, stressed the importance of moving towards a Knowledge-based Economy. The basis for competitiveness would be the intellectual capital and capability to absorb, process and apply knowledge and innovation to meet the challenges of rapid technological change and globalisation. Within manufacturing emphasis would increasingly have to be on knowledge-driven industries and capabilities in the entire value chain, i.e. especially beyond production in activities such as R&D, marketing and sales. Simultaneously "Singapore should develop into the premier service hub for Asia with a global orientation, with strong competencies in both its existing hub services as well as high growth services" (Grunsven, 2000) such as media.

Only since the 1990s with the implementation of the SEP and the report of the CSC (see table 4.8), has the Singapore government thus started more actively supporting local enterprises and promoting a shift from process specialisation to product innovation (Wong, 1999).

Policies were devised to encourage and nurture local entrepreneurship, R&D operations, technology start-ups and locally owned TNCs. To support this shift, government has accelerated the establishment and funding of public research institutes/university R&D, encouraged TNCs to start product R&D operations in Singapore and launched an ambitious Technopreneurship Program to promote the growth of new technology start-ups (Wong, 1999). It must be noted though that the growing attention for local firms concerns relatively young enterprises and enterprises in specific (high tech, knowledge intensive) sectors, rather than existing local enterprises in mature industries.

The question is whether a shift from a local sector of (dependent) process specialists to local entrepreneurship, creativity and innovativeness can be as easily achieved as the earlier move from labour intensive to capital intensive manufacturing. The legacy of TNC domination and favouring, corporatism and government intervention, as well as government's 'neglect' of local entrepreneurship over the years (which will undoubtedly have affected the attitudes towards local entrepreneurship) might have created a path dependent development trajectory that could prove hard to overcome.

In addition, despite these shifts, the predominant focus remains on FDI. This becomes clear for instance from the fact that there has always been a tendency to measure the rate of success of economic development strategies by its effects on FDI patterns. Or, put differently, economic strategies aimed at transforming Singapore's industrial and economic structure continued to look at foreign capital as one of the main drivers of this transformation.

Thus the intended shift towards becoming a regional (manufacturing) services, trading and shopping centre were encouraged through incentives for TNCs to set up establishments

involved in non-production activities, such as OHQ and R&D centres, or for existing TNC establishments to develop into such centres. In addition investments by global services providers or services TNCs (e.g. investment banks, insurance companies, law firms, consultants, etc.) by ‘key hub services’ providers<sup>13</sup> and by foreign retailers were encouraged. Thus, despite a shift towards more attention for local capital, entrepreneurship and SMEs, policy and government strategy continued its dominant focus on FDI. Although some of the indigenous manufacturing firms that originated as contract manufacturers and supporting industries to TNCs subsequently adopted an OEM-ODM-OBM migration route, the majority remained directly linked to TNCs, which provided much needed capital, knowledge and technology. Singapore’s “national innovation system” has therefore been referred to as a “DFI-leveraging model” (Wong, 1999, p.20).

#### 4.4.5 Government as an Entrepreneur and Investor

Finally, the role of government as an entrepreneur and investor in its own right has played an important role in the structuring of Singapore’s economic development and organisation. In the early years of development the government established a number of state-owned enterprises for specific developmental purposes, such as infrastructure development. But public enterprises were also established in manufacturing, reflecting government’s reasoning that the question of industrial structure should not be left solely to the market. Although many of these state-owned enterprises were privatised over the years, government interest in quite a few remained substantial. These companies, in which government’s share is still substantial are therefore often referred to as government linked companies (GLCs). Several of these are top players in their respective industries. A holding company, Temasek Holdings, was set up in 1974 to hold and manage Singapore government’s S\$345 million equity invested in more than 35 companies. The public sector and GLCs together account for about 60 percent of Singapore’s GDP (Yeung, 2002, p.82).

In addition since the late 1980s, the government started investing a sizeable share of its surpluses abroad (Okposin, 1999). This is done through state/enterprises and GLCs, but also through e.g. the EDBI. Thus the Singapore government has created ‘new economic spaces’ overseas, i.e. industrial parks in China, India, Vietnam and Indonesia, where it has tried to create an operational environment of similar standards to Singapore (www.sedb.com), or what Haley, Low & Toh (1996, p.25) refer to as ‘Virtual Singapores’

**Table 4.11 Singapore’s Institutional Context**

|                            |   |
|----------------------------|---|
| Political Institutions     | <ul style="list-style-type: none"> <li>• Developmental democracy</li> <li>• Technocratic, strong economic bureaucracy</li> <li>• Corporatism</li> </ul>   |
| Economic Institutions      | <ul style="list-style-type: none"> <li>• Managed capitalism</li> <li>• Both bank centred capital markets and</li> <li>• Active stock markets</li> </ul>   |
| Dominant Economic Ideology | <ul style="list-style-type: none"> <li>• ‘Singapore Incorporated’</li> <li>• Creative destruction</li> <li>• Technocracy, corporatism</li> <li>• Favouratism (sectors, FDI, high-tech, etc.)</li> <li>• FDI leveraging</li> </ul> |

*Sources: Yeung (2002); Wong (1999); Haley et al (1996); Rodan (1989)*

It has been argued that state enterprises and GLCs, which have influence in almost every aspect of Singapore’s economy may not get in the way of foreign producers, but in many ways directly compete with local private entrepreneurs, adding to the ‘crowding out’ of local

capital already caused by foreign capital (Okposin, 1999; Lim & Pang, 1991; Chan & Ng, 2001). On the other hand it could be argued that some government investments have paved the way for private investments, either directly through for instance the setting up and managing of overseas industrial estates, or indirectly, through demonstration effects. Table 4.11 gives an overview of the core tenets of Singapore's institutional context.

#### 4.5 Local Business Environment II: The National Business System and Dominant Forms of Economic Organisation

Singapore's institutional structure and economic policies, and its ideology of social alliances and corporatism have created a business system which seems to combine western style capitalism with its emphasis on free markets, with elements of the Chinese business system, with its emphasis on the collective interest over the individual. Government acts as a patron and patriarch, yet at the same time promotes free trade and competition.

The most important elements or core tenets of the national business system are summarised in table 4.12. Most of these have been dealt with in the previous.

In manufacturing in particular, SMEs play a minor role compared to large firms in terms of contributions to employment, remuneration, output, value added and domestic exports. This is in part due to the fact that local entrepreneurs had a long trading legacy, from the days of entrepot trade during the colonial rule. Thus locally owned firms were more concentrated in the commercial and trading sectors, and not so much in manufacturing.

**Table 4.12 Singapore's Business System and Dominant Forms of Economic Organisation**

|                                      |   |
|--------------------------------------|---|
| Ownership Patterns                   | <ul style="list-style-type: none"> <li>• Large presence of foreign controlled enterprises</li> <li>• Significant presence of GLCs</li> <li>• Domination of large firms and their affiliates</li> <li>• SMEs large in number, yet modest impact on economy as a whole and differences per sector; most SMEs are Chinese family owned businesses</li> </ul>                           |
| Capital Markets                      | <ul style="list-style-type: none"> <li>• Well developed banking system and stock market</li> <li>• High rate of forced individual savings (through the CPF)</li> </ul>  |
| Business Formation and Co-ordination | <ul style="list-style-type: none"> <li>• Low firm birth</li> <li>• Some reliance on relationships in private business formation and organisation (especially amongst Chinese SME)</li> </ul>  |
| Management Processes                 | <ul style="list-style-type: none"> <li>• Professional management foreign enterprises</li> <li>• Bureaucratic management in GLCs</li> <li>• In SME usually (Chinese) family management (?)</li> </ul>  |
| Work and Employment Relations        | <ul style="list-style-type: none"> <li>• Lack of unionism, dependence on foreign workers for low skilled work</li> <li>• Moderate preference for self employment and ownership, yet</li> <li>• High labour absorption in foreign firms and GLCs and preference for job security as employees among younger generation (?)</li> <li>• Some political appointments in GLCs</li> </ul> |

Source: Yeung, 2002

Most SMEs are locally owned and family managed. Elements of the Chinese business system with its characteristics of familialism, strong inter-personal relationships and business networks (Whitley, 1992; Yeung, 2002) and 'self-reliance' are probably still found among Singapore's SMEs. However, the dominant ownership patterns and management processes have overshadowed this business system and have resulted in a rather limited role of indigenous private enterprises altogether. Although Yeung (2002) argues there is a preference for self-employment and ownership, this was probably true for the older generation of Singaporeans<sup>14</sup>. The majority of Singaporeans nowadays, especially the younger generations,

have become contented with their job security in well-paid jobs in foreign firms or the government sector, which have a high employment absorption capacity.

Work and employment relations are characterised by a lack of unionism, corporatism and rather unilateral decision making powers of employers with regards to virtually all labour issues. This allows for substantial flexibility on their part, as hiring and firing (or rather retrenchment) is relatively easy and cheap. Flexibility was further enhanced by the controlled pool of foreign labour that was allowed to enter the country and lift the burden of labour shortages when needed. Although these benefits accrue to all firms, observations have been made of the relative ease with which high-tech and high value added foreign firms in Singapore can obtain foreign worker approval and quotas.

#### **4.6 Local Business Environment III: Industry Specific Context**

Finally we must extend the concept the national business environment to include the industry's own logic in terms of the industry specific context and characteristics, i.e. the structure and organisation of the industry and industry specific institutions and policies.

##### *4.6.1 Structure and Organisation of the Industry*

Although we will go into the details of the internal structure and organisation of firms in the empirical chapters, some of the existing data and literature can already give a general insight into some distinct features of the Singapore garment industry in terms of firm size, ownership patterns, managerial practices, business networks and trust and business attitudes.

Even an initial assessment of the industry already reveals that it is quite distinct from other industries and diverges strongly from the dominant forms of economic and industrial organisation in Singapore.

Firm ownership is predominantly local, especially since most of the East Asian garment firms that initially invested in Singapore have long since left, closing or selling their Singapore branches. The industry overwhelmingly consists of small and medium-sized enterprises (SMEs) and few companies are vertically integrated. The dominant form of business organisation is the Chinese family business (CFB). Most firms are owner managed, with the head of the family (sometimes second generation) functioning as managing director. Despite the fact that many of the larger firms have to a large extent professionalised management and have shareholders outside the family, crucial strategic decisions will usually still be made by the head of the family, i.e. the owner-manager.

Before further characterising the industry and firms within it, it is important to make a distinction between two groups of firms within it: a small group of relatively large firms with strong ties to buyers who export most, or all of their production on the one hand, and a larger group of small to micro-businesses, of which part may function as subcontractors and most will have a more diversified portfolio of customers and markets. These two segments or groups of firms exhibit different characteristics. Generally speaking, typical characteristics of CFBs such as familialism, the importance of social networks and strategic preferences are more often found in small companies. Whitley describes the strategic preferences in the CFB in Taiwan and Hong Kong as focusing "on the intensive use of resources, short payback periods for new investments, reliance on price and cost competition and a reluctance to share control or responsibility (...). Risks are managed largely by restricting commitments and maximising resource flexibility" (Whitley, 1992, p.55). Such preferences are more likely to be found among small firms in Singapore. Trust among these firms towards both government and other firms is usually low and 'ascribed' (Schmitz, 1999) on the basis of social and family networks.

The second group of firms, the larger export oriented firms, display more tendencies towards professionalisation and formalisation of their organisation, as this is often seen as necessary for compliance with external pressures from government and higher-end buyers. These firms are also likely to display more openness and co-operate amongst one another and with government, e.g. through a strong voice in the industry association. Moreover, their stronger positions in terms of export and the fact that they seem to have shifted to production for the 'top fashion labels' (The Straits Times, January 17, 2003) gives them some leverage with government, as these elements better fit Singapore's general policy and strategic directions. Relations with other firms e.g. suppliers and subcontractors, are based on so-called 'earned' as opposed to 'ascribed' trust. This implies trust is earned by the provider of the highest quality and best delivery times<sup>15</sup>. Although elements of the CFB are probably still found among even these larger firms, they most likely represent a hybrid form.

The predominant role in production networks and chains of the larger firms is that of OEM supplier of clothing, whereby producers source their own inputs and sell to overseas buyers (Douglas et al, 1994; Clark & Kim, 1995). But even smaller producers often produce to the order of buyers or else are indirectly connected to export networks as subcontractors. The industry as a whole is thus quite strongly export oriented.

Most garment companies in fact have relatively few local linkages. Many have developed extensive subcontracting networks, which extend beyond Singapore, while larger companies have even set up their own branches overseas in the past few decades, in locations such as Malaysia, Indonesia and Sri Lanka (Douglas et al, 1994).

Most inputs are sourced overseas (e.g. from Taiwan, Hong Kong, Japan and Korea, but even from Europe and the USA) and thus imported. This is a consequence of the fact that supplying industries such as textiles and fabric mills, have been discouraged by the government because of their use of relatively scarce resources on the small island state: water and land. Textile and fabric mills often require big factories, and large amounts of water for the washing and dyeing processes. In addition they tend to create large amounts of (polluted) waste-water<sup>16</sup>. Thus by the mid-nineties the small textile industry that had been present in Singapore had all but disappeared (Douglas et al, 1994). Local interconnections concern mostly those with local subcontractors and with trading companies or branches of international input suppliers.

The fashion segment that has evolved consists mostly of small firms based around a designer or group of designers. A substantial part of this segment has no direct connection to garment production and never did. The organisation of these businesses does not revolve around the Chinese family business but rather around a professionally trained (group of) designer(s). Behaviour and business attitudes are therefore likely to be quite distinct from garment manufacturing firms. In addition this segment generally experiences a more positive approach by government, which will most likely have influenced their trust and attitudes towards government.

#### *4.6.2 Industry Specific Institutions and Policies*

Despite the fact that the industry receives little to no attention in national policies, some industry specific institutions and policies are in place.

##### *Industry association*

The Singapore Textile and Fashion Federation (TaFF) is the official industry association. The roles and functions of the industry include (i) representing the interests of the industry vis-à-vis the government (industry voice), advising in policy matters concerning the industry; (ii) providing education and training for its members (professional development); (iii) organising

seminars, workshops and conferences, disseminating and providing information (communication); and (iv) providing a general forum and meeting place for industry members (networking). In addition the association tries to promote the industry through activities such as a yearly fashion week (organised jointly with the TDB and the Singapore Retailers Association) and trade missions ([www.taff.org.sg](http://www.taff.org.sg)).

Over the years the focus of the industry association has broadened from functioning mainly as a manufacturers association to also representing and encouraging local designers, brands and retailers. This seems to be in line with the general strategy adopted by the Singapore government. The activities of TaFF therefore now include both manufactures oriented activities and non-manufacturing activities. In addition, the industry has close contacts with several of the buying offices located in Singapore and even has members among this group, another illustration of the broadening of the association's scope.

This broadening of the scope of its functions and especially the emphasis on 'fashion' was probably not just a reflection of changes in the industry, but also a way to be able to secure more government support and co-operation for the industry as the shift of emphasis towards 'fashion' better fitted general policies towards higher value added activities. Thus TaFF seems to have adjusted the industry's image in part to accommodate government strategies. As such it has been instrumental in retaining and perhaps even renewing at least some interest from the government for the industry, despite its relatively small size.

#### *Training and education*

Professional training is organised predominantly through the TaFF, or takes place in-house. There are four fashion and design schools: Raffles LaSalle International Design School, Temasek Polytechnic School of Design, LaSalle SIA College of the Arts and Nanyang Academy of Fine Arts. These schools – as their names suggest – focus on design and merchandising skills and less on technical and production skills. In fact such skills are scarce in Singapore and in some cases firms hire skilled professionals (production workers) from for instance China and Hong Kong (Finnerty, 1991). This presents somewhat of a contradiction to the 'usual' motivation for hiring foreign workers namely the scarcity of cheap low skilled labour in Singapore, not the scarcity of skilled labour.

#### *Industry specific policies*

The industry specific policies and incentives that are in place have mostly been orchestrated and implemented by the Trade Development Board (TDB), a government institution, in co-operation with TaFF. Programs were developed to:

- stimulate technological upgrading and IT applications (e.g. development of a management information system);
- encourage skills enhancement (through subsidised training programs, both in-house and external);
- improve information flows (e.g. through publications, seminars and workshops);
- encourage overseas activities (e.g. assistance with production relocation, exploring new markets through trade missions and subsidies for the setting up of sales and marketing offices overseas).

In addition specific quota allocation policies are in place for the industry. Although quota regulations are implemented by importing country governments, how these quotas are subsequently divided and allocated to individual firms is left to the government in the exporting country. The local government thus controls how transparent and fair this quota allocation process is, and whether quota are free. The Singapore government has opted for a quota tendering system (see box 4.1). The argument for such a system was that it greatly

enhances transparency and fairness of the quota allocation process. However, some industry members disagree, as it is argued that it adds to producers cost (quota have to be bought). In addition, as the system allows performing companies to hold on to quota allocations from the previous year, entry into export markets is very hard for newcomers, as existing quota holders prefer to pay the price for unused quota rather than lose these quota altogether (Finnerty, 1991). As such it also increases inefficient use of allocated quota.

#### **Box 4.1 Garment Quota Allocation in Singapore**

For each exporting country quota (growth) levels are set by the importing country (e.g. the US) on a yearly basis. It is then left up to the exporting country's government to allocate these quota and to ensure quota regulations are upheld.

In the case of Singapore, the government introduced a tender quota system in 1987 to make quota distribution more transparent. The Trade Development Boards manages all quota and quota bidding.

Quota were split in three categories: (1) Basic Quota (80% of all quota); (2) Non-performance quota (20% of all quota); and (3) Performance quota (un-utilised basic quota).

When a company successfully bids for a performance quota, it becomes a basic quota. Before 1994 each company was only allowed to retain 75% of the basic quota the following year, forcing it to bid every year. The system was adjusted in '93/'94, after which companies were allowed to retain 100% of basic quota if they fulfilled it in the previous year. A levy has to be paid on basic quota.

The actual bidding is completely computerised and bids are posted online. Every company can submit two bids for each product category. The price of the quota is equal to the lowest bid.

For instance there is an item up for tender with a quota of 100 dozen. Three companies bid, A bids 40 dozen at three dollars/piece, B bids 50 dozen for 2 dollars/piece and C bids for 30 dozen at 1 dollar/piece. The outcome is that both A and B will get their full bid, while C gets only 10 dozen. All pay 1 dollar a piece, since this was the lowest bid. Thus it happens that a company will bring out one bid for 60 dozen at 10 dollars and 10 dozen at 1 cent. If the one-cent bid makes it, all bids will be at 1 ct. This happens quite often in the 'cold' items, in which quota often aren't fulfilled anyway. In the case of Singapore only a few categories, such as knitted shirts and polo's are completely filled

#### **Effects of the quota tender system**

The tender system has made the whole business of quota allocation transparent and no longer subject to human decisions. i.e. fair. However, some members of the industry claim the government collects the money, but doesn't 'pump it back into industry'. According to one company manager:

"Up till now (12 years after the system was introduced), government has made an estimated 400 million S\$ off the quota system. The only thing it puts back into the industry is the funding of the yearly Fashion Connections week. This comes down to approximately S\$600.000, in other words a little over 7 million over the past 12 years. A stark contrast with what it has subtracted from the industry" (Interview, 1999).

As such, they argue, the quota bidding system functions as an export or sales tax, profits creamed off from the industry. Hence these profits can not be used for (re-)investments. Some even see the system as an indirect way of pushing the industry out, thus releasing labour for other industries and sectors.

#### **Overseas production and quota**

Singapore producers producing abroad and exporting these goods to a third country have two options:

- \* Make use of local quota of the country where they produce
- \* Make use of Outward Processing Arrangement (OPA). In this case the company must still have a production facility in Singapore and add value in Singapore.

#### **Illegal transshipments**

If a company exports products from Singapore under Singapore quota, yet hasn't added any value to these products in Singapore, this is considered illegal transshipping. Sometimes foreign firms will set up mock factories in a country that has quota available (usually higher cost countries). In the early 1990's for instance a lot of Singapore quota were actually being filled by other countries in this way. However, after a slap on the wrist by US customs, the Singapore government has taken action

against this practice and it is now hard or impossible to get away with. Quotas are now allocated according to number of staff and amount of local subcontracting (minimum 30%). There is some leverage, but a company must be able to show production records. In other words, if you have very little staff and do not subcontract any production locally, you are not eligible for large quota.

*Source: Interview Secretary TaFf (1998)*

In line with the general development path promoted by the Singapore government and institutions since the late 1980s, for the garment industry too the intention has been to create and stimulate an industry focusing on non-production and downstream activities (moving along the value chain to higher value added activities). Several more recent policies have therefore focused on areas such as design, branding, marketing, retailing, and more generally the promotion of Singapore as a fashion and trading hub, and regional/international 'shopping paradise' for high-end international fashion brands. It is assumed this has had a positive effect on local designers and labels (Douglas et al, 1994).

In concurrence with promotion of OHQs establishments in Singapore, ample incentives have been provided to both buyers and distributors for the setting up regional trading, sourcing and distribution offices. Besides providing direct incentives, government also continued to upgrade supporting services and infrastructure to accommodate its function as a regional hub. Government policies towards the industry thus seem to have been twofold, fitting the general policy of encouraging higher value chain activities, while discouraging lower value-added, labour intensive production activities. From a production point of view, the industry is clearly not targeted by the government as one to be encouraged and (further) developed. Most policies have pushed for restructuring and relocation, there are relatively few specific incentives, linkages within the industry haven't really been promoted and there is a lack of specialised supplying and supporting industries and institutional linkages (the industry was clearly not a target of the government's cluster policy). However, from a chain perspective, new possibilities in other, non-production segments of the chain seem to have opened up and are being supported as desirable directions for the industry.

#### *Firm specific policies*

Next to industry specific policies and incentives, at the firm level, the Singapore government has introduced extensive government development assistance programmes (GDAPs), particularly for SMEs. This was in line with the renewed interest in the role and possibilities of SMEs and local entrepreneurship from the late 1980s onwards (Chan & Ng 2001). Incentives may take the form of grants, loans and tax incentives, but also courses and consulting services. Just like other manufacturing firms, garment manufacturers, which predominantly fall in the SME category, can make use of these schemes provided they meet the eligibility criteria and the assistance requested fits into the government's general policy directions of technological upgrading, higher value added production and internationalisation. It appears, however, that few garment companies in fact make use of these programs.

#### **4.7 Effects and Implications of the Changing Local Business Environment for the Development of the Garment Industry**

We conclude this chapter with a contemplation of the impact of the local business environment on firm behaviour in the industry.

Although only a few policies were devised specifically for the garment industry or for garment firms, national strategy and generic policies (national economic, sectoral and industrial) have all affected the industry, and particularly production restructuring.

The overall implication of the government's development strategy was that certain activities and industries, which were at one point encouraged, in later phases were quite deliberately 'pushed out' and discouraged (creative destruction). The garment industry is perhaps one of the most prominent examples of such an industry. Although the general policy was thus for adjustment and upgrading, the effects of these generic policies and Singapore's development path differed substantially per industry and between different activities within them.

Generally speaking, the predominantly local and labour intensive, low-tech garment industry may have fit Singapore's earlier development strategy of labour absorption, it ill fitted the general FDI-leveraging model of Singapore's development strategy and the government's relentless drive towards higher value-added, higher skilled, high-tech and more recently knowledge intensive activities and industries. Although some policy initiatives were undertaken, these appear erratic and were often selective, making overall attitudes towards the industry ambiguous at best. What seems to be lacking is a clear, consistent and focused strategy towards the industry, which is probably also a consequence of the fact that different segments are often viewed separately (e.g. production from design and fashion, foreign buyers from local entrepreneurs, etc.). Increasingly, however, there is agreement over the fact that effective industry policies need to take a more integrated approach (see e.g. ILO, 1998a, 1998b). Support is not absent, but can hardly be called active. It requires a very pro-active attitude (of a generally somewhat conservative group of local entrepreneurs) and creativity in 'striking the right cord' with government institutions (e.g. adding terms like fashion, brand and design to names and proposals), when applying for it.

In terms of the garment manufacturing segment, years of neglect of local firms and discarding of labour intensive industries and activities may have created somewhat of a psychological barrier between policy makers and garment manufacturing firms. This would also explain the low participation rate of garment firms in existing GDAPs. Smaller manufacturing firms in particular therefore probably see the government as a source they need not expect any help or support from and in the worst case should even distrust. Such an attitude is hard to overcome, although for instance the TaFF is actively trying to bridge this gap and overcome the barrier, both by trying to convince the government of the industry's contribution and importance and by encouraging trust and networking between firms and between firms and the government. Although perhaps successful at the level of medium sized companies, the gap may prove harder to bridge for the smallest firms, as they are usually also not very well connected to industry specific institutions.

On top of the ambiguous position of government towards the industry and its generally 'peripheral' position vis-à-vis the dominant forms of economic organisation, the garment industry was also more strongly affected than other industries by some of the general changes in the local environment since the 1980s and subsequent policies implemented.

For instance, lack of technical and managerial expertise (due to generally lower education levels) in especially the smaller garment firms (which also lacked capital) made it very difficult for many of them to adjust to these policies.

In addition, due to the nature of the industry, wage increases can not be compensated by automation and productivity increases, while garment firms have a harder time competing on local labour markets. The consequent high share of foreign workers in most companies added, rather than reduced overall cost due the two-tier levy system. Finally, lack of capital for overseas investments meant many of particularly the smaller firms are probably 'stuck' in Singapore's high cost business environment and cost cutting and labour strategies (particularly exploitative ones) are seen as the only strategic options for these firms.

On the other hand, however, the typical characteristics of CFBs may well be found in Singapore garment firms as well. The use of social and business networks, even across borders, and especially 'self reliance' and survivalist attitude, could explain in part the industry's resilience despite the generally unfavourable business environment and the official institutional neglect of local indigenous enterprise and downright negative attitude towards labour intensive industries and activities.

Similarly it has been argued that an economy with few entrepreneurs and few entrepreneurial resources and support of local indigenous entrepreneurship (i.e. Singapore) could actually stimulate internationalisation processes, as local firms go international to compensate for the lack of business opportunities and support at home. Following this strategy might eventually make them more entrepreneurial and competitive (Yeung, 2002). It has been noted that the Singapore garment industry was in fact among the first to regionalise production and by now produces about three quarters of its total output overseas (The Straits Times, January 17, 2003). Lack of unionism and general labour laws have been favourable to garment firms and entrepreneurship as well, as it allowed for a great deal of flexibility and has probably made the process of restructuring production and relocating operations overseas easier (firing workers can be done fast and at little cost, making e.g. relocation of production capacity overseas relatively easy).

The inclinations of the CFB to subcontract and rely on extensive business networks, while retaining core decision making processes, may have been given an extra push by the deliberate policies for regionalisation by the government from the late 1980s onwards. This would in part explain the sudden decline observed in terms of domestic output and exports in the early 1990s (see table 4.1).

Finally, it could be argued that the observed shift to higher value added products in existing firms, which has been noted by several authors and articles (Douglas et al, 1994; Straits Times, January 17, 2003) were driven mostly by buyer requirements and needs (as the GCC literature seems to suggest, see e.g. Gereffi, 1999). However, it could also be argued that the producers' capacity to respond adequately to these requirements may have been influenced by the Singapore government and its economic and industrial policies of accommodation of the demands and requirements of foreign capital. Most garment firms perhaps fit perfectly in the process specialist category suggested by Wong (1999), even though this term was originally seen to apply to local (sub-)contractors of TNCs.

In terms of the fashion segment, the shift of attention towards higher value added and fashion may have created opportunities for firms that actively moved in these directions (developing own brands) and newcomers such as local designers.

Finally, government policies, Singapore's strategic location and advanced infrastructure have attracted a number of buyers and buying agents to set up regional sourcing offices in the city-state. They could be indicative of a shift towards Singapore becoming a regional sourcing and trading hub for garments, competing with Hong Kong. As they are foreign investments they will undoubtedly receive more government support, and their relationship with, and attitudes towards government will most likely be positive.

## **Conclusion**

At first sight, increasing competitive pressures - particularly Government's relentless push for restructuring, upgrading and relocation of labour intensive activities and industries - seems to have had mostly negative effects on the Singapore garment industry. Particularly since the early 1990s official statistics demonstrate a substantial decline of the industry in terms of production output, employment and exports. However, a review of existing literature and our

own inventory of the industry already revealed underlying dynamics may in fact be more complex.

An in-depth analysis of Singapore's institutional context, national business system and industry specific context, revealed that firm behaviour and developments in the garment industry may prove to be consistent with national strategies of restructuring and creative destruction, even though official statistics seem to merely suggest industry decline. Effects of the national business environment were thus not entirely negative, despite the fact that the garment industry had a generally 'peripheral' position vis-à-vis the dominant forms of economic organisation, received little to no specific policy support and had more or less been neglected in favour of FDI and large conglomerates. The strong economic bureaucracy and the State's ability to diffuse philosophies of continuous upgrading, relocation and creative destruction through economic and industrial structures, corporatism (enabling flexibility) and specific characteristics and business attitudes within the industry seem to have contributed to a remarkably resilient segment of garment production companies as well as the entry of new segments, while this is most likely also the result of the industry's own internal logic.

In chapter 8 we return to the local business environment, linking it more explicitly to actual strategies and development trajectories in the industry, derived from the empirical analysis of survey results in chapter 6.

First, however, the evolution and local business environment of the Malaysian garment industry will be considered in the next chapter

## Notes

<sup>1</sup> Due to the small size of the Singapore economy, it does not feature among the top importers of apparel, nor in the top apparel trading nations. Therefore the focus here is on exports only, which remarkable considering the City State's small size.

<sup>2</sup> Although the imperatives are presented here as separate factors at separate scale levels, this is only done for analytical purposes. It is important to keep in mind that they are often interrelated and overlapping

<sup>3</sup> Our own survey and conceptualisation of firm strategies was in part based on this survey.

<sup>4</sup> This assertion was based on the fact that almost 24% of orders for garment firms in the survey originated from local import/export companies, with another 17 % going to local wholesale-retail establishments. Official statistics however do indicate that more than 80% of the industry's total output is exported.

<sup>5</sup> These included the Trade Union Amendment Bill (1966), effectively declaring strikes illegal ; the Employment Act (1968); and the Industrial Relations Amendment Act (1968) (Chiu, Ho & Lui, 1977).

<sup>6</sup> Until 1986 the CPF took 25% of workers' salaries, and employers had to contribute a further 25%. In 1986 the employers' contribution was reduced to 10% while the employees' remained unchanged. The payroll tax (2% of salaries) was suspended and the skill development tax halved (from 4%) for a 3 year period. From July 1, 1988, the employers' CPF rate was set at 12% with the employees' rate reduced to 24%. In addition, government announced that mandatory contributions to the CPF for workers over 55 years old would be cut (Finnerty, 1991)

<sup>7</sup> Encouraged by tax incentives, labour intensive manufacturing operations would be transferred to Riau province in Indonesia and Johore State in Malaysia to take advantage of the lower labour costs there. This has been called the SIJORI growth triangle (Kim, 1993).

<sup>8</sup> The Singapore government has stimulated the establishment of so called Operational Headquarters (of large TNC's) within its territory. Functions performed by OHQ's are firm-specific and include the co-ordination/overseeing of production/the operation of production plants in the region, financial functions, R&D, logistics functions, etc. (Dicken & Kirkpatrick, 1991)

<sup>9</sup> I am indebted to Professor Rajah Rasiah for bringing the statistics of the World Bank Institute to my attention

<sup>10</sup> Thus, for instance, Singapore managed to manifest itself as 'a leading electronics contract manufacturing hub with 4 of the world's top 10 contract manufacturers being Singaporean firms' (Wong, 1999, p.22).

<sup>11</sup> In addition the rapid growth of foreign labour during the 1970s and the high share of the total workforce they made up, was cause for alarm, as the government feared the social problems they might bring with them.

<sup>12</sup> The Central Provident Fund was set up in 1955 to provide financial security for workers in their retirement or when they are no longer able to work

<sup>13</sup> Including international trading services, transport and logistics, professional services, media and communications and tourism (CSC, 1998)

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<sup>14</sup> This older generation or their parents migrated from mainland China for perceived better opportunities. They went through Singapore's first steps towards independence and economic development, when unemployment and poverty were still high

<sup>15</sup> For a more detailed discussion of ascribed and earned trust, see Schmitz (1999).

<sup>16</sup> In addition local demand (from garment producers) was not sufficient to sustain capacity and due to the industry's local orientation, this insufficient local demand was not compensated by exports.

## **5 Evolution of the Malaysian Garment Industry in Local Context**

### **Introduction**

The focus of this chapter will be our second case: the Malaysian garment industry. It analyses the development of the industry and the national business environment in Malaysia in a comparative perspective, revealing the differences and similarities with the Singapore case.

The industry, and specifically the production segment in Malaysia, continues to play a significant role in the industrial and economic development and structure of Malaysia, much more so than is the case in Singapore. To an extent this may stem from the different phases of economic and industrial development the two countries find themselves in, but it is also likely that it is a consequence of differences in sources of competitive advantage. Generally speaking, the economic development path of Malaysia shows similarities with Singapore's, with FDI and Government policies playing an important role. However, there exist some marked differences between the national business environments in the two countries, which have subsequently affected the development of the apparel industry differently.

In this chapter we will first consider the industry's development according to official statistics, and the main pressures or imperatives it faces (section 5.1). Subsequently we present our own inventory of the industry, highlighting some of the discrepancies with official statistics (section 5.2), followed by an in-depth look at the national business environment in which Malaysian apparel firms operate focusing on the institutional context (section 5.3), the national business system (section 5.4) and the structure and characteristics of the industry and its industry specific local context (section 5.5). We conclude with a consideration of the (possible) effects and implications of the local business environment for the apparel industry, given its specific characteristics (section 5.6).

### **5.1 Incorporation and Development of the Malaysian Apparel Industry**

The development of the apparel industry in Malaysia is closely related to the export industrialisation phases of the Malaysian economy, especially since the mid 1980s onward. The incorporation of the industry in global production networks and chains coincided with two major and inter-related developments in the global and regional economy: (1) the ongoing economic and industrial restructuring in the West; and (2) the emergence and development of a regional division of labour within Asia, driven by a wave of FDI from Japan and the NIE's into the rest of Asia (see also Rasiah, 1995; Aoki, 1995). The Malaysian apparel industry managed to profit from both these trends and incorporation took place in two ways: (i) through investments from Japanese and NIE producers (especially Taiwan, Singapore and Hong Kong) that set up manufacturing branches in Malaysian EPZs, making the country part of the triangle manufacturing arrangements that developed within Asia (see chapter 1); (ii) in the course of the 1980s, local firms managed to develop the specific competencies and capabilities for direct CMT or OEM supply to lead firms from the West. Malaysia's initial role in these global networks and chains was thus predominantly based on low cost assembly operations.

#### *5.1.1 Growth and Development: The Statistics*

Before taking a closer look at the subsequent development of the industry as found in official statistics, some notes must be made regarding these official statistics, as their analysis presented several problems. First of all, the statistics presented by the different sources often differ substantially (see table 5.1).

**Table 5.1 Number of Apparel Establishments<sup>1</sup> in Malaysia Based on Different Sources (1991-'99)**

|             | Number of establishment according to    |  |   |   |  |                       |
|-------------|---|--|---|---|--|-----------------------|
|             | DOS, Monthly Mfg. Statistics, Jan. 2001 | DOS, Annual Survey of Mfg. Ind., 1993/94 | DOS, Census of Mfg. Industries, 1993/97 | DOS, Yearbook of statistics, 1998/99/00 | BERNAMA, Int'l Trade & Industry Report, 1999 | MIDA, Industry Briefs |
| <b>1991</b> | -                                       | -  | -                                       | 354                                     | -  | 1000                  |
| <b>1992</b> | -                                       | -  | -                                       | 363                                     | -  | 1000                  |
| <b>1993</b> | 158                                     | 377                                      | 3764 <sup>1</sup>                       | 3764 <sup>2</sup>                       | -  | 1000                  |
| <b>1994</b> | 157                                     | 352                                      | -                                       | 352                                     | -  | 1000                  |
| <b>1995</b> | 153                                     | -  | 3606                                    | 3606 <sup>2</sup>                       | -  | 1000                  |
| <b>1996</b> | 146                                     | -  | -                                       | 2726 <sup>2</sup>                       | -  | 1000                  |
| <b>1997</b> | 152                                     | -  | 3265 <sup>3</sup>                       | -                                       | -  | 1000                  |
| <b>1998</b> | 146                                     | -  | -                                       | -                                       | -  | 1000                  |
| <b>1999</b> | 134                                     | -  | -                                       | -                                       | 190  | 1000                  |

<sup>1</sup> This number includes 'clothing factories': **750** establishments (19.9% of total), accounting for 89.7% of total value of output; 'custom tailoring and dress making': **2,934** establishments (77.9% of total), accounting for 6.1% of total value of output; and 'manufacture of miscellaneous wearing apparel n.e.c.': **80** establishments (2.1% of total), accounting for 4.2% of total value of output.

<sup>2</sup> Coverage is that of a census

<sup>3</sup> This number includes 'clothing factories': **701** establishments (21.5% of total), accounting for 91.5% of total value of output; 'custom tailoring and dress making': **2,486** establishments (76.1% of total), accounting for 5.0% of total value of output; and 'manufacture of miscellaneous wearing apparel n.e.c.': **78** establishments (2.4% of total), accounting for 3.5% of total value of output.

Sources: DOS & MIDA, various years; Bernama (1999)

This is probably due to different definitions, different inclusion and exclusion considerations (e.g. DOS statistics include only establishments with more than 50 employees) and different methods of data collection and manipulation, as well as a lack of awareness of the importance of such data gathering and a lack of manpower to collect and maintain up to date information. Although discrepancies between statistics from different sources are common, in this case some are too substantial to just disregard. Secondly, data weren't always easy to come by as the textiles and apparel sub-sectors were often thrown together in statistics. The contribution of each sub-sector to value added, output, exports, etc. varies though. For instance, over the past decade or so, the share of the textiles sub-sector in total exports has been between 26 and 35 percent and the share of the apparel sub-sector between 74 and 65 percent (MKMA, 2000). Another problem encountered was inconsistency in the definition of categories. For instance, sometimes statistics are presented for 'wearing apparel', while in other cases (and sometimes within the same documents or reports) they pertain to a number of specific product categories (e.g. in SITC codes). This makes data comparison extremely hard<sup>2</sup>. Finally, it must be noted that the MIDA estimate of 1000 (last column) has remained the same since the early 1990s, which is probably not a good reflection of reality, as at least some changes could be expected over a ten year period.

These difficulties do not preclude an analysis, but indicate that it is important to keep in mind the origin of the statistics and take into consideration their coverage. The principal statistics of the apparel industry presented in table 5.2 are for the greater part based on the Yearbook of Statistics, Malaysia, published annually by the Department of Statistics (DOS). These data pertain only to the group of firms employing 50 or more employees, with the exception of some years when census data were used. These statistics are complemented with export statistics from the annually published DOS External Trade Statistics. These export figures pertain to all apparel exports though (i.e. including from firms with less than 50 employees

and including some re-exports) and therefore are higher than the value of output presented in column four.

As becomes clear from the table production and exports grew rapidly in the late 1980s and early 1990s. The industry played an important part in labour absorption and – due to its strong export orientation – in export earnings.

**Table 5.2 Key Indicators of the Malaysian Apparel Manufacturing Industry, 1979-1999**

|                         | No. of establishments (DOS) <sup>1</sup> | No. of factories (MIDA) | Output <sup>1</sup> (RM mln) | Value added <sup>1</sup> (RM mln) | Workers (no. of paid employees) <sup>1</sup> | Exports (RM mln) <sup>2</sup> | Share of total merchandise exports (%) |
|-------------------------|--|-------------------------|------------------------------|-----------------------------------|--|-------------------------------|--|
| <b>1979</b>             | 187                                      | -                       | 276.0                        | -                                 | 16,712                                       | -                             | -                                      |
| <b>1981</b>             | 172                                      | -                       | 443.0                        | 151.0                             | 23,283                                       | 369.1                         | 1.4                                    |
| <b>1982</b>             | 295                                      | -                       | 469.0                        | -                                 | 24,855                                       | 406.3                         | 1.4                                    |
| <b>1984</b>             | 213 <sup>3</sup>                         | -                       | 550.0 <sup>3</sup>           | 549.2                             | 30,900                                       | 682.2                         | 1.8                                    |
| <b>1986</b>             | 195                                      | -                       | 876.0                        | 295.0                             | 34,103                                       | 1,108.2                       | 3.1                                    |
| <b>1988</b>             | 214                                      | -                       | 1,443.0                      | 471.0                             | 46,153                                       | 2,174.8                       | 3.9                                    |
| <b>1990</b>             | 323                                      | 1000                    | 2,381.0                      | 758.0                             | 64,644                                       | 3,556.4                       | 4.5                                    |
| <b>1992</b>             | 363                                      | 1000                    | 2,981.0                      | 938.0                             | 71,417                                       | 4,756.3                       | 4.6                                    |
| <b>1995</b>             | 3,606 <sup>4</sup>                       | 1000                    | 3,386.0                      | 1,196.0                           | 76,949                                       | 5,682.0                       | 3.1                                    |
| <b>1997</b>             | 152                                      | 1000                    | 3,637.5 <sup>5</sup>         | 2,334.0 <sup>5</sup>              | 57,564 <sup>5</sup>                          | 6,555.6                       | 3.0                                    |
| <b>2000<sup>6</sup></b> | 2,682                                    | 1000                    | 5,170.0                      | 1,669.0                           | 77,021                                       | 8,562.5 <sup>7</sup>          | 2.7                                    |

<sup>1</sup> Based on DOS Yearbook of Statistics, only includes companies with more than 50 employees

<sup>2</sup> 1986 based on MIDA, Industry Brief, April, 1996; 1990-1999 based on DOS External Trade Statistics

<sup>3</sup> 1983

<sup>4</sup> Coverage is that of a census; includes 'clothing factories', 'custom tailoring & dress making' and 'manufacture of miscellaneous wearing apparel n.e.c.'

<sup>5</sup> Based on DOS, Annual Survey of Manufacturing Industries, 1998, figure for 'Workers' refers to total number of persons engaged

<sup>6</sup> Based on DOS Census of Manufacturing Industries Malaysia, 2001

<sup>7</sup> 1999

*Sources: DOS (various years); MIDA (various years); UNIDO (1991); WTO (1999)*

Although, as in Singapore, the apparel industry was quickly overshadowed by the electronics industry (which had a 53 percent share in total merchandise exports in 1998), it demonstrated remarkable resilience, especially during economic downturns. By 1998, it was still the fourth biggest contributor to manufactured export (MKMA, 2000).

### *Products and markets*

The main products manufactured in Malaysia for export are basic casuals and sportswear, with little production of more fashion oriented or highly sophisticated products. There seems to have been a tendency to move towards knit apparel as well, which indicates an increasing specialisation in basic knitwear. Thus while in 1990 a mere 12.8 percent of apparel exports consisted of knit apparel and 35.5 percent consisted of woven apparel, by 1999 the picture had changed completely, with knit apparel accounting for almost 33 percent and woven apparel having dropped to just over 23 percent of total apparel exports (DOS, 1991, 2001).<sup>3</sup>

The main destination for Malaysia's apparel exports are the USA followed by Europe (most notably the EU countries). Throughout the 1990s approximately 30 percent of all Malaysian apparel exports went to the USA. The share of exports destined for the EU markets declined though, from almost 22 percent in 1993, to just over 14 percent in 1999. This relative drop in exports to the EU was mainly compensated by an increase in exports to Asian countries, most

notably Singapore and Japan, although the 1997 Asian Economic crisis substantially decreased the attractiveness of these markets.

Globally Malaysia's export position improved substantially during the 1980s and early 1990s. However, despite overall growth of the industry, since the early 1990s it seems to be tapering off (MIER, 1996), as is reflected in the industry's share in total merchandise exports (see table 5.2) and in its global export position (see table 5.3). This tapering off continued throughout the 1990s.

**Table 5.3 Malaysia Apparel Exports and Global Export Position 1980-1999**

|  | 1980 | 1990  | 1995  | 1999  |
|--|------|-------|-------|-------|
| Value total apparel exports (mln US\$)   | 149  | 1,315 | 2,266 | 2,253 |
| Share in world apparel exports (%)       | 0.4  | 1.2   | 1.4   | 1.2   |
| Global ranking Malaysian apparel exports | 36   | 21    | 21    | 19    |

Source: WTO, 2000

This could imply that a similar process as took place in Singapore is occurring in Malaysia. Indeed many of the imperatives experienced by the industry in Singapore in the late 1980s seem to be encroaching on the competitiveness of Malaysian apparel firms as well. Specific imperatives will be considered in more detail below, as some are in fact different or have (had) a different effect than in the Singapore case.

### 5.1.2 International Imperatives

#### *Global and regional economic climate*

Although the global recessions of the 1970s and mid 1980s had similar effects on Malaysia as they did on Singapore, Malaysia was much harder hit by the 1997 Asian economic and financial crisis than Singapore. For a detailed overview of the unfolding of this crisis in Malaysia and the immediate responses, see Nesadurai (1998) and Jomo (1998).

The actual beginning of the crisis can be traced back to well before 1997, as structural weaknesses in the (real) economies of Thailand, Korea, Indonesia and also Malaysia led to their declining competitiveness since the mid 1990s, especially in comparison with Latin American countries and China.

Although the crisis started in Thailand, eventually the Malaysian economy too was heavily impacted, with a sharp devaluation of the Ringgit, substantial capital flight, and a banking crisis, which eventually affected the real economy. The handling of the crisis by the Malaysian Government has evoked international criticism. It refused IMF assistance and instead installed capital controls and pegged the Ringgit. In addition it seemed the Government did not want to give up its ethnic bases distributive policy, which has been criticised as encouraging political patronage and crony capitalism (see below).

Although the crisis initially did not seem to affect the export oriented apparel industry directly (export markets remained strong) some of the structural weaknesses such as lagging productivity and dependence on (cheap) foreign labour, eventually became apparent. The effects of the crisis on the industry have been mostly felt indirectly, through foreign workers policies and exchange rates, as we will explain in more detail below

#### *International trade restrictions (MFA)*

The international institutional environment at the time when the Malaysian garment industry entered into global production networks and developed within them was strongly influenced

by the quota system under MFA (see chapter 1). However, effects for Malaysia were dual. On the one hand it stimulated the growth of the industry in the initial stages of incorporation, as NIE companies, having filled quota at home, were looking for new production locations with available quota and buyers were looking for new sourcing locations. In later stages it cushioned and to an extent protected the industry from regional competition, especially from countries like China. The latter is a substantially cheaper production location, but is severely limited in its export expansion by quota restrictions. Therefore many buyers still source from relatively more expensive locations such as Malaysia.

On the other hand however, quotas may have hampered expansion of the industry locally. With only a limited amount of quota to be allocated among industry members annually, some firms were unable to expand further (i.e. orders could be obtained, but quota to be able to fulfil these orders couldn't), while others were unable to get into certain export markets altogether.

The effects for the industry as a whole (which of course may not be positive for all individual companies) seem to have been positive though. Whether the same will be true for the phasing out of the quota system is unclear as of yet. However, given the drawing force of China as a production sourcing location for the world (also due to its accession to the WTO) and the tariff advantages given to many African and Latin American countries (see chapter 1), it is likely that competitive pressures due to international trade policies will increase substantially.

#### *Regional and global competition*

Malaysian garment companies entered into global production networks and chains somewhat later, hence under different circumstances, than did firms in Singapore. By the time Malaysian firms became incorporated a large number of countries, not just in Asia, had already done so or were in the process of doing so. This number seemed to be increasing at an accelerated pace, implying Malaysia felt the pressures from regional and international competition from a relatively early stage of its development. Although the industry did not directly compete with the East Asian NIEs, or Singapore, it did compete directly with other ASEAN countries such as Thailand and Indonesia, which have managed to retain lower cost levels, while Thailand has also managed to achieve higher (growth of) productivity. Table 5.4 presents a comparison of labour cost and productivity between Malaysia, Thailand and Indonesia.

**Table 5.4 Comparison of Labour Cost and Value Added per Worker in Malaysia, Thailand and Indonesia (US Dollars per Annum)**

|                  |   | 1980/84 | 1990/1994 | % change |
|------------------|---|---------|-----------|----------|
| <b>Malaysia</b>  | Average labour cost per worker (US\$/annum) | 2,519   | 3,429     | 36.1     |
|                  | Average value added per worker (US\$/annum) | 8,454   | 12,661    | 49.8     |
| <b>Thailand</b>  | Average labour cost per worker (US\$/annum) | 2,305   | 2,705     | 17.4     |
|                  | Average value added per worker (US\$/annum) | 11,072  | 19,946    | 80.1     |
| <b>Indonesia</b> | Average labour cost per worker (US\$/annum) | 898     | 1,008     | 12.2     |
|                  | Average value added per worker (US\$/annum) | 3807    | 5139      | 35.0     |

Source: *Business Monitor International (1999)*

On the other hand the emergence of China as an industrial powerhouse with its abundance of cheap, relatively skilled labour is putting increased pressures on Malaysia.

More recently Malaysia seems to be squeezed on the one hand by the lowest cost locations in Asia, and on the other hand by countries closer to the markets and under preferential agreements<sup>4</sup>. This is most clearly illustrated by the changes in import composition of US apparel imports, as the USA is Malaysia's most important export market (see table 5.5).

**Table 5.5 Imports of Apparel into the USA\***

| Year | Malaysia                |       |      | Mexico                  |       |      | Bangladesh              |       |      |
|------|-------------------------|-------|------|-------------------------|-------|------|-------------------------|-------|------|
|      | Value<br>(million US\$) | Share | Rank | Value<br>(million US\$) | Share | Rank | Value<br>(million US\$) | Share | Rank |
| 1989 | 620                     | 2.38  | 11   | 596                     | 2.29  | 12   | 359                     | 1.38  | 16   |
| 1992 | 940                     | 2.85  | 10   | 1196                    | 3.63  | 7    | 763                     | 2.32  | 13   |
| 1995 | 1253                    | 3.03  | 10   | 2904                    | 7.02  | 3    | 1142                    | 2.76  | 13   |
| 1998 | 1418                    | 2.55  | 15   | 6867                    | 12.32 | 2    | 1718                    | 3.08  | 12   |
| 2000 | 1380                    | 2.06  | 18   | 8809                    | 13.13 | 2    | 2279                    | 3.40  | 9    |

\* SITC number 84: Articles of Apparel and Clothing Accessories

Source: USITC (2002)

#### *Global apparel industry developments and increased buyer requirements*

Obviously the increasing importance of lead-time considerations (hence proximity of markets) combined with the effects of favourable trade agreements have put enormous pressures on Malaysian producers. The disadvantage of distance and thus relatively longer lead times had to be compensated by other competitive advantages, such as quality, reliability and an ability to meet ever increasing buyer requirements. This is most likely what has stimulated a move in the late 1980s and early 1990s away from mere assembly operations (CMT) towards full packages supply (OEM). Even foreign owned firms started functioning increasingly as independent set-ups (with local equity shares) and less as dependent subsidiaries of overseas parent companies.

#### *5.1.3 Local Imperatives*

##### *Cost increases*

Table 5.6 presents a more detailed look at changes in labour cost and productivity levels in the Malaysian manufacturing sector and apparel industry since the early 1980s. In the early 1980s wage increases surpassed productivity increases, which led to a deterioration of Malaysia's (cost) competitiveness. This effect was even more pronounced in the apparel industry, where productivity (in terms of output per worker) increased even less.

**Table 5.6 Change (%) in Productivity and Wages in the Manufacturing Sector and Apparel Industry in Malaysia (1979-1997)<sup>1</sup>**

|         | Mfg.<br>output/<br>worker | Mfg.<br>value added/<br>worker | Mfg.<br>remunera-<br>tion/worker | Apparel<br>industry<br>output/worker | Apparel<br>industry value<br>added/worker | Apparel indus-<br>try remunera-<br>tion/worker |
|---------|---------------------------|--------------------------------|----------------------------------|--------------------------------------|---|--|
| 1979-83 | 46.0%                     | -                              | 60.6%                            | 20.8%                                | -   | 59.6%  |
| 1983-86 | 5.3%                      | 42.8% <sup>2</sup>             | 17.7%                            | 28.8%                                | 33.4% <sup>2</sup>                        | 18.3%  |
| 1986-89 | 28.3%                     | 13.5%                          | -0.5%                            | 32.8%                                | 24.1%                                     | 11.2%  |
| 1990-93 | 20.0%                     | 25.4%                          | 28.5%                            | 15.5%                                | 17.7%                                     | 28.9%  |
| 1994-97 | 30.6%                     | 38.4%                          | 30.5%                            | 30.9%                                | 38.3%                                     | 27.0%  |

<sup>1</sup> As numbers were taken from publications from various years, output and remuneration are in current prices.

<sup>2</sup> 1981-1986

Source: DOS (1984/'85, 1990/'91, 1994, 1998, 1999/'00)

The imbalance was partially corrected in the second half of the 1980s. The switch from a focus on import substitution to export oriented production (with its emphasis on competitive labour cost and labour flexibility) and the rise of unemployment after two recessions in the 1980s had weakened the bargaining power of labour (Jomo, 1993). Thus wage increases were limited or even negative in the late 1980s. In addition flexibility was increased by for instance the curbing of the (already limited) power of unions (see section 5.3).

Remarkable is the low increase in output per worker for the manufacturing industry as a whole between 1983 and 1986, especially when compared to the same figure for the apparel industry. However, value added per employee was in fact higher for manufacturing as a whole than for the apparel industry, which may suggest a shift towards higher value added manufactured products took place that was not apparent in the apparel industry. Throughout the 1990s finally, wage increases seem to have been more or less in keeping with productivity increases.

Unfortunately these DOS statistics once again only pertain to a selection of firms, and it is possible that it represents the most productive part of the sector and industry. For instance Tan & Ariff (2001) argue that there is a mismatch between productivity and wage growth, as up till 1997 labour productivity in manufacturing rose 11 percent per annum, while the real average wage in that same period increased by 20 percent (Tan & Ariff, 2001, p.71).

Generally speaking wage increases in the apparel industry have more or less followed manufacturing wages trends, yet productivity increases have lagged behind. As a consequence, according to the National Productivity Corporation (NPC), in terms of labour cost competitiveness the industry has showed a decline of 3.26 percent in 1991-92 and 2.68 percent during 1992-1993 (MIER, 1996, p.6).

The main implication has been that the apparel industry has been affected more by wage increases as it couldn't compensate these with productivity increases in the same way as other industries (e.g. electronics) could.

### *Labour shortages*

With rapid and continued industrialisation and economic growth, the labour surplus experienced until the mid 1980s turned into a shortage by the late 1980s and between 1990 and 1995 the unemployment rate dropped from 5.1 percent to 2.8 percent.

Besides putting pressures on wages, this shortage made it hard for employers' to find enough workers, even if they did pay higher wages. In addition it has contributed to a high labour turnover. This in turn aggravated the problem of the shortage of *skilled* workers in the industry, as skills in apparel production are generally achieved through on the job experience, i.e. the most skilled workers are the ones that have worked in the industry longest. As shortages could not be solved with the use of local labour, many firms resorted to the use of foreign labour. This is especially true for apparel firms, which had a harder time competing for local labour with other industries that paid higher wages, and/or had a better image than the apparel industry. Pay in the industry is predominantly based on a piece rate system and although it has been claimed that because of this experienced workers can take home more pay than they would in industries that pay monthly wages, for the less experienced workers it usually leads to lower pay and in many cases higher wages are only achieved by working overtime. The industry thus has an image of hard work and long hours.

The issue of labour shortages were exacerbated by the 1997 crisis, which caused Government to apply stricter rules and quota for the use of foreign workers and higher levies. Despite the fact that the crisis caused a rise in unemployment locally (i.e. the local labour market became less tight), apparel firms were hardly able to replace foreign workers with locals,

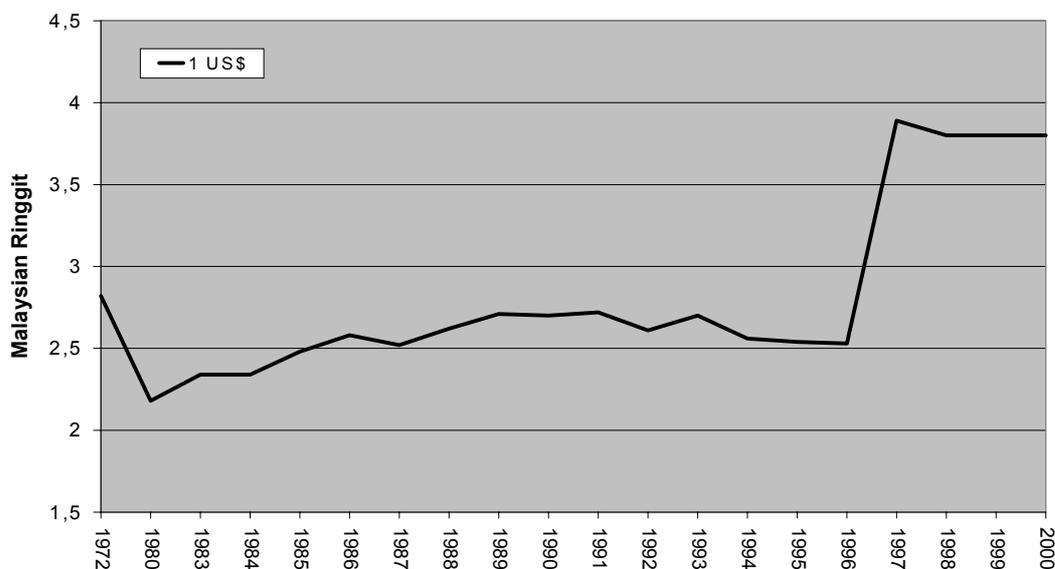
demonstrating the structural nature of the labour shortage issue for the industry: even in times of relative abundance finding and retaining (local) employees is hard for garment firms.

#### *Exchange rate and currency peg*

Throughout the 1980s and the first half of the 1990s the exchange rate of the Malaysian Ringgit against the US dollar remained more or less stable (see figure 5.1). Thus the country was not faced by the substantial currency appreciation Singapore was faced with. In fact, to stimulate the drive for export oriented industrialisation and to enhance the cost competitiveness of Malaysia, the Ringgit was depreciated in the mid 1980s. Overall, the Ringgit remained very stable when compared to other countries in the region (see figure 4.1). This has probably contributed to the strong performance of the industry between the mid 1980s and the early 1990s, with exports more than tripling between 1986 and 1990.

Although the following period saw a slight appreciation of the Ringgit again, the Asian Economic and Financial crisis of 1997 caused a landslide devaluation of the currency almost overnight. To avoid capital flight the Malaysian Government pegged the Ringgit to the US\$ dollar at 3.8 Ringgit per dollar. This peg is still in place.

**Figure 5.1** Exchange Rate of the Malaysian Ringgit (1972-2000, RM/US\$)



Sources: Jomo (2001); DOS, various years; UNIDO (1991)

The devaluation and the subsequent peg have had varying effects on the industry, which is the consequence of the high import share of inputs and the high export share of output.

At first sight, devaluation seems favourable, as it made Malaysian apparel exports cheaper in US\$ terms (and most payments were indeed received in US\$) and indeed the export oriented manufacturing sector of which apparel was a part continued to grow as the US and European markets were still performing well. However, the peg was seen even by most garment producers as mostly positive, as it provided a stable exchange rate, decreasing volatility and risk for the highly export oriented industry.

Just as other capital constraints introduced by the Government, the peg was only intended as a temporary measure to cushion the effects of the crisis, until the economy had stabilised again. However, to date the peg has not been lifted and there is general concern about the adjustments that will inevitably take place once it is lifted. What the outcome will be is not clear and will depend on timing, but overall it may be argued that the longer the peg is

maintained the greater the insecurity and the possibility of substantial adjustments once lifted. All in all currency fluctuations thus seems to have had differential effects on the economy as a whole, and apparel in particular, and the future remains to an extent uncertain.

#### *Limitations of local market and regional integration*

Although in terms of number of consumers the Malaysian domestic market is of course substantially larger than the Singapore market, it does still have some limitations affecting the opportunities for expansion, product development and the emergence of a local fashion industry. This is on the one hand due to the lower income levels in Malaysia. Thus although there is a sizeable domestic market for basic, low priced lower quality garment, the high-end segment is still very small and mostly limited to affluent urbanites in Kuala Lumpur and a handful of other big cities in western peninsular Malaysia. In addition, this small segment of affluent consumers seems to prefer Western brand and designer labels.

Another limiting factor for fashion oriented apparel, is the popularity of the Malay traditional and Muslim dress among especially Malay women (a substantial part of the total population), which are often imported or supplied by local dressmakers or tailors.

Finally, low import duties and the ASEAN free trade agreement (AFTA) imply easy access for (cheaper) products from other ASEAN countries such as Indonesia and Thailand, hence increased competition in domestic markets. The effects of regional integration on the apparel industry thus pertain almost exclusively to domestically oriented producers. Still few exports are destined for the ASEAN markets and free trade between these countries therefore has little or no effect on the export segment. In addition imported Chinese products are very competitive in local markets.

#### *Chinese ownership*

A large number of companies in the Malaysian apparel industry are locally owned Chinese businesses. Although this is not an imperative in itself, it distinguished the industry from many others, the consequences of which will be discussed in more detail below.

Overall similar imperatives to retaining competitiveness can be found in Malaysia as in Singapore. However, generally speaking they were not as pronounced or outright negative as in Singapore (e.g. quota and currency fluctuations), and in some cases effects aren't as clear (yet?). The most pressing issues stem from labour shortages, increased regional and international competition, exacerbated by an apparent lag in productivity development vis-à-vis main competitors.

The question then is, whether the tapering off of growth and the fact that effects of certain imperatives are as of yet unclear, indicate a transitional period for the Malaysian apparel industry and if it is possible to give insight into the direction of such a possible transition.

## **5.2 Sustaining Connections to Global Chains, a Period of Transition?**

Just as in Singapore, at the onset of our research in Malaysia an inventory was made of the apparel industry, which would serve as a database from which companies could be selected to approach for participation in our survey (see table 5.7). For more details see annex A.

In addition this database, which was compiled from various published sources and validated through phone-calls, served to give us an initial insight into the structure of the industry in terms of number and spread of firms present in Malaysia.

Our inventory also illustrated the geographical spread of the industry, which is concentrated in four regions: (1) Central Region (Kuala Lumpur and Selangor); (2) Northern Region

(Penang, Kedah and Perak); (3) Southwest Region (Batu Pahat, Kluang, Muar/Tangkak and Melaka); and (4) Southern Region (Johor Baru & vicinity) (see map 5.1).

**Table 5.7 Inventory of Apparel Firms by Source (excluding double counting) (1999)**

| Source <sup>1</sup> | Initial no. of firms found | No. of firms con-firmed closed | No. of firms not traceable | No. of firms not verified | No. of firms still in operation |
|---------------------|----------------------------|--------------------------------|----------------------------|---------------------------|---------------------------------|
| MTMA                | 154                        | 2                              | 1                          | 3                         | 149                             |
| MKMA <sup>2</sup>   | 9                          | -                              | -                          | -                         | 9                               |
| MGMA                | 124                        | 2                              | 45                         | -                         | 77                              |
| MIDA                | 73                         | 11                             | 17                         | 4                         | 41                              |
| FMM                 | 45                         | 3                              | 5                          | 6                         | 31                              |
| YP                  | 64                         | 5                              | 27                         | -                         | 32                              |
| MITI                | 52                         | 2                              | 9                          | 2                         | 39                              |
| HRDC                | 8                          | -                              | 1                          | -                         | 7                               |
| Other               | 11                         | -                              | 1                          | -                         | 10                              |
| <b>Total</b>        | <b>540</b>                 | <b>25</b>                      | <b>106</b>                 | <b>15</b>                 | <b>394</b>                      |

<sup>1</sup> The following sources were consulted: membership directories of the Malaysian Textile Manufacturers Association (**MTMA**), the Malaysian Knitting Manufacturers Association (**MKMA**), the Malaysian Garment Manufacturers Association (**MGMA**), and the Federation of Malaysian Manufacturers (**FMM**); the company directories of the Malaysian Industrial Development Authority (**MIDA**), the Ministry of International Trade and Industry (**MITI**) and the Human Resources Development Corporation (**HRDC**); company listings in the Yellow Pages of the regions where interviews were held (**YP**) and **Other** 'sources' such as walking or driving by, recommendation by other companies, etc.

<sup>2</sup> Although the MKMA has more members (136 in 1999), many of these were also a member of the MTMA and thus included under this source. In addition a large number are textile, fabrics and accessories producers, as well as washing and dyeing firms, etc., which were not directly relevant for our research.

Source: UU Research, '99/'01

### **Map 5.1 Peninsular Malaysia with Main Garment Production Regions**

As becomes clear from both tables 5.7 and 5.8, the number of companies found that were still in operation (394) is in fact much lower than the estimated of 1000 given by MIDA, yet a lot higher than the number in DOS statistics (see table 5.1).

The lower number of companies in the DOS survey are a consequence of the fact that only companies with more than 50 employees are included. The high estimates of MIDA and MKMA on the other and can be attributed to the fact that this number pertains to production companies of all sizes, including the smallest set-ups and subcontractors, yet probably excluding tailors, which explains the lower number than that of census statistics.

The relatively low number for our own inventory (even before correction) is in part also due to the fact that many garment companies were hard to trace (see annex A).

Accurate statistics as to the size of the industry in terms of numbers of companies are thus hard to find. However, the fact that our own inventory indicated that a large share (almost 20%) of the firms found initially, turned out to have closed or 'disappeared' (not be traceable) points to the fact that the suggested *stable* number of 1000 is unrealistic. Could a similar kind of adjustment as took place in Singapore in the early 1990s be taking place Malaysia? Considering the increasing competitive pressures and the apparent drop in number of companies, as demonstrated by our inventory, the question arises what this means for the industry's connection to global chains.

At this stage official statistics do not seem to be able to give an in-depth picture of developments, gaining further insight into the more complex dynamics requires probing deeper into firm level dynamics, which will be done in chapter 6.

However, first a more in-depth look will be taken at the (changing) local business environment, beyond just the imperatives, as it is an important determinant of firm strategies and firm and industry development trajectories.

### 5.3 Local Business Environment I: The Institutional Context

The focus of this section is mainly on the role of the State in Malaysia and particularly its close relationship with business, as it has pervaded virtually all other elements of Malaysia's institutional context. The power of the State in Malaysia is paramount and can be considered 'developmental', with economic development as a primary goal. However, there has also been a strong social element in economic policy, based on redistribution of wealth among the different ethnic groups. Growth, poverty alleviation and redistribution were achieved under circumstances of both interventionist policies as well as market coordination (Rasiah & Shari, 2001). To understand how the institutional context has structured the national business system and ultimately has influenced the development of the apparel industry it is therefore necessary to first take a closer look at the political economy of development in Malaysia, particularly the role of Government, the core tenets of its policies and ideology, the role of the economic bureaucracy and the intimate relationship that has developed between politics, the state and (big) business.

#### 5.3.1 Political Economy of Malaysian Development Since Independence

Table 5.8 presents a more or less chronological overview of Malaysia's political and economic development, focusing on the most important features of each periods and the enduring legacies, which are all to some extent still present today

The most enduring legacy of the colonial period was the emergence of a plural society with an ethnic division of labour and an uneven distribution of wealth. By 1957 only 53 percent of the population consisted of *Bumiputeras* (literally 'sons of the soil'), which included most prominently the Malays<sup>5</sup>. The rest of the population consisted mostly of Chinese (36 percent) and Indians (11 percent). Ownership shares and income levels varied significantly per ethnic group, with the Chinese holding by far the largest share. After independence the colonial division of labour largely remained, although with increasing industrialisation the Chinese became more involved in manufacturing, Indians often worked in public utilities and the Malays became even more involved in public administration.

Independence marked the beginning of increasingly vocal Malay majority and mobilisation of Malays interest – sparked by discontent over the unequal distribution of wealth – through the United Malay National Organisation (UMNO). UMNO was led by Malay so-called administocrats (civil servants of aristocratic background) that held important positions in the public administration under British rule (Searle, 1999).

During the independence transition UMNO successfully negotiated granting of a special position for Malays, with more restrictive citizenship for non-Malays. When the Federation of Malaya gained its independence in 1957, UMNO formed the Alliance with the Malayan Chinese Association (MCA), which consisted mainly of successful Chinese businessmen, and the Malayan Indian Congress (MIC) to form the first independent Government.

UMNO was the dominant party in the Alliance, after having negotiated a few important compromises before independence with the MCA and MIC, which were later reflected in the Constitution. Known "as 'the bargain' its essence was that in return for liberalized citizenship regulations and a tacit understanding that the Chinese economic interests would not be disadvantaged, the non-Malays agreed to Malay political paramountcy and the paramountcy of Malay symbols in the definition of State" (Searle, 1999, p.32).

**Table 5.8 Political Economy of Malaysia's Industrial and Economic Development: Characteristics and Legacies**

| Period   | Important Socio-Economic and Industrial Features   | Legacy  |
|--|--|---|
| Colonial period prior to 1957                        | <ul style="list-style-type: none"> <li>Economic structure: Foreign owned plantations and tin mines on the one hand and locally owned small holdings (agricultura) on the other</li> <li>Malaysia major exporter of rubber and tin</li> <li>British backed Malay ruling elite</li> <li>Large influx of Chinese and Indian (labour) immigrants, encouraged by British to work in mines, commerce and plantations</li> </ul>  | <ul style="list-style-type: none"> <li>Dual economic structure</li> <li>Hierarchical power structure (Malay elites at top)</li> <li>Plural society and colonial division of labour: Chinese in mining and commerce, Indians on plantations and Malays in small peasant holdings &amp; public administration functions</li> <li>Uneven distribution of economic wealth over ethnic groups, highest ownership shares and income levels among the Chinese</li> </ul> |
| Early independence 1957-1969                         | <ul style="list-style-type: none"> <li>Mobilisation of Malay interest &amp; discontent through UMNO</li> <li>Negotiation of special position of Malays within Malaysian society (the 'bargain')</li> <li>Laissez faire economic policy and continued reliance on foreign capital</li> </ul>  | <ul style="list-style-type: none"> <li>Establishment of UMNO as ruling and most important party, incorporation of Chinese and Indian parties in Barisan Nasional (national Front); Malay dominated Government and State</li> <li>Constitutional recognition of special position Malays</li> </ul>   |
| New Economic Policy (NEP) 1970-1990                  | <ul style="list-style-type: none"> <li>NEP: "to eradicate poverty, irrespective of race"; and to "restructure Malaysian society to reduce and eventually eliminate the identification of race with economic function".</li> <li>From laissez faire to strong Government intervention to appease Malay discontent</li> <li>Restructuring of wealth as primary socio-economic goal</li> <li>Industrial Co-ordination Act</li> <li>Continued industrialisation and economic growth</li> </ul> | <ul style="list-style-type: none"> <li>Restructuring of wealth through 'favouring' of Bumiputeras and Bumiputera entrepreneurship (in practice Malay)</li> <li>Development of Bumiputera industrial and capitalist community</li> <li>Large public administration</li> <li>Economic structure dominated by large corporations and conglomerates</li> </ul>  |
| 'Mahathirism' 1981 – present                         | <ul style="list-style-type: none"> <li>Concentration of power in the Executive</li> <li>Emphasis on business</li> <li>Emergence of wide-spread patrimonialism and political patronage</li> <li>Import substitution industrialisation with National Projects (e.g. National Car Project) (early 1980s)</li> </ul>   | <ul style="list-style-type: none"> <li>Domination of large corporations and conglomerates</li> <li>Political appointments and development of close nexus between business, Government and State; rent-seeking behaviour</li> <li>UMNO = Barisan = State Malaysia Inc.</li> </ul>  |
| Economic Recession 1984-1985                         | <ul style="list-style-type: none"> <li>Spate of corporate and public scandals</li> </ul>   | <ul style="list-style-type: none"> <li>Burgeoning public debt</li> </ul>  |
| Economic liberalisation & Vision 2020 1989 – present | <ul style="list-style-type: none"> <li>Curbing of public expenditures</li> <li>Export oriented industrialisation</li> <li>Industrial Masterplans</li> <li>Towards a 'developed nation' status</li> </ul>   | <ul style="list-style-type: none"> <li>Growth restored (Renewed) attention for foreign investors, SMEs and local entrepreneurship; emphasis on industrial restructuring, upgrading and competitiveness</li> <li>Easing of NEP policies; curbing of rent-seeking behaviour</li> </ul>  |

Sources: Searle (1999); Jomo (1993); Grunsvan & Westen (1997); Gomez & Jomo (1997)

This meant UMNO would control the highest offices of Government, Islam became the State religion and Malay the national language. In addition there were provisions for the 'special position' of the Bumiputeras in terms of official preference in education, the bureaucracy and business. Effectively, however, 'the bargain' and the strong influence of the MCA in the Alliance as provider of most funds for the party's organisation and holder of two key economic portfolios (the Ministries of Finance and of Commerce and Industry) ensured a laissez faire economic policy, which did not actively favour Malay business interests or disadvantage Chinese.

The basic character of the economy and the distribution of wealth thus remained the same and continued to feed Malay discontent culminating in the race riots of 1969. This signalled a significant shift in Government involvement in economic development, as wealth restructuring became a prominent goal, anchored in the New Economic Policy (NEP).

The Government set as a target that by 1990 at least 30 percent of the total commercial and industrial activities in all categories and scales of operation should have participation of Malays and other indigenous people in terms of ownership and management. The main objective of the NEP thus became the development of a Malay industrial and commercial (or capitalist) community. Government expected to achieve the NEP goals on the basis of continued economic growth and development. Industrialisation was seen as a key economic strategic thrust, which would ensure economic growth and open up opportunities for Bumiputra entrepreneurs.

At the same time, power became increasingly concentrated within UMNO, while UMNO as a party strengthened its dominant position within Barisan Nasional, gaining control over the portfolios of the Ministries of Trade and Industry and Finance (formerly held by the MCA).

In 1975 the Industrial Co-ordination Act (ICA) was introduced, which stipulated that all manufacturers with more than RM 100,000 turnover and 25 full-time paid employees, must obtain a license. The granting of such license required the fulfilment of the NEP objective of a 30 percent Malay employment and ownership participation. The immediate effect of the ICA was a drop in investments (Ali & Wong, 1993) and capital flight<sup>6</sup>. The NEP also marked a period of growth of public enterprises (among them large trust agencies) in many sectors, seen as instrumental in assisting and protecting Malay capital accumulation. Both non-Malay and foreign capital alike saw this increased Government involvement in the economy as possibly crowding out their investments and damaging their interests (Gomez & Jomo, 1997). At the national level, increased Government involvement indeed succeeded in substantially increasing Malay participation in the economy. However, public investments in achieving this were substantial, as the Government set-up a large number of public enterprises, trust, holdings and development corporations, while simultaneously expanding the public administration to a point that by the mid 1980s it was the single largest employer in the country, putting an enormous strain on the Government budget.

Another notable effect at this level was the setting up by political parties of special funds to protect the interests of the (ethnic) communities they claimed to represent. This involved the establishments of large holding companies for the pooling of resources for Malays, Chinese, or Indian interests (e.g. the Multi-Purpose Holdings Berhad (MPHB) under the MCA in 1975). In combination with the establishment of a substantial number of (large) public enterprises and the continued presence of (large) TNCs in the country, this led to an economic structure dominated by large firms and conglomerates.

The assumption of power in 1981 by Dr. Mohamed Mahathir signified a shift in Malaysian polity and society, and more firmly established the growing nexus between politics and business. Mahathir placed an even stronger emphasis on business than his predecessors. His close circle of advisors and friends were businessmen. The political system "assumed a more

patrimonialist caste. Persons who were politically loyal and committed to the leadership's world view were given authoritative positions, rather than those who were technically competent" (Searle, 1999, p.47). Political appointments in important institutions and even the banking system became commonplace. Likewise, political patronage of businesses became ever more important and Mahathir seemed less pre-occupied with the reservation of such privileges for Malay businessmen. Under his leadership a number of large Chinese businesses and business interests have successfully 'courted' UMNO politicians for privileges, for instance through financial backing of the party.

In part due to Mahathir's ambitions and personality, political and state power became increasingly centralised, while Government and particularly UMNO increasingly became synonymous with the State. This increasing concentration of power and importance of political patronage also increased the scope for abuse and rent-seeking behaviour.

As a response to the economic recession of the mid 1980s and the mushrooming public debt, at the end of the 1980s a number of economic liberalisation policies were introduced, public sector expenditures were curbed and an explicit EOI strategy once again adopted. These profound measures were not just a result of the recession, but also grew out of Mahathir's own frustration with the rent-seeking behaviour of some Malay (and Chinese) businessmen.

The shift in economic policy was given form through the so-called Industrial Masterplan (1986-1995), followed in 1996 by the Second Industrial Masterplan (IMP-2), which will be further discussed below. The period from the mid to late 1980s also signified a shift away from outright favouring of the Malay community through NEP principles, although some remain visible to date.

In summary, socio-economic developments under more than 40 years of UMNO rule and 30 years of NEP have resulted in (1) the development of a Malay business class and an increase of the Malay ownership of share capital, although the Chinese continued to own the largest amount of corporate assets among the major ethnic communities in Malaysia<sup>7</sup>; (2) a tradition of political patronage; (3) a predominance of large firms and conglomerates; (4) centralisation of power of the State; (5) a continued – albeit less heavy – reliance on foreign capital. As the more negative results some have argued the rent-seeking behaviour of Malaysian businessmen - most notably, but not exclusively Malay businessmen - (Rasiah & Shari, 2001), 'ersatz capitalism' (Searle, 1999), cronyism and corruption.

As a whole, these developments have profoundly impacted the non-Malay, and most notably the Chinese business community in Malaysia. As Chinese ownership is dominant in the apparel industry, these impacts deserve a closer consideration

### 5.3.2 *Effects of Malaysia's Political Economy on the Chinese Business Community*

The impact of Malaysia's political economic developments is best understood in terms of the reactions of the Chinese business community to developments and policies. These included:

1. *Concealment of investments.* In order to limit Malay interest in their businesses many Chinese investors concealed the extent of their investments by setting up diverse and widespread cross-holding networks.
2. *Diversification of operations overseas*
3. *The setting up of so-called 'Ali Baba' constructions.* This meant Malay participation was in fact bought, without involvement in the day-to-day operation and strategic decisions made in the company. Participation was thus purely on paper.
4. *Political patronage.* Particularly since the ascent of Mahathir, many Chinese businessmen started actively courting influential Malay politicians as connections to the powerful political elite became essential in assuring business development (Gomez, 1999).

Reactions differed by firm size and characteristics and thus essentially resulted in the development of a divide *within* the Chinese business community. On the one hand there were the large-scale companies and conglomerates, and increasingly also medium-scale Chinese companies, which were engaging in political patronage as a way to secure and expand their business activities, or were part of large conglomerates connected to political parties such as the MCA. On the other hand there was a group of SMEs (usually CFBs), lacking the capital and connections to engage in such tactics and generally experiencing a sense of neglect or even discouragement by Government, being neither Malay, nor foreign, nor large.

It has been argued that the former, the large and medium sized enterprises have increasingly started relying on inter-ethnic business co-operation, whereas SMEs still adhere to intra-ethnic business co-operation (characteristic of Chinese family businesses) as a means to counter the growing influence of well-connected Malay businessmen over the corporate sector. However, there is in fact “ little evidence of significant mobilization of intra-ethnic resources for mutual economic benefit among Chinese owned small-scale enterprises” (Gomez, Loh & Lee, 2001, p.69), pointing to a degree of distrust even *among* this group of Chinese owned SMEs.

### 5.3.3 *Economic Bureaucracy*

The Government sector is dominated by Malays, who form approximately 60 percent of its total workforce (Gomez & Jomo, 1997). Since the introduction of the NEP, and especially with the ascent to power of Mahathir, there has been an increasing concentration of power within a few Government institutions, which were strongly linked to the political elite. Generally speaking there was an increasing concentration of power in the Executive. The economic bureaucracy has been strongly involved in economic and industrial planning and development, yet at the same time has had to incorporate and comply with social policies objectives under the NEP. Therefore it functions a lot less as an independent think-tank and is not a purely technocratic institution, as is the case in Singapore. In fact it more or less functions as an instrument of the Government, and is ideologically based. In addition, much of the economic planning research is in fact outsourced to private research institutions, consultants, etc. What has resulted is an economic bureaucracy that appears influential, but is in reality strongly controlled by Government and has weak competencies, due to a substantial gap between the Executive levels (political appointments), research (outsourced) and mid-level management. Translation into action and implementation of policies is therefore often fraught with problems.

In addition, coordination and cooperation *between* the different institutions often leaves much to be desired. This became clear from our discussion of official statistics above and is further illustrated by the problems encountered when making an inventory of the apparel industry (see annex A). Lack of such basic information exchange as company listings between the different institutions has led to overlap, inconsistencies and lack of a clear overview.

Finally, these weaknesses have implied that connections to companies – insofar these companies weren't part of the politically well-connected group of companies – and the ability to 'reach' especially the SMEs with policies have also been rather limited.

Having outlined these core tenets of the economic bureaucracy, we will only take a brief look at some of the main institutions (insofar of relevance to industrial development and trade in general and the apparel industry specifically) and their role in economic and industrial development.

#### *NPC, NDPC and EPU*

The highest level of decision making in matters of major public policy in the economics and social fields is the National Planning Council (NPC), the economic committee of the cabinet,

comprising of key economic ministers. The NPC is assisted by the National Development Planning Committee (NPDC), a committee of senior Government officials, responsible for formulating, overseeing the implementation of, and reviewing all development plans as well as making recommendations for the projects involved.

Finally, the Economic Planning Unit (EPU) – set up in 1961 in the Prime Minister’s Department – serves as the secretariat to the NPDC and prepares the medium and long term plans, such as the five year development plans and the Outline Perspective Plans, which have formed the basis of industrial and socio-economic development policies since the late 1960s. Although these institutions play an important role in strategic economic planning, strategic directions and policies are still formulated by the Executive.

In terms of industrial development and trade promotion the most important and powerful institution is the Ministry of International Trade and Industry (MITI) and under its responsibility the Malaysian Industrial Development Authority (MIDA), the Malaysian Trade Development Council (MATRADE) and the Small- and Medium-sized Industries Development Council (SMIDEC). Missions and functions of these institutions are outlined in table 5.9.

**Table 5.9 Main Malaysian Economic and Industrial Development Institutions**

| <b>Institution</b> | <b>Main objectives/mission</b>   | <b>Functions</b>  |
|--------------------|--|---|
| <b>MITI</b>        | To promote and safeguard Malaysian interests in international trade arena, spur development of industrial activities and further enhance Malaysian economic growth towards realisation of objectives Vision 2020 | <ul style="list-style-type: none"> <li>➤ Development of Industrial Masterplans</li> <li>➤ Formulation of general strategic directions and policy objectives</li> <li>➤ Facilitator and support centre (implementation left to departments residing under MITI)</li> <li>➤ Coordination of cooperation with/between other institutions</li> </ul>  |
| <b>MIDA</b>        | Malaysian Government’s principal agency for promotion and co-ordination of industrial development in Malaysia, closely involved in the industry  | <ul style="list-style-type: none"> <li>➤ Actual realisation and implementation of IMPs</li> <li>➤ First point of contact for investors intending to set up projects in Malaysia</li> <li>➤ Provider of incentive programs (sponsored by MITI) for manufacturing sector &amp; individual firms (e.g. incentives for human resource development, (re-) investment tax allowances, tax and duty exemptions)</li> </ul>               |
| <b>MATRADE</b>     | Trade promotion arm of MITI<br>Focal point for Malaysian exporters and foreign importers for trade related information   | <ul style="list-style-type: none"> <li>➤ Formulation and implementation of export marketing strategies, trade promotion activities, commercial intelligence and market research activities, training programs to improve international marketing skills, etc</li> <li>➤ Help Malaysian companies internationalise</li> <li>➤ Promote Malaysia’s exports to the world, e.g. through overseas offices</li> </ul>                    |
| <b>SMIDEC</b>      | Make Malaysian SMEs internationally competitive and develop them into viable support and ancillary industries capable of exporting high quality and high value-added products.                                   | <ul style="list-style-type: none"> <li>➤ Incentive programs for SMEs (e.g. the Industrial Linkage Programme (ILP), which aims to link SMEs with large MNCs; programs for technical assistance, acquisition and competencies development, etc.)</li> <li>➤ Training programs.</li> <li>➤ Development of industrial sites and</li> <li>➤ Promotion of mutual co-operation among SMEs/between SMEs and larger industries.</li> </ul> |

Sources: [www.epu.gov.my](http://www.epu.gov.my) (2003); [www.mida.gov.my](http://www.mida.gov.my) (2003); Leusink & Veldhuisen (2001)

#### 5.3.4 Financial Institutions

The banking sector in Malaysia has constituted an important vehicle for the transfer (redistribution) of funds and assets to the Bumiputera community under the NEP. As such the sector has contributed and encouraged industrial development only to a limited extent, as it seemed to favour Malay interests and those well connected to the political elite. In recent years Government and Malay control over the sector has eased somewhat and foreign banks

were allowed larger shares of ownership.

The stock market also formed an important instrument for the achievement of NEP objectives and was expanded in the 1970s, under the control of the capital issues committee (CIC). Again, Malay interests seemed to dominate, although since the late 1980s the Government has encouraged the development of the capital market and the Kuala Lumpur Stock Exchange (KLSE) into a sophisticated international market (i.e. a free market). This objective was however hampered by the capital restrictions implemented as a reaction to the 1997 crisis, making international investors somewhat weary of investing in Malaysia.

### 5.3.5 Foreign Direct Investment

Despite the NEP policies and Government's wish to reduce reliance on foreign capital, throughout Malaysia's development foreign investments have continued to play an important role. Government's attitude towards foreign capital continued to be encouraging, attracting and accommodating foreign investors through incentives and exemptions. For instance, since 1972 a number of Free Trade Zones (FTZs) were established, where export oriented TNCs could produce and export without having to comply with normal trade regulations (such as duties on imported inputs). Other important incentive included the granting of Licensed Manufacturing Warehouses (LMWs) status to companies that exported at least 80 percent of their output. LMW status was introduced to stimulate the spread of industry beyond the FTZs, as it gave firms exemption of duties over imported inputs, despite not being located in such FTZs (Rasiah, 1993).

Malaysia remains a major recipient – surpassed only by Singapore and more recently China (Chan & Abdullah, 1999) – of especially manufacturing FDI from developed countries in the West, the Asian NIEs and Japan (see table 5.10). Although in relative terms (in relation to total investments) FDI decreased, in absolute terms it continued to increase and from 1990 onwards, even the share of foreign ownership of share capital in Malaysia increased again.

**Table 5.10 FDI Flows into Malaysia, 1981-2000 (US\$ billion)**

|              | 1981-1985 <sup>1</sup> | 1986-1990 <sup>1</sup> | 1991 | 1996 <sup>2</sup> | 2000 <sup>2</sup> |
|--------------|------------------------|------------------------|------|-------------------|-------------------|
| <b>TOTAL</b> | 1.1                    | 1.1                    | 4.0  | 6.7               | 5.2               |

<sup>1</sup> Annual average

<sup>2</sup> Calculated from MIDA and MITI statistics on *approved* projects

Sources: Chan & Abdullah (1999); [www.mida.gov.my](http://www.mida.gov.my) (2003)

To the Malaysian Government foreign capital was of strategic importance to its development policy. Two considerations seem to be at the base of this view. Firstly foreign capital was to encourage technology transfer. TNCs were seen as essential for the dynamism of the Malaysian economy, as indigenous entrepreneurs were not believed to possess the managerial and technical skills for the kind of rapid industrialisation envisioned by the Government. Through the leveraging of FDI, local businesses would learn the skills and technology necessary to compete in global markets<sup>8</sup>.

Second, the consistently positive attitude of the Malaysian Government towards a large foreign stake in the economy has been explained in terms of Malay insecurity over Chinese economic power, especially in the early days of independence. The Malays preferred a large degree of foreign domination over heavier reliance on Chinese enterprise (Searle, 1999).

### 5.3.6 Industrial Development Policy

Having outlined general political and economic developments in the above, in this subsection we will focus on industrial policy and specifically the Second Industrial Masterplan (IMP-2)

as it has been of direct relevance to the apparel industry. Table 5.11 gives an overview of economic and industrial planning and development in Malaysia.

**Table 5.11 Economic and Industrial Planning and Development in Malaysia (1950 - ...)**

| Period                    | Economic structures  | Generic Economic Industrial Policies/Strategy   |
|---------------------------|--|---|
| Late 1950's – late 1960's | - Protected local market, dependence on agriculture and mining, manufacturing: predominantly primary processing industries   | <ul style="list-style-type: none"> <li>➤ First Import-Substitution Industrialisation phase (ISI-1); partial isolation attempted</li> <li>➤ Industrialisation through domestic and foreign capital<sup>1</sup>, protected domestic market, tax incentives, infrastructure and subsidies.</li> </ul>                    |
| Late 1960's – 1980        | - Growth of manufacturing, decline of traditional economic activities agriculture & mining. Manufacturing share of GDP increased from 14% to 20% and agriculture share fell from 30% to 23% between 1970-1980. | <ul style="list-style-type: none"> <li>➤ Export-Oriented Industrialisation (EOI-1) on a selective basis (FDI in FTZs)</li> <li>➤ NEP (1971)</li> </ul>  |
| 1981 – 1985               | Recession  | <ul style="list-style-type: none"> <li>➤ Heavy Import-Substitution Industrialisation (ISI-2)</li> <li>➤ Look East Policy &amp; "Malaysia Incorporated" (corporatism)</li> </ul>   |
| 1986 – 1995               | 1987: Manufacturing becomes largest economic sector both in terms of output and exports. Electronics industry became main export industry  | <ul style="list-style-type: none"> <li>➤ Export-Oriented Industrialisation (EOI-2).</li> <li>➤ First Industrial Master Plan (IMP-1)</li> </ul>  |
| 1995 - .....              | Towards a developed country status (?!)  | <ul style="list-style-type: none"> <li>➤ 1995: Vision 2020 &amp; the Multimedia Super Corridor; push to shift beyond manufacturing</li> <li>➤ 1996-2000: Seventh Malaysian Plan</li> <li>➤ 1996-2005: IMP-2: Continued EOI-2, with technology push and cluster approach</li> <li>➤ 2001-2010: OPP3 and MP8</li> </ul> |

<sup>1</sup> The majority of 'IS-industries' were in fact dominated by foreign owned companies, which made high profits at the expense of Malaysian consumers, while often remitting these profits outside of Malaysia. (Jomo, 1993)

Sources: Barlow (2001); Searle (1999); Grunsven & Westen (1997); Jomo (1993); UNIDO (1991)

To achieve its main economic and industrial development goals, the Malaysian Government has developed and implemented a myriad of economic and industrial plans, strategies and visions, which were constantly adjusted to economic and social circumstances as well as the evolving philosophy of the political leadership.

All policies and strategies were basically devised under the Outline Perspective Plans (OPP), of which the first one covered the 1971-1990 period, the second one the 1991-2000 period and the third has taken effect in 2001. Under the OPPs, five-year plans – the so-called Malaysia Plans (MP) – were developed. Having discussed the NEP policy and its implications for industrial and socio-economic development in the previous, we will not discuss OPP1, the NEP and MP2-5 here any further, but instead will focus on industrial development policy since the mid-1980s, specifically IMP-2.

From 1986 onwards, industrialisation strategies were developed under the umbrella of two Industrial Master Plans (IMP-1 and IMP-2). These masterplans coincided with an important shift in general Government outlook and policy and signified new strategic directions and a period of rapid industrial development. The policy shift, incorporated in these industrial masterplans, was a reaction to the recessions of the early 1980s, growing public debt, the excesses of rent seeking behaviour, and the limited success of the heavy industry ISI policy implemented in 1981.

The new policy perspective placed a much stronger emphasis on export-oriented industrialisation and export-led development, international competitiveness and local

entrepreneurship. The public sector was to be reduced and economic- and trade-liberalisation were given priority over unlimited support of Malay interests.

The corporatist movement initiated in the early 1980s with the so-called 'Look East Policy' (Okposin et al, 1999) was further developed as unionism was further curbed and the bargaining power of labour effectively reduced (Gomez & Jomo, 1997), to encourage export competitiveness and further FDI in manufacturing. The latter was also encouraged through incentives (tax and duty exemptions) and given a boost in the late 1980s by the stark appreciation of the Japanese Yen and consequent surge in Japanese FDI into the rest of the Asian region (see Aoki, 1995).

IMP-1 was a resumption of the first EOI stage during the 1970s, was based on foreign capital and met with huge successes as it coincided with favourable international developments. IMP-2 can be characterised as a continued internationalisation strategy, whereby not only foreign investments were to be attracted, but Malaysian firms were to invest abroad as well and generally trade links were to be boosted. The successful implementation of the IMP-2 is one of the key determinants for the realisation of Vision 2020 (developed country status by 2020). It was to address remaining issues and weaknesses in Malaysia's economic and industrial structure, including:

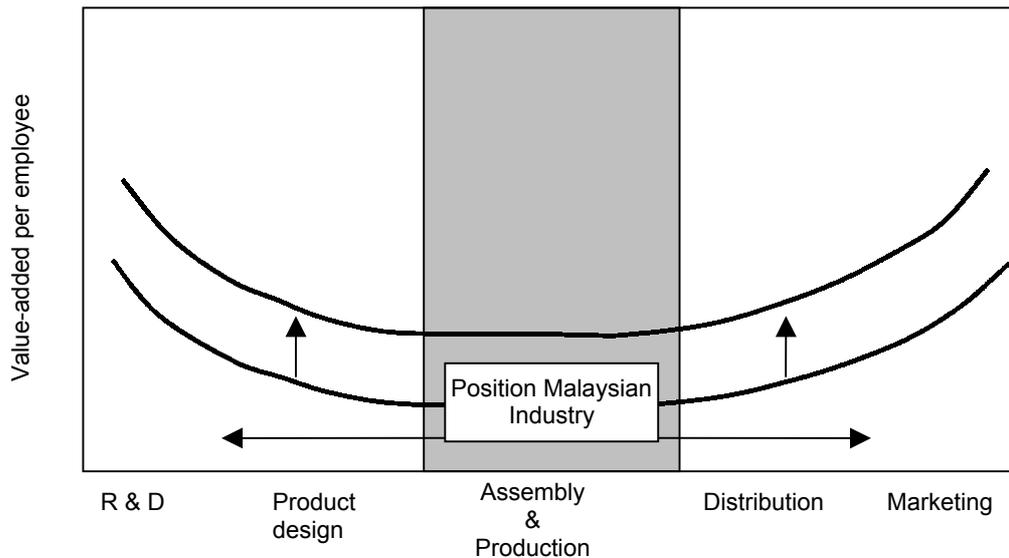
- 1) The existence of three distinctly different sectors within the economy, with little to no linkages between them: (i) a domestically owned and export oriented natural resources sector; (ii) an 'imports substitution sector' (mainly heavy industry); and (iii) an extensive, largely foreign owned, export oriented sector (mainly consumer goods industries).
- 2) A narrow and shallow manufacturing base, i.e. a small number of different industries or sub-sectors, specialised in a limited range of activities, with limited local forward and backward linkages and heavily dependent on imported inputs and foreign capital, technology and markets.
- 3) Resource limitations, hence the need for increasing efficiency and productivity.
- 4) Lack of dynamic locally owned SMEs, hence the need for a more explicit support of local entrepreneurship and specifically local SMEs.
- 5) Need for restructuring and upgrading to retain international competitiveness and cope with increasing local costs and regional/international competition.

Five strategic thrusts were identified in IMP-2: (1) a global orientation of Malaysian industry, and 'deeper' integration into global economy (no longer just as a low cost assembly location); (2) enhancement of competitiveness; (3) improvement of economic foundations (human resource and infrastructure development, technology and R&D); (4) development of internationally competitive local business and industrial community; and (5) Encouragement of information-intensive and knowledge driven processes.

These strategic thrusts were to be achieved through the implementation of two new strategies: the Manufacturing++ strategy and the Cluster Based Development Strategy. The Manufacturing++ strategy (see figure 5.2) aimed to achieve a higher value added industrial base through two main strategies.

On the one hand firms and industries were encouraged upgrade by *moving along the value chain*, diversifying into both upstream (sourcing, R&D, design) and downstream (marketing and distribution) activities. This reflects the first 'Plus'. On the other hand firms and industries were encouraged to *shift the entire value chain curve to a higher level*, thereby increasing value added at every point along the chain. In combination with productivity increases, value added per employee would then also improve to a higher plane at all levels of the chain. This movement stands for the second 'Plus'.

**Figure 5.2 The Manufacturing ++ Concept**



Source: MIER (1996); MITI (1996)

The IMP-2 defines a number of different firm level strategies through which companies can generate an increase value added and sets out to develop the institutional support structure needed to encourage such strategies through for instance MIDA and SMIDEC. Identified core strategies at the firm level were for instance product differentiation, diversification or integration into up- or downstream activities, deepening of inter-firm linkages (both horizontal and vertical) and increasing productivity (Leusink & Veldhuisen, 2000).

The second development strategy under IMP-2, the Cluster Based Development Strategy, was developed to address the lack of local linkages both between and within industries and to encourage stronger linkages between industry and institutions (policy networks). It is based on the notion – as expressed in an impressive literature developed in both academic and policy circles<sup>9</sup> – that such clustering will increase, through synergy and increased efficiency the competitiveness of certain industry groups, enabling them to compete in a global arena and thus ultimately enhancing Malaysia's competitiveness in the global economy.

The cluster-based policy formulation placed emphasis both on the strength of the supporting industries and institutions and on links between them and the leading industries (Akveld & Liebrechts, 2001).

Eight industry groups with the potential of developing into strong, internationally competitive clusters were identified. For these eight, industries specific weaknesses and issues were identified in extensive background studies conducted by the Malaysian Institute for Economic Research (MIER) and strategies and policy objectives as well as incentives programs were recommended. The textiles and apparel industry was one of the identified potential industry clusters to be developed<sup>10</sup>. We will take a closer look at specific strategies, policies and incentives developed for the industry in section 5.5.

All in all, the period since the mid-1980s seems to be the longest most consistent period in terms of industrial development policies, with export led industrialisation, increased competitiveness and upgrading towards higher value added (high-tech) activities and products taking shape as the main strategic thrusts of Malaysia's industrial development. Although Malaysia has indeed made impressive progress in the past two decades, the possibilities for sustaining the industrial development momentum remain subject to debate. One of the reasons this is debatable is the fact that there have long remained numerous

possibilities for evasion (for individual companies) of (often painful) policies intended to push industries towards higher value added activities, and the continued protection and shielding of (certain) industries by Government, despite its claims of encouragement of free markets. Examples include reactions to the economic crisis, such as capital restrictions and the currency peg as discussed in the above, and (foreign) labour policies, discussed below.

### 5.3.7 (Foreign) Labour Policies

Malaysia has a long history of ‘imported labour’, dating back to the Colonial era, when the British brought in labourers from for instance India and China to work the plantations and mines. Subsequently and continuing after independence, foreign labourers were brought in to work in an increasing number of sectors. Today, the main sectors employing foreign workers are agriculture (plantations), mining, domestic services (maids) and manufacturing. Despite the fact that Government has aimed to reduce and limit dependence by increasing local labour participation rates and encouraging automation and labour saving technologies, it has accepted that importation of foreign workers could not be completely phased out, but should be seen as a last resort. Therefore policies were designed that allowed for the use of foreign workers, but at a cost.

However, there is a discrepancy between policy intentions and practice, as companies have up till recently still been able to import large numbers of foreign workers, to the extent of counting on them as a structural part of the workforce. Only recently - as a consequence of the 1997 crisis - has Government seriously limited the number of foreign workers allowed per year, much to the dismay of employers, many of whom have become dependent on them.

The principles of foreign worker policies are more or less the same as in Singapore: selective admission of foreign workers in specific sectors with structural labour shortages that cannot be filled by local labour. However, specific policies adopted differ. Malaysia hasn’t introduced a dependency ratio per sector for foreign workers, but rather sets an overall quota each year for the number of foreign workers allowed to enter the country on temporary – usually two-year – contracts. It does this on the basis of regular assessments of the needs of the labour markets.

**Table 5.12 Cost of Renewing Temporary Workpasses and Average Income of Foreign Workers in 1998 (Applicable to Indonesian workers only)**

| Payment type                              | Sector | Construction<br>(RM) | Plantation<br>(RM) | Services<br>(RM) | Domestic Help<br>(RM) | Manufacturing<br>(RM) |
|---|--------|----------------------|--------------------|------------------|-----------------------|-----------------------|
| Annual Levy                               |        | 1500.00              | 360.00             | 1500.00          | 360.00                | 1500.00               |
| Visa <sup>2</sup>                         |        | 15.00                | 15.00              | 15.00            | 15.00                 | 15.00                 |
| Temporary Work Pass                       |        | 60.00                | 60.00              | 60.00            | 60.00                 | 60.00                 |
| Medical Examination                       |        | 200.00               | 200.00             | 200.00           | 200.00                | 200.00                |
| Processing Fee                            |        | 50.00                | 10.00              | 50.00            | 10.00                 | 50.00                 |
| <b>Total Cost</b>                         |        | <b>1825.00</b>       | <b>645.00</b>      | <b>1825.00</b>   | <b>645.00</b>         | <b>1825.00</b>        |
| <b>Average Monthly Income<sup>3</sup></b> |        | <b>650.00</b>        | <b>400.00</b>      | <b>450.00</b>    | <b>350.00</b>         | <b>500.00</b>         |

<sup>2</sup> Visa charges for different nationalities vary as follows: Thailand - (free); Pakistan/Bangladesh - RM20.00; Myanmar - RM19.50; India - RM12.00

<sup>3</sup> Inclusive of overtime

Source: Kassim (1998)

Contracts need to be renewed every year and on top of ‘normal’ visa related cost (visa, work-pass, processing fees, etc.), annual levies are imposed, which differ in height per year and per sector (for an example, see table 5.12).

The fact that both quota and levies may differ per year creates uncertainties for employers in certain sectors, whom have come to depend heavily on foreign workers. One of the ways to deal with the uncertainty of cost has been to subtract levies and other cost from foreign workers' wages, leading to a diversion of the cost away from the employer. This practice is much less common in Singapore, where employers have to pay the levies<sup>11</sup>. Thus the very goal of levies and increased cost of foreign worker employment is being undermined, which has effectively been condoned by the Government. When the textile workers union in Penang brought the issue to court, arguing the levies should be paid by the employers, the ruling was in favour of the employers, stating that payment of the levies by foreign workers was not an illegal practice, as it is in Singapore.

This confusion and lack of transparency is exacerbated by the fact that Malaysia has no separate legislation for foreign labour, as for instance Singapore has in the form of the 'Employment of Foreign Workers Act'. This may lead to confusion and vagueries as to how to interpret rulings and in the worst case it leads to employers interpreting them in their own favour. Both at the firm and national levels moreover, the existing practices have led to instances of human rights abuses, which have been criticised both nationally and internationally. These abuses, in combination with exorbitant prices for contract renewal and the often disappointing average monthly incomes<sup>12</sup> has resulted in a substantial number of illegal workers. It has been estimated that in 1998, there were approximately 1,140,000 legal foreign workers and 560,000 illegal foreign worker (Chan & Abdullah, 1999). These 1.7 million foreign workers represent 19 percent of the total workforce<sup>13</sup>. It is likely that numbers were much higher in year preceding the 1997 crisis, as one of the responses was a crack-down on illegal foreign workers and a reduction in quota and approved applications<sup>14</sup>.

Generally, Government seems to have 'looked the other way' and thus effectively has left businesses with means to evade measures intended to drive up cost and encourage restructuring and upgrading. Only recently, since the 1997 crisis, has Government become more serious in its restriction of foreign workers and this is likely to have an impact on a number of sectors and industries, particularly labour intensive ones like the apparel industry.

### 5.3.8 Malaysia's Institutional Context: an Overview

**Table 5.13 Malaysia's Institutional Context**

|                            |   |
|----------------------------|---|
| Political Institutions     | <ul style="list-style-type: none"> <li>• Developmental democracy, redistributive policy (affirmative action): NEP</li> <li>• Strong bureaucracy in terms of executive powers, but weak in terms of competencies, cooperation and independence from politics (ideological instead of technocratic in nature)</li> <li>• Development of Malay business community</li> <li>• Strong link between Government, State and business (political patronage)</li> </ul> |
| Economic Institutions      | <ul style="list-style-type: none"> <li>• Free market in principle, but some sectors and industries regulated and protected (instrumental and tactical liberalism)</li> <li>• Both bank centred capital markets and</li> <li>• Active stock markets, but spirit of NEP entrenched in these sectors as well and since 1997 capital restrictions apply</li> </ul>  |
| Dominant Economic Ideology | <ul style="list-style-type: none"> <li>• Government strategic plans and visions to achieve economic growth and balanced distribution of wealth between races, unified nation</li> <li>• Malaysia Inc.</li> <li>• FDI leveraging</li> <li>• Political patronage &amp; development of Malay entrepreneurship</li> </ul>   |

Sources: Gomez & Jomo (1997); Nesadurai (1998); Searle (1999); Gomez, Loh & Lee (2001)

Concluding this section, table 5.13 gives an overview of the main characteristics of Malaysia's institutional context and its core tenets as discussed in the above.

#### 5.4 Local Business Environment II: The National Business System and Dominant Forms of Economic Organisation

The institutional context as described in the previous section has played an important part in the structuring of the national business system found in Malaysia today. Although Malaysia has to an extent had the same background to its economic development as Singapore did and indeed has attempted in some instances to copy the City-State's industrial policies, certain typical elements in Malaysia's institutional context, specifically the ethnic component (embodied in the objectives of the NEP) have created a quite distinct national business system in Malaysia.

Table 5.14 presents an overview of the most important elements of Malaysia's national business system

**Table 5.14 Malaysia's Business System and Dominant Forms of Economic Organisation**

|                                      |  |
|--------------------------------------|--|
| Ownership Patterns                   | <ul style="list-style-type: none"> <li>• Large presence of foreign controlled enterprises</li> <li>• Significant presence of large conglomerates</li> <li>• Large number of politically linked companies (to either Government or other parties representing different ethnic groups)</li> <li>• Large number of companies part of larger development- or trust agencies established to facilitate development of Bumiputera industrial and commercial community</li> <li>• Dominance of large firms</li> <li>• Substantial share of Bumiputera ownership, although to a large extent concentrated in institutions, trust agencies and relatively small number of individuals</li> <li>• High share of Chinese business ownership, especially among SME</li> <li>• Number of protected industries, often Government linked and/or established under ISI program</li> </ul> |
| Capital Markets                      | <ul style="list-style-type: none"> <li>• Well developed banking system and stock market, yet some NEP elements still discernible; only recently more business oriented</li> <li>• Capital and currency restrictions</li> </ul>   |
| Business Formation and Co-ordination | <ul style="list-style-type: none"> <li>• High firm birth (NB data on firm deaths lacking)</li> <li>• Reliance on relationships for business formation, either political, or ethnic/social (especially amongst Chinese SME)</li> <li>• Political patronage</li> </ul>   |
| Management Processes                 | <ul style="list-style-type: none"> <li>• Existence of both professional (foreign enterprises) and family management (in Chinese businesses) styles in large enterprises</li> <li>• Increasing role Malay entrepreneurship, though also often 'Ali Baba' constructions</li> <li>• In SME usually (Chinese) family management</li> </ul>   |
| Work and Employment Relations        | <ul style="list-style-type: none"> <li>• Weak unionism, high dependence on foreign workers</li> <li>• Political appointments/Bumiputra participation requirements in medium and large firms</li> <li>• Preference for self-employment among Chinese businessmen (SME)</li> <li>• Ethnic division of labour still present</li> </ul>  |

Sources: Gomez & Jomo (1997); Nesadurai (1998); Searle (1999); Gomez, Loh & Lee (2001)

Ownership patterns are diverse, large firms dominate and the industrial structure remains somewhat unintegrated, with a lack of both forward and backward linkages and interconnections between the foreign sector, large firms and conglomerates, and SME. Chinese and foreign capital continue to play an important role in the economy, despite especially smaller Chinese firms having been neglected for most of the 1970s and 1980s. It has been argued that these Chinese businesses have been quick and successful in adjusting

precisely because they were operating in such an ‘unfriendly’ environment and through reliance on intra-ethnic ties.

Firm birth are high, on the one hand because of the stimulation of Malay entrepreneurship and on the other hand because of the preference among ethnic Chinese for self-employment and the status attached to being ‘the boss’ of a company. The survival rate of these start-ups is not clear though, as data on firm deaths are limited.

Political patronage and a close relationship between Government and business remains a distinct characteristic of the Malaysian business system, although Government has attempted to act against the worst cases of (unproductive) rent-seeking behaviour.

Finally, labour policies have ensured a situation of continued access to relatively cheap labour, and lack of unionism, both favouring businesses in terms of labour flexibility. It must be noted though that continued labour shortages and more restrictive foreign labour policies, will reduce this effect.

## **5.5 Local Business Environment III: Industry Specific Context**

Finally we turn to the industry’s own logic in terms of the industry specific context and characteristics, i.e. the structure and organisation of the industry and industry specific institutions and policies.

### *5.5.1 Structure and Organisation of the Industry*

The apparel industry in Malaysia is dominated by small and medium enterprises, although a few large scale operations are present as well. These larger firms tend to be concentrated in the Southern and Northern regions, which is in part due to the higher share of foreign ownership in these regions (on average foreign firms tend to be larger than local ones). This can be explained on the one hand by the presence of EPZs in the Northern region, which initially attracted a large number of investors from for instance Japan, Taiwan and Hong Kong, and on the other hand in Johor by investments of Singapore producers who were encouraged by the External Wing program of the Singapore Government (see chapter 4).

Although initial foreign ownership in the industry was high, over the year this share has dropped significantly, due on the one hand to ICA requirements for larger firms and the fact that some of these firms applied for listing on the KLSE (also entailing Malay ownership requirements). On the other hand, many of the initial investors from Hong Kong and Taiwan moved out again as cost levels rose and other, cheaper locations in Asia ‘opened up’ either closing down their operations in Malaysia, or selling them to Malaysians. Finally the number of local OEM suppliers has increased. The industry seems focused on contract manufacturing to the order of Western buyers on a CMT or full package basis (MIER, 1996). Thus, while up till 1990 foreign ownership in the industry ranged from 40 to 66 percent, by the late 1990s this figure had dropped to less than 20 percent (MIER, 1996, p.3)

Ownership in the industry is overwhelmingly Chinese, and the predominant form of organisation is the Chinese family business (CFB). To comply with ICA regulations, many of the medium and larger firms have Bumiputera shareholders and/or connected Malays on their Boards, yet the involvement of these Bumiputerans in the actual running of the business is usually very limited and often their function is solely a ‘paper’ one.

Although a number of firms have indeed obtained listings on the KLSE, most firms are still owner managed, with the head of the family (sometimes second generation) functioning as managing director. Despite the fact that many of the larger firms have at least in part professionalised management (this is especially true businesses where the second generation has already taken over, a point we will return to below), and have shareholders outside the

family, crucial strategic decisions will usually still be made by the head of the family, i.e. the owner-manager.

Before further characterising the industry and firms within it, a distinction must be made between three groups of firms within it and describe their somewhat different characteristics:

- 1) Foreign or majority foreign owned companies, medium to large export oriented producers under direct control of overseas parent. Often these firms are run by professional managers. Local linkages are usually limited and inputs are almost entirely procured overseas. These firms were often encouraged to invest in Malaysia and operate out of EPZs or have acquired LMW status.
- 2) A group of medium to large firms, functioning as OEM suppliers to many of the well-known Western brands and retailers (Douglas et al, 1994). They export most, or all of their production. They are often still CFBs displaying some of their typical characteristics (see previous chapter). However, due to external linkages (to buyers) their general outlook is probably more open and there is a tendency for professionalisation within these organisations.
- 3) A large group of small to micro-businesses, functioning either as subcontractors to OEM suppliers, manufacturers of apparel (sometimes local brands and labels) for the domestic markets or for regional wholesalers. This is the group that is likely to display most strongly the typical CFB characteristics and is most fragmented. Fragmentation is encouraged by the fact that a relatively large share of employees is likely to eventually start its own business, given the strong desire to be 'own boss' and the virtual impossibility for an outsider to climb to the highest ranks within a family business. Business attitudes in this segment are usually most conservative and closed of all three segments.

Export orientation is most prominent among companies in the first and second group, as many have LMW status and thus export at least 80 percent of their output. Many companies have developed extensive subcontracting networks.

The industry structure is still dominated by actual manufacturing (as opposed to the Singapore garment industry), and as of yet there is little evidence of other segments really evolving, despite the fact that Government has targeted the development of such segments (see below).

Most inputs are imported from for instance Hong Kong, Taiwan and China, as there are relatively few input suppliers. For 1995 it was estimated that 84 percent of raw materials (by value) for the industry were imported (MIER, 1996)<sup>15</sup>. Limited use of local input by producers is also caused by the fact that there are only a few nominated Malaysian input suppliers, as they often don't meet international quality standards set by buyers. The high share of imported inputs implies a disadvantage in terms of exchange rate vulnerability and lead times.

Local input suppliers supply mostly to domestically oriented apparel firms, or firms that export to non-Western markets (e.g. to regional wholesalers). Figure 5.3 is a graphic illustration of in- and output flows in the Malaysian apparel industry.

All in all a marked quality divide has developed between the domestically oriented textile and apparel industry, which provides lower quality standards and the export oriented industry, which provides higher, international quality standards based on imported inputs.

Apparently there are also distinct differences between the different garment production regions in terms of company size, ownership and sales orientation. These differences will be analysed in more detail in chapter 6

**Figure 5.3 Input and Output Flows of the Malaysian Garment Industry**



Note: Width of arrow indicates relative volume

<sup>1</sup> It is possible that a local supplier in fact sells a large share of its output to export oriented garment companies, but due to the often small size of local suppliers, this doesn't mean these local inputs make up a large share of total inputs of the garment exporter.

### 5.5.2 *Industry Specific Institutions and Policies*

#### *MITI and MIDA*

Recognition of the apparel industry as an industry which makes an important contribution to Malaysian exports and industrial development is reflected in the fact that there are quite a number of Government and non-government institutions directly or indirectly involved with the industry. The Ministry of International Trade and Industry (MITI) and the Malaysian Industrial Development Authority (MIDA) both have separate textile and apparel units.

MITI is the main policy developer, but leaves policy implementation regarding the apparel industry mostly to MIDA, although the quota allocation system is directly controlled by MITI, in co-operation with the biggest industry association, MTMA. There is a lot of controversy over how this quota allocation takes place, especially among those firm, which do not hold quota yet, as initially obtaining quota is hard. Firm level solutions have included (illegal) trading of quota (see box 5.1)

#### **Box 5.1 Garment Quota Allocation in Malaysia**

Quota allocation in Malaysia is organised by MITI and MTMA, who are responsible for a fair distribution of available quota. Quota are free, as Malaysia has no tender system.

##### **Quota allocation**

There are several criteria for the annual quota allocation:

- \* The apparel producer has to be a bonafide manufacturer, registered at MITI
- \* A first time applicant, has to demonstrate past performance in terms of exports to non-quota markets, as it is seen to provide the company with the necessary expertise on international (quality) standards to enable it successful exports to quota markets.
- \* Existing quota holders with a good export performance will receive the same quota as the year before under the condition that it was fully filled last year. Therefore, quota holders must present an overview of export performance and production capacity every year. If a company hasn't fulfilled its allocated quota, part of the allocation will be reallocated to others. The extra released quota are usually given to the new applicants. Growth of the quota (about 3-6% per year) will be mostly allocated to existing quota holders.
- \* Available quota are not just allocated on the base of past export performance, but also on the base of confirmed orders (of buyers).
- \* Finally, priority will be given to MTMA members.

**Non-quota holders**

Every year there are more applications for quota than there are quota to go around, especially in certain product categories. Therefore newcomers in particular (those wishing to export for the first time or expand exports into quota markets) find it hard to gain access to quota markets. Institutions like MTMA and MITI support companies without quota to find suitable non-quota markets. In addition they give advice to companies to diversify their product range to avoid being overly dependent on (the annual growth of) quota.

**Illegal trade in quota**

In many cases if firms aren't successful in obtaining quota through the official application system, they resort to other means, such as trading or exchanging of quota with other companies. These are considered illegal practices, however it has been hard for MITI to uncover such practices. According to the Ministry this is because the Malaysian apparel industry is relatively small and everybody knows each other. Most manufacturers will therefore not inform the Ministry of such trading going on and even in the case a company gets caught, it will often not reveal the other party involved in the transaction/exchange.

With help of other institutions, such as the MTMA, MITI has attempted to prevent illegal trade in quota items by introducing the so-called 'mechanism of surrender': exporters who have not received any orders and still have a quota balance in their hands (i.e. unfilled quota) can surrender any quantities they wish before 30th June. This is the first period to surrender and no penalty will be imposed. The second period ends on the 15th of September and in this case they will be charged 20 percent of the quantities surrendered. The last period of surrender ends on 30th October with a penalty of 50 percent of the quantities surrendered. Those who kept the quotas later than this date will be charged one to one. In addition, in return betraying a company to the Government for selling or buying quota, a company can count on a reward in the form of extra quota.

Similar penalties are applied to companies found engaging in illegal transshipments of products from third countries (this mostly concerns product categories for which Malaysian quota aren't filled).

Source: Interview MTMA (1999)

MIDA plays an important co-ordinating and monitoring role in implementing and achieving the goals of the IMP-2. For instance, it plays a leading role in the so-called cluster-working group, which also includes the industry associations MTMA and MKMA, MITI and a number of large companies. Here they get feedback from the associations and companies, which they use to try and adjust or improve the programs and policies. In addition MIDA provides and co-ordinates a number of firm incentive programs.

*Industry Associations: MTMA, MKMA and MGMA*

The apparel industry is represented by three different industry associations: The Malaysian Textile Manufacturers Association (MTMA), based in Kuala Lumpur, the Malaysian Knitting Manufacturers Association (MKMA), based in Batu Pahat and the Malaysian Garment Manufacturers Association (MGMA), based in Kuala Lumpur. They all seem to represent a slightly different segment of the industry, although in the cases of MTMA and MKMA, membership in part overlaps (with a number of firms being members of both).

MTMA is the biggest textile and apparel association with approximately 230 members in 1999, of which the majority (three quarters) consisted of apparel producers. The MTMA is the main contact and discussion partner for the Government's apparel-related institutions and departments and plays an important role in quota allocations and information dissemination among its members regarding quota regulations. Besides representing the industry's interest towards the Government (industry voice) and being active in quota allocation, MTMA's functions include:

- Gathering and dissemination of information on trends and issues in both local and global markets
- Trade promotion and development

- Representation of the Malaysian industry and its interest in the ASEAN Federation of Textile Industries (AFTEX)
- Support of training and skills development through MATAC, established by the MTMA to provide training for the workforce (at both production and management levels)

MTMA members tend to be larger exporting companies, located throughout the country (i.e. in all four regions).

MKMA members on the other hand tend to be smaller, more regionally concentrated (in the state of Johor and around Batu Pahat in particular) and a large share of its members is in fact involved in textiles or accessories production or in textile and apparel related production activities (e.g. dyeing). In addition fewer of its members are large exporters. Finally, overall, MKMA has fewer members than MTMA (136 in 1999).

The objectives of MKMA are fairly similar to those of the MTMA, although it is not directly involved in the quota allocation process. MKMA's proximity to its members make it a very 'accessible' platform for the exchange of information and encouragement of co-operation among members. On the other hand it does not seem to appeal much to companies outside the Southern region.

The third industry association finally is the MGMA, which represents almost exclusively small, domestic oriented producers located in and around Kuala Lumpur. In fact the status of this industry association remains somewhat unclear. Although it has a large number of apparel members (124 in 1999), it did not seem to be 'active' at the time of the research and members were not very accessible, or even aware of their membership. The role of this institution for the industry as a whole can therefore safely said to be negligible.

Membership of an association appears wide-spread (see annex A), yet it unclear how many of the members truly make use of the range of services provided by the associations and how many actively participate in them.

Cooperation between the associations is fairly minimal, although MTMA and MKMA are often invited together by Government institutions when discussing matters of importance to the national apparel industry.

### *Education and training institutions*

There are a number of training industries and schools that offer textile and apparel courses and programs. These include:

- 1) The Malaysian Textile and Apparel Centre (MATAC), which was established by the MTMA. MATAC provides and maintains facilities for education and research, develops workers skills, serves as an office that collects and circulates statistics and other information and as an advisor or consultant.
- 2) The Majlis Amanah Rakyat (MARA)<sup>16</sup> Institute of Technology (ITM), which offers technical training
- 3) A number of colleges, technical universities and polytechnic schools, which offer courses and degrees in textiles and apparel, such as the Institut Teknologi Tun Hussein Onn (ITTHO) in Batu Pahat, Penang Polytechnic in Penang and the Universiti Teknologi Malaysia (UTM). The latter also offers course in design and marketing.

Generally speaking education and training institutes appear to still be geared mostly to technical (i.e. production oriented) training, with only a few design schools, this in stark contrast to Singapore. However, with the exception of MATAC, linkages between the training institutions, the associations and especially companies are not very well developed, which is surprising considering the industry's dire need for skilled labour.

### *SMIDEC*

SMIDEC provides special funds for SME in selected industries (including apparel) to encourage investments, upgrading and expansion of these firms. In order to be able to apply for such funding a firm must fit the *SMI-funding* criteria, i.e. annual sales turnover not exceeding RM 50 million, and Malaysian ownership (or citizens residing in Malaysia) of the firm. The funding is offered at a relatively favorable interest rate and the payback period is relatively long ([www.smidec.org.my](http://www.smidec.org.my)). In addition, SMIDEC coordinates the industrial linkage program (ILP) under the IMP-2

### *Industry specific policies*

As mentioned, for IMP-2 Manufacturing++ and Cluster Based Strategies, the textiles and apparel industry was identified as an industry group with the potential of becoming a strong internationally linked cluster. Therefore, an extensive research was conducted by the MIER in 1995, to identify main issues and weaknesses of the industry, as well as opportunities and strategic directions to be taken to take advantage of these opportunities. This resulted in a number of recommendations for action initiatives for both the public and private sector. Table 5.15 schematically presents the main findings and recommendations, limited to the apparel sub-sector.

In general policies were to include such measures as the minimising of bureaucracy, the streamlining of incentives systems, support for the establishment of several federations, agencies and other bodies promoting industry interests and especially co-operation, and investments in the economic infrastructure. In addition trade and tariff policies had to ensure protection against dumping and protection of certain supplying industries against competition, while allowing duty free import of inputs. Such policies were intended for both textiles and apparel, but in reality posed somewhat of a dilemma. If Government wanted to stimulate the local supplying industry it made sense to maintain duties and tariffs, so as to promote the use of local inputs by local apparel producers. However, export oriented apparel producers, many of which had LMW status, preferred duty free imports of inputs, as they were forced to use overseas suppliers by their buyers. Duty free imports at least ensured lower prices of these inputs. Finally, domestically oriented producers were not allowed to import inputs duty free and were thus often relegated to lower quality local inputs. Thus the two segments seemed to be locked into systems that the proposed policies did not seem to be able to unlock, as it faced a dilemma between local development and export development.

It must be noted that the recommendations listed in the table are based on those made in the MIER industry study in preparation for the IMP-2. Not all industry members were in fact enthusiastic about the proposed strategies and actions and in reality many have never been realised, in part due to lack of support, in part due to the very lack of cooperation among and between institutions and companies identified as a weakness in the MIER report.

The MIER study and the IMP-2 report based on it clearly identify issues in an international and value chain perspective, thus recognising the need for a comprehensive approach to industry adjustment and upgrading (i.e. looking at positioning in a global and chain perspective). The actual strategies recommended reveal a quite specific interpretation of how upgrading should be achieved and what it in fact entails.

**Table 5.15 Issues/Weaknesses, Strategic Directions and Strategies for the Apparel Industry Identified by MIER For IMP-2 (1996)**

| Issues/weaknesses   | Strategic directions   | Strategies/Action Initiatives (recommended)  |  |
|---|--|--|--|
|   |  | Private Sector   | Specific Public Sector/<br>Public-Private Partnerships   |
| <ul style="list-style-type: none"> <li>Low value added products and low productivity</li> </ul>   | <ul style="list-style-type: none"> <li>Position for Key Markets</li> <li>Product Differentiation</li> <li>Strategic Repositioning</li> </ul>               | <ul style="list-style-type: none"> <li>Move to higher value-added commodity apparel and higher value-added specialty apparel, by upgrading plant and equipment (automation and flexible manufacturing), improvement of work methods, introduction of labour saving technologies and an increased focus on design/marketing</li> <li>Relocation of lower-end commodity apparel</li> <li>Encourage only certain size commodity companies, to take advantage of economies of scale</li> <li>Development into OEM and improvement of services (e.g. QC and after sales services).</li> </ul> | <ul style="list-style-type: none"> <li>Provide incentives for upgrading and relocation of production</li> <li>Encourage establishment of design houses and sourcing offices in Malaysia</li> </ul>   |
| <ul style="list-style-type: none"> <li>Dominance of contract manufacturing (CMT &amp; OEM)</li> </ul>   | <ul style="list-style-type: none"> <li>Move from OEM to ODM/OBM</li> <li>Development of Local Fashion Industry</li> <li>Strategic Repositioning</li> </ul> | <ul style="list-style-type: none"> <li>Development of own brands, encourage and attract local designers to create own designs</li> <li>Development of pool of marketing experts</li> </ul>   | <ul style="list-style-type: none"> <li>Setting up of design houses in major fashion centres in the world and stimulating Malaysian designers</li> <li>Continue to cover the cost under HRDF of sponsoring local designers to study/gather information overseas.</li> <li>Liberalised entry of foreign textile technologists and designers.</li> <li>Provide tax holiday for promotion OBM</li> </ul> |
| <ul style="list-style-type: none"> <li>Two tier system (large, integrated MNCs vs. local SMEs) with big differences in competitiveness</li> </ul> | <ul style="list-style-type: none"> <li>Cluster Development</li> </ul>  | <ul style="list-style-type: none"> <li>Emphasise speed and flexibility through specialisations (rather than integration) through the SMEs</li> </ul>   | <ul style="list-style-type: none"> <li>Promote specialisation</li> </ul>   |
| <ul style="list-style-type: none"> <li>Dependence on imported inputs and licensed machinery</li> </ul>  | <ul style="list-style-type: none"> <li>Strengthening Capacity of Key Suppliers</li> </ul>  | <ul style="list-style-type: none"> <li>Upgrading of local textile industry (product and process development)</li> <li>Specialisation of SMEs in fancy yarn, weaving, knitting and dyeing and finishing</li> </ul>  | <ul style="list-style-type: none"> <li>Encourage development of local textile industry</li> <li>Encourage foreign textile machinery producers to set-up production facilities for manufacturing of spare parts in Malaysia for local market and exports</li> </ul>   |

|   |   |  |  |
|---|---|--|--|
| <ul style="list-style-type: none"> <li>• Relatively poor state of automation and information technology use</li> </ul>  | <ul style="list-style-type: none"> <li>- Developing process technology capabilities</li> <li>- Strengthening Capacity of Key Suppliers</li> </ul> | <ul style="list-style-type: none"> <li>- investments in information technology to smoothen product and information flows</li> </ul>  | <ul style="list-style-type: none"> <li>- Encourage IT investments and linkages between IT companies and textile &amp; apparel industries</li> </ul>  |
| <ul style="list-style-type: none"> <li>• Critical dislocation between sectors within textile and apparel industry</li> <li>• Little interactive and intra-industry collaboration</li> </ul> | <ul style="list-style-type: none"> <li>- Cluster Development</li> </ul>   | <ul style="list-style-type: none"> <li>- creation, development and strengthening of linkages between the primary textiles and apparel sectors, both on a functional and a geographical basis</li> <li>- Greater collaboration among firms (both vertical and horizontal), between industry specific institutions and between firms and institutions</li> </ul> | <ul style="list-style-type: none"> <li>- Special programs, such as the industrial linkages program (ILP), were set up to encourage cluster development.</li> <li>- Role of EPZs and LMW's in intra-industry linkages to receive extra attention.</li> <li>- Reform quota allocation system to encourage technology development of upstream activities (quota allocation not just based on past performance but also on local content)</li> <li>- Support establishment of umbrella Federation</li> <li>- Promote MIDA to become not just regulatory, but also promotional agency, providing strategic information regarding investment opportunities.</li> </ul> |
| <ul style="list-style-type: none"> <li>• Inadequate supply of specialised skilled labour</li> </ul>   | <ul style="list-style-type: none"> <li>- Improve Economic Infrastructure</li> <li>- Human Resource Development</li> </ul>                         | <ul style="list-style-type: none"> <li>- Human resource development and participation in training programs</li> </ul>  | <ul style="list-style-type: none"> <li>- Encourage MATAC and MARA's Institute of Technology (ITM) to strengthen courses in textile technology, fashion &amp; textile design.</li> <li>- Encourage private and public institutions to develop courses in textiles- &amp; fashion design, marketing, distribution &amp; retailing.</li> <li>- Continued covering of training cost for employers by HRDF</li> <li>- Liberalise entry of foreign textile technologists to train local counterparts.</li> </ul>   |
| <ul style="list-style-type: none"> <li>• Lack of product/process specialisation, esp. among SMEs; lack of specialised supporting industries</li> </ul>                                      | <ul style="list-style-type: none"> <li>- Strengthen Capacity of Key Suppliers</li> <li>- Improve Economic Infrastructure</li> </ul>               | <ul style="list-style-type: none"> <li>- Product specialisation and upgrading of products and processes</li> </ul>   | <ul style="list-style-type: none"> <li>- Set-up of SME Textile and Apparel Industrial Park</li> <li>- Establish technical assistance and research centres</li> </ul>   |

Source: MIER (1996)

For instance it stresses technological and process upgrading on the one hand, enabling the retention of lower-end production on a large scale mass production base, and design, marketing and retailing on the other, following the commodity chains logic of the OEM-ODM-OBM route. In addition it sees clustering as an important basis for achieving increased efficiency, specialisation and quality. How successful these strategic directions and policy recommendations were, given the particular characteristics of the industry is not clear, as to date no monitoring or assessment report for the case of apparel have been made.

Two aspects make the MIER report and the IMP-2 an important policy initiative with regards to the apparel industry. First of all it was the first extensive study done on the industry and as can be observed in the table, clearly highlighting a number of weaknesses and threats and as such represents the first strategic vision on the industry.

Second, it signifies quite a dramatic shift away from earlier policies and attitudes towards the industry and the general tendency of neglect and 'sunset industry designation'. It is however not clear to which extent this shift is being followed by the predominantly local Chinese entrepreneurs in the industry, as distrust towards Government seems deeply ingrained.

#### *Firm specific policies and incentives*

Many policies were implemented through a range of incentives, which can be divided into cost incentives (reducing cost) and investment incentives (encouraging investments). The former include direct and indirect tax incentives. Direct incentives grant partial or total tax holidays for a limited period of time to foreign investors in the country (these kind of incentives are often given in the EPZs), while indirect tax incentives are provided in the form of *exemptions from import duty, sales tax and excise duty*. Cost incentives are thus mostly geared towards export-oriented companies in EPZs or with LMW status.

Investment incentives, seen as an important instrument for the achievement of IMP-2 goals, include the so-called *Investment and Re-investment Tax Allowance*, which are intended to stimulate new capital investments by companies, and upgrading of their products and production facilities. Eligibility for the investment tax allowance is determined according to whether activities or products for which the incentive is requested have been identified as 'promoted activities' or 'promoted products'. According to the Promotion of Investments Act 1986 for apparel these are only knitwear, skiwear & outerwear and non-woven products. Coverage is thus rather limited. Levels of value added, local material content, technology and industrial linkages are also taken into consideration before granting the tax incentives.

Finally there are a number of funds, primarily set-up or further developed as a result of the IMP-2, providing easier access to capital through 'cheap' loans and grants. Examples are the Industrial Technical Assistance Fund (ITAF) for investments in technology and the Human Resource Development Fund (HRDF) for investments in human resources and skills<sup>17</sup>.

## **5.6 Effects and Implications of the (Changing) National Business Environment for the Development of the Apparel Industry**

We conclude with a contemplation of the impact of the local business environment on firm behaviour in the industry. Given the characteristics of the apparel industry and prevailing socio-economic policies and general business system in Malaysia, all companies in the apparel industry will most likely have experienced a certain sense of neglect by the Government. Although this was the case in Singapore as well, in Malaysia the perception appears to have an added dimension in Malaysia due to the ethnic divide and NEP objectives. To assess the effects a distinction must be made between the different segments identified (see section 5.5.1), and between the different economic and industrial policy 'eras' (see section 5.3.6).

With the distinct divide between different segments of the industry that has developed it is likely that, attitudes, (perceived) effects of policies and consequences for firm level strategies differ between the segments.

The first segment – the branches of foreign apparel firms – will have most likely felt encouraged by the Government and its policies and hence have a more positive attitude towards it, as they received incentives, especially when they set-up in the EPZs. However, as their connections to the national business environment are likely to be limited, they are probably also more inclined to pick up and leave when cost pressures are seen to become too high. Their limited scope for strategic decision making within the overall company (after all they are usually manufacturing branch plants) will make shifting towards different roles or positions within chains less likely.

The second segment, larger export oriented local apparel producers, received increasing recognition and support from the Government, while some were part of large conglomerates, such as the Berjaya Group and the Pemas Group, thus profiting to an extent from the established political connections such conglomerates often had, not to mention their funds.

Moreover, exposure to Western management practices and standards, due to incorporation into global networks and chains and ensuing quality requirements, has made this segment more open in general and has encouraged increasing professionalisation within their organisations. In combination with the fact that these companies have their roots in Malaysia, a more pro-active business attitude and strategies might be expected from this group.

However, due to years of ‘neglect’ and the interaction between the national business environment and industry specific characteristics, elements of distrust towards the Government and the idea of having to depend mostly on itself are probably still to some extent noticeable in this segment, as are more short term strategic perspectives on business in general. This despite more recent and more explicit attention for the industry in official policy.

Finally, the third segment, the domestically oriented or subcontracting SMEs, has probably experienced the Malaysian business environment as being most hostile to their interests, exacerbated by the generally stronger CFB characteristics of closedness and conservative business practices in this segment. Lacking the ability (and will?) to establish forms of patronage and lacking the capital to expand overseas, it is essentially stuck in a business environment that appears non-supportive of their interests at best. Distrust is probably highest among firms in this group and likely to extend to other firms in the industry. Other firms are still predominantly seen as competitors and social networks are probably used to mobilise supplier and complementing resources and form loose alliances.

Although more recently there have been attempts to engage this SME segment more through separate SME oriented institutions and policies, ingrained notions of distrust of Government, conservative business attitudes, and generally a ‘go it alone’ mentality will probably have limited the effect and ‘reach’ of these policies and institutions.

Generally speaking, CFB characteristics aside, a business environment that is perceived to be relatively hostile to a firm’s interests is more likely to encourage short term, risk-averse strategic behaviour and retention strategies (which require little investment). Ironically, where the local business environment is more ‘positive’ – consider for instance the leniency towards foreign labour and the diversion of the cost of this labour – this has probably also encouraged more retentive strategies, as such policies and practices enabled apparel firms to continue to engage in cost based competitive strategies for a much longer period than their counterparts in Singapore. The question arises whether increasing competitive pressures and the shift in policy incorporated most explicitly in the IMP-2, have encouraged a move away from cost based strategies and towards upgrading trajectories, or may do so in the near future.

The policy shift in the late 1980s and especially the introduction of the IMP-2 have created and further developed a rather impressive number of institutions, programs and policies aimed specifically at the apparel industry, including very prominently the production segment. This as opposed to in Singapore, where the specific policies that are in place do not seem to really be geared towards the production segment.

However, successful implementation of these policies and functioning of these institutions will probably have been made difficult by a number of deeply ingrained issues, including (i) an apparent gap between policy planning and its actual implementation; (ii) the fact that the effects of 20 years of NEP and consequent attitudes of the industry towards the Government and views from the Governments on the industry can not easily be undone; and (iii) prevailing business attitudes among a large number of firms in the industry are still to some extent conservative, short term focused and inward looking.

As to the first point, this can be related to some of the weaknesses of the economic bureaucracy, as outlined in section 5.3.3. Competencies at the administrative and mid-levels of the economic bureaucracy, which is responsible for policy implementation, are often weak and at this level direct connections to the business world (so prominent at the higher, executive levels) are limited. In addition, policies sometimes conflict and there is often a discrepancy between policy aims and practice.

As to the second point – the long term psychological effects of the NEP on the industry – there still appears to be considerable distrust among Chinese run apparel companies towards the predominantly Malay Government and economic bureaucracy. Many still believe the main motivation of these institutions is the protection and advancement of Malay interests.

Thus, although political connections have become less relevant in context of IMP-1 and IMP-2, the idea of ‘connectedness’ as the only real means to receive Government/institutional support remains. This is reflected in the distrust of many SMEs towards even industry specific institutions such as MTMA and even MKMA, the very institutions that could bridge the gap between Government and the industry. There appears to be a notion among especially smaller firms that these institutions only represent the interests of larger, well connected and exporting firms.

‘Distrust’ is to some extent mutual, as the Malaysian Government often blames the inability to reach especially the SME with its programs and incentives on the attitudes of Chinese businessmen. As one MITI official remarked regarding illegal trading of quota:

“Severe penalties will be imposed on companies who are selling quota, but to be frank it is very difficult to find those culprits because those who buy will not tell MITI about the sellers. It is due to the fact that this industry is very small and everybody knows each other and most of these Chinese businessmen will not inform the Ministry... maybe that is part of their business ethics. There’s also cases where exporters exchange quota with each other and no money transaction is involved, This practice is not allowed by Ministry, but most of them do it secretly.” (*Interview MITI official, 2000*)

The closed nature of Chinese family business obviously also makes the (predominantly Malay) bureaucracy somewhat distrustful towards the industry.

This brings us to the third point, prevailing business attitudes in the industry, which in all fairness cannot simply just all be attributed to NEP and the Government. Apparel firms also just seem hard to reach in general. Despite all the incentive programs available and the information provided about these programs through for instance the industry associations, not that many apparel firms actually apply. It is unclear whether this is because of ineffective information dissemination by policy institutions or an inherent reluctance amongst industry members to do the paperwork and become actively engaged in application processes.

Likewise, the extremely low response to a benchmarking study for apparel undertaken by the National Productivity Corporation (NPC) in co-operation with the MTMA and the MIDA

(which was supposed to become an annual undertaking) - which could in fact be of use to the industry and to policy makers alike - further illustrates such attitudes.

Similar observations by Government officials were made with regards to the implementation of for instance the ILP. Although local linkages in terms of inputs are indeed limited, the industry group was not considered as a priority cluster group for this program, as, according to a SMIDEC official, textiles and apparel firms were simply not willing to co-operate with one another and not really interested in the program. This being the case it was argued that money and time would be better spend on other industries that are more willing to make the cluster concept work.

All in all, the relationship between the industry and its national business environment has not been without problems and this may be expected to be reflected in rather conservative, risk averse company behaviour.

## **Conclusion**

Incorporation into global production networks and chains and consequent 'take-off' of the Malaysian garment occurred at a later time and in a slightly different mode (as an extension of NIE production networks and with a generally larger share of FDI) than was the case in Singapore. Accordingly, an initial consideration of the industry's evolution suggested the industry in Malaysia was still experiencing growth and the production segment still plays an important role. However, similar imperatives as were identified in the case of Singapore have started encroaching on the competitiveness of Malaysian garment manufacturers, although their effects are as of yet not as pronounced. The more recent tapering off of growth and the findings of our own inventory of the industry seemed to suggest a process of profound restructuring may have set in.

How the industry will come out of this restructuring process will depend to a large extent on firm behaviour, which in turn is influenced by the local business environment. An in-depth analysis revealed a similar peripheral position of the industry vis-à-vis the dominant forms of economic organisation as in Singapore, yet the gaps between the industry and the institutional context, within the institutional context and among firms within the industry were found to be much wider due to both factors within the business environment, most notably the social dimension of economic policy and its explicit ethnic dimensions, and the more pronounced differences between different segments within the industry, where particularly (but not only) the SMEs, are often characterised as rather closed, relying on family and business relations, reluctant to make commitments and displaying high levels of distrust.

Moreover, although explicit policy, especially from the late 1980s onward, encouraged restructuring and upgrading towards higher value added products and processes and quality as opposed to cost based competition, several factors have prevented the effectiveness of such policies. These factors include for instance the possibilities for evasion, for instance through the use of foreign workers and diversion of cost onto them, and because the corporatist nature of labour relations allowed for continued labour exploitation, but also the weakness of the economic bureaucracy and failure to implement policy formulated 'at the top'.

Taken together, the different characteristics and core tenets in the local business environment and attitudes within the industry of risk averseness and - to an extent self imposed, or perceived - isolation, have likely resulted in rather conservative firm behaviour, with short term considerations prevailing.

This also seems to indicate that the differences between Singapore and Malaysia are not merely a result of different timing of entry and phases of development

As the quota system in fact protected Malaysian garment exports to US and European markets, against truly severe competition from countries such as China, such conservative

behaviour has sufficed to keep Malaysian garment manufacturers connected to global networks and chains.

With recent and pending changes in Malaysia's international and local business environment, the question is if it will continue to be enough for even sustaining connections, let alone advancing.

In chapter 8 we return to the local business environment, linking it more explicitly to actual strategies and development trajectories in the industry, derived from the empirical analysis of survey results in chapter 7. First, however, we return to Singapore once more in the next chapter, which presents an extensive description and analysis of survey results.

## Notes

<sup>1</sup> An added complication was the fact that it was not always clear what was covered by the statistics: companies, establishments or factories.

<sup>2</sup> This is for instance the reason it is hard to assess the actual export share of total output, as exports and output often pertain to different categories. Thus in several statistics, value of exports far exceeds value of output.

<sup>3</sup> Woven apparel includes SITC categories 841 and 842, Knit apparel includes categories 843 and 844. Of the other categories (845-848) the fabric type is not specified or neither woven or knitted.

<sup>4</sup> Up until the mid 1990s Malaysia itself still had preferential treatment in major Western under the Generalized System of Preferences. However, this privilege was revoked in 1997.

<sup>5</sup> Originally even the Malays were immigrants, originating from Indonesia. The true original population of Malaysia was tribal, but currently only East Malaysia has a sizeable share of indigenous tribes (e.g. the Iban and Bidayuh). On Peninsular Malaysia only a small minority of so-called Orang Asli (aboriginal communities) remain. Political and economic power of these indigenous tribes in Malaysian society is minimal.

<sup>6</sup> Capital flight has been estimated to have amounted to as much as US\$12 billion between 1976 and 1985 (Gomez & Jomo, 1997, p.42).

<sup>7</sup> In 1999, Chinese owned limited companies owned 37.9% of share capital in Malaysia (Gomez, Loh & Lee, 2001; [www.epu.gov.my](http://www.epu.gov.my), 2003)

<sup>8</sup> The most prominent example being the national car project, established during the second ISI-phase in the early 1980s. The national car, the Proton, was developed in co-operation with Japanese carmaker Mitsubishi, which provided necessary technology. Inputs were imported, leaving just the assembly to take place in Malaysia. The idea was that inputs and technology could eventually be sourced and developed locally. In reality this does not seem to have been successful as of yet.

<sup>9</sup> Indeed the idea of industrial clustering for competitiveness is deeply rooted in the history of economic thought, going as far back as the 19<sup>th</sup> century with Marshall's Industrial Districts and Coase & Williamson's transaction cost theory. See e.g. Alchian & Demsetz (1972); Håkansson (1987); Porter (1990, 1998); Douma & Schreuder (1998); ILO (1998a, 1998b); Schmitz & Nadvi (1999); Maskell & Malmberg (1999).

<sup>10</sup> The other seven identified clusters were (1) electrical and electronics; (2) transportation; (3) chemical; (4) resource based (5) materials and advanced materials; (6) agro-based and food products; and (7) machinery and equipment.

<sup>11</sup> Although some diversion of levies onto foreign workers takes place here as well, it is on a much smaller scale and often involves only partial payment of levies. Officially even this is not allowed though.

<sup>12</sup> To make matters worse, foreign workers usually have to pay recruiting agents large sums for their mediating services. In combination with the cost of contract renewals this often amounts to foreign workers spending most of their income on repayment of fees and cost, leaving them with little income to send/take home.

<sup>13</sup> Based on a total workforce number of 8,843,800 for 1998, calculated from Abdullah (1999) p.18

<sup>14</sup> Exact numbers of foreign workers are not known, also because only new applications and renewals are registered, and up to recently little monitoring of amount of workers that remain in Malaysia existed.

<sup>15</sup> This number pertains to the textile and apparel industry group as a whole, but is representative for major sub-sectors within it, most notably the apparel sub-sector

<sup>16</sup> MARA was one of the first and main Bumiputera trust funds set up to encourage the development of the Malay community, for instance through the offering of education and training to upgrade (lagging) skills.

<sup>17</sup> This fund incurs a levy on all firms of 0.5 to 1 percent of monthly workers' basic wages and fixed allowances (<http://www.hrdnet.gov.my>). In return, companies can participate in courses and training programs for skills development. As payment of this levy is compulsory, many firms make use of these programs, so as to at least get some of their money 'back'.

## 6 The Singapore Garment Industry: Competitive Adjustment Strategies and Development Trajectories

### Introduction

While the previous chapters have focused on the literature, theorisation and conceptualisation of the research and secondary data, the remaining chapters will focus on the empirical data gathered for the research. Using the conceptual framework presented in chapter 3 as a basis and taking into account the general developments in both the global garment industry (chapter 1) and Singapore's business environment (chapter 4) an analysis of these empirical data<sup>1</sup> is presented.

In section 6.1 a general outline of the characteristics, structure and organisation of companies in the survey will be given. Based on these characteristics a categorisation of companies is presented. Subsequently we take a closer look at the changing environment in which companies have operated and how they have perceived this changing environment (section 6.2). In section 6.3 we then turn to the strategies implemented by the companies in the survey over the past 10 years and the main effects of these strategies in terms of company's functions, capabilities and competitive positioning. In section 6.4 the main firm level development are identified and discussed, while section 6.5 finally turns to the industry level, taking a closer look at industry development trajectories.

### 6.1 Structure and Characteristics of Garment Companies in the Survey<sup>2</sup>

An in-depth look at the characteristics of the companies in the survey gives an idea of their structure and organisation in terms of size, ownership, organisation structure, sales orientation, buyers, production organisation, etc. It must be noted that this is essentially a snapshot and can be seen as the outcome of changes and strategies in the past decades.

#### 6.1.1 Ownership, set-up and Size Distribution of Companies in the Survey

Most companies in the survey were established in the 1970s and 1980s and domestically owned (see table 6.1).

**Table 6.1 Year of Establishment by Ownership**

| year of establishment | Ownership establishment |         |               | Total | Share |
|-----------------------|-------------------------|---------|---------------|-------|-------|
|                       | domestic                | foreign | joint-venture |       |       |
| >1971                 | 5                       | 2       | 1             | 8     | 14%   |
| 1971-1980             | 20                      | 2       | 1             | 23    | 40%   |
| 1981-1990             | 15                      | 2       | 1             | 18    | 30%   |
| 1991-1998             | 5                       | 1       | 2             | 8     | 16%   |
| Total                 | 45                      | 7       | 5             | 57    | 100%  |
| Share                 | 79%                     | 12%     | 9%            | 100%  |       |

Foreign ownership and joint ventures were less common. In addition, a number of these foreign investments (approximately half) had been part of the Singapore garment industry for a long time (see tables 6.1) and have become independently functioning establish-

ments.

Before 1990 more such foreign owned companies and joint ventures were present in Singapore, however, most were closed or sold in the late 1980s and early 1990s. The majority of companies in the survey were part of a larger or multi-establishment company, and performed the function of parent or main establishment in these multi-establishment companies. Most foreign owned ones indicated they functioned as independent units - as opposed to (dependent) subsidiaries - within their larger company structures.

Table 6.2 gives an overview of the ownership, set-up and status of companies in our survey.

**Table 6.2 Ownership, Set-up and Status of Companies in the Survey (1998)**

| Ownership                            | Set-up                            | no. of comp. | Share   | Status   | no. of comp. | Share                   |
|--------------------------------------|-----------------------------------|--------------|---------|--|--------------|-------------------------|
| <b>Domestic (45)</b>                 | single establishment              | 14           | 31.1%   | parent/main  | 14           | 100.0 %                 |
|                                      | multi-establishment               | 31           | 68.9%   | subsidiary<br>parent/main<br>independent unit  | 0<br>30<br>1 | 0.0%<br>96.8%<br>3.2%   |
| <b>Foreign (7)</b>                   | single establishment              | 1            | 14.3%   | parent/main  | 1            | 100.0 %                 |
|                                      | multi-establishment               | 6            | 85.7%   | subsidiary<br>parent/main<br>independent unit  | 2<br>0<br>4  | 33.3%<br>0.0%<br>66.7%  |
| <b>Joint-venture<sup>4</sup> (5)</b> | single establishment              | 0            | 0.0%    | -  | -            | -                       |
|                                      | multi-establishment               | 5            | 100.0 % | subsidiary<br>parent/main<br>independent unit  | 0<br>5<br>0  | 0.0%<br>100.0 %<br>0.0% |
| <b>Total (N) (57)</b>                | <i>total single establishment</i> | 15           | 26.3%   | <i>total parent/main</i>   | 15           | 100.0 %                 |
|                                      | <i>total multi-establishment</i>  | 42           | 73.7%   | <i>total subsidiary</i><br><i>total parent/main</i><br><i>total independent unit</i> | 2<br>35<br>5 | 4.8%<br>83.3%<br>11.9%  |

<sup>1</sup> This company was part of a large Hong Kong owned group, but was part of a holding company listed on the Singapore stock exchange, hence its domestic ownership.

<sup>2</sup> This company was formally Taiwanese owned, but functioned as main and only establishment of the company.

<sup>3</sup> Includes 1 manufacturing branch and 1 regional manufacturing/sales & marketing branch

<sup>4</sup> Of these five joint ventures, three had less than 50 percent foreign participation; for all five the Singapore establishment was the main establishment/headquarters of the company

As to the size of the companies in the survey, in terms of employment the majority of companies (almost 65 percent) could be classified as small, i.e. with less than 50 employees and almost 80 percent could be classified as SMEs (i.e. with less than 100 employees). Measured in terms of turnover, the picture is a little different, with average firm size somewhat larger. Thus half of the companies in the survey had an annual turnover of more than 5 million Singapore dollars (see figures A and B in the appendix to this chapter). Average number of employees for the interviewed establishment was 91, while the average annual turnover was approximately S\$ 30.8 million.

However, it must be noted that because a large number of establishments in the survey were part of multi-establishment companies (see table 6.2), listed turnover was often consolidated, i.e. included the turnover of other establishments. If employment is also listed for *all* establishments, almost 54 percent of all companies fall into the larger company categories (more than 100 employees) (see figure C appendix). Average number of employees for the entire company was 1251.

Most of the multi-establishment companies extended beyond Singapore and included overseas investments and subcontractors.

Only approximately 10 percent of all companies in the survey produced exclusively in Singapore, while a third conducted *all* production outside of Singapore. More than 70 percent of the interviewed companies had over-seas investments, while almost 76 percent had overseas sub-contractors. Approximately 39 percent of the interviewed companies did not, or no longer, produce in-house.

This is also reflected in employment numbers and ratios between the (interviewed) establishment and the entire company, and between Singapore and overseas locations. For every employee in the interviewed establishment there were on average 15 working in other establishments or subsidiaries, while for every employee in Singapore, there were on average 13 outside of Singapore within the same company (see table A in the appendix to this chapter). In addition, at 1:3.6, the ratio of non-production to production employees in the Singapore establishment was also very low (i.e. a low number of production employees per non-production employee). These non-production employees in the Singapore establishments performed activities for other establishments as well, e.g. management, administration, finance, procurement of inputs and buyer negotiations.

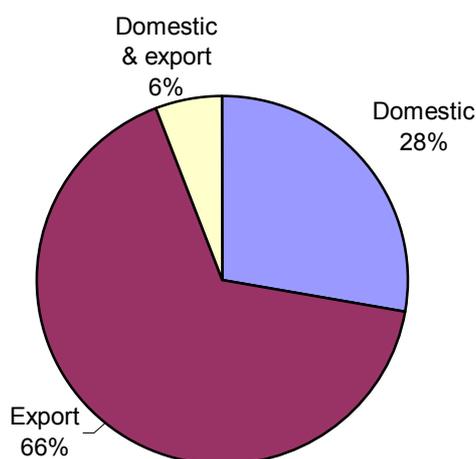
### 6.1.2 Markets, Buyers and Products

Almost all companies (93 percent) produced garments to the order of buyers and almost half sold all their output to buyers, while more than 80 percent sold at least half of their output to buyers.

Although more than half of the companies in the survey (29) indicated to manufacture their own brand, for only 12 of those did the manufacturing of their own brand account for more than 75 percent of their output, while only 4 focused exclusively on their own brand. It is only the group of companies with a share of more than 75 percent of own brands in output that can rightfully be considered OBM producers. In addition, in a number of cases the 'own brand' concerned the design and manufacturing of labels for wholesalers or local/regional department stores. The ownership of these labels was in hands of the wholesaler/department store though. In other words, the brand was not an owned brand at all.

The export oriented nature of the industry was reflected in the survey sample (see figure 6.1), with only 4 companies not being involved in any exports and approximately 30 percent of companies exporting less than 25 percent of their output.

**Figure 6.1 Sales Orientation of Singapore Garment Manufacturers (1998)**



On the other hand 62 percent exported more than 70 percent of their output and twenty-seven companies (or 47 percent of all companies), even produced exclusively for export. The companies with a low share of exports usually exported to regional markets, whereas companies with 100 percent export were more likely to export to US and/or European markets.

#### Notes:

- Non-response is 3
- Sales of entire company, including other establishments/subsidiaries
- Domestic =  $\geq 70\%$  of sales for domestic market; Export =  $\geq 70\%$  of sales for export markets; Domestic & export =  $< 70\%$  of sales for domestic and  $< 70\%$  sales for export markets

About 30 percent of exporting companies exported only to other Asian countries, while the rest exported to the USA or Europe, or combinations of these and, sometimes, Asian markets.

However, the US market was the dominant export destination, not just in terms of number of companies exporting their output to this market, but also in terms of average shares of output going there. For instance, for companies that exported to both the US and European markets, the average shares of output going to these markets was 73 percent and 27 percent respectively (see table B in the appendix).

This is mainly due to the fact that European buyers are usually smaller than US buyers and the European market is more fragmented<sup>3</sup>. Accordingly their orders tend to be smaller and more diversified. Therefore some producers preferred working with US buyers.

Most companies that produced to the order of buyers also indicated they preferred to spread orders over a number of buyers so as not to become too dependent on one or two buyers. Despite the fact that many companies had repeat orders from their customers and often had been working with the same buyers for a number of years, there was no binding contract and there was always a chance that a buyer might 'drop' its vendor (producer) at a moment's notice. This was the experience of one producer in the early 1990s, when one of its main customers (a European discounter) suddenly decided to source all its products from Bangladesh. Although the company survived the sudden drop in orders, it was a lot more careful not to "lay all its eggs in one basket" again (*-Interview manager Singapore garment company, 1998*).

Only approximately 13 percent of companies producing to the order of buyers worked with 1 or 2 buyers, while the majority of companies worked with more than 10 buyers. Of the producers that worked with as small number of buyers, most exported to regional markets, whereas companies exporting to US and European markets tended to have a larger number of buyers (see table C in the appendix to this chapter). This may have something to do with the fact that US and European buyers were more likely to shift orders to other (lower cost) countries, making it necessary for producers not to become too dependent on these buyers, assigning only a limited amount of production capacity to each buyer.

As to the type of buyers Singapore contract manufacturers worked for (see table 6.3), the most popular ones were branded US and European marketers and retail chains, such as Nike, the GAP, Eddie Bauer, Warner Brothers, Polo Ralph Lauren, Yves Saint Laurent and Adidas.

Second were US and European department stores, such as Federated Department Stores, May Department Stores, JC Penney, Great Universal Stores (G.U.S.), La-Redoute, C&A.

**Table 6.3 Type of Buyers of Singapore Manufacturers (1998)**

| Type of buyer                          | No. of comp. | Share (N=53) <sup>1</sup> | Buyer combinations <sup>2</sup>   | No. of comp. | Valid % (N=48) |
|--|--------------|---------------------------|---|--------------|----------------|
| Local/regional department store        | 11           | 21%                       | US brand/US Department store/US mail order                                | 17           | 35 %           |
| US department store                    | 13           | 25%                       | US brand/US Department store and European brand/European department store | 12           | 25 %           |
| European department store              | 2            | 4%                        |   |              |                |
| US branded marketer/retail chain       | 28           | 53%                       | Local/regional department store only                                      | 9            | 19 %           |
| European branded marketer/retail chain | 14           | 26%                       | European brand/European dept. store                                       | 3            | 6 %            |
| Asian branded buyer                    | 3            | 6%                        | Local/regional department store & US/European non-branded                 | 3            | 6 %            |
| Local/regional non-branded             | 2            | 4%                        |   |              |                |
| US/European non-branded                | 4            | 8%                        | US department store/brand & local/regional department store/ brand        | 3            | 6 %            |
| US Mail order                          | 3            | 6%                        |   |              |                |
| European mail order                    | 4            | 8%                        | Other   | 2            | 4 %            |
|  |              |                           | not applicable <sup>1</sup>   | 4            | -              |
|  |              |                           | non-response  | 4            | -              |
|  |              |                           | Total   | 57           | 100 %          |

<sup>1</sup> Four companies were not contract manufacturers, hence did not work with buyers

<sup>2</sup> slash (/) denotes and/or

In addition a number of companies produced for local/regional department stores such as Metro, Takashimaya, Isetan and Robinson's. Sales to these buyers were often either on a consignment basis (own labels), or on an outright sales basis (department stores' own/private labels). Outright sales imply the department store buys products from a producer or wholesaler and then sells them in its stores. The department store thus takes the risk if products are not sold. Consignment on the other hand implies the producer or wholesaler retains ownership of the product until it is sold to the final consumer and pays the department store a royalty (or rather rent, as it owes the department store this money whether it sells its products or not) for the use of the retail space. Often he is also left with the responsibility of providing sales staff and the layout and furnishing of its corner in the department store (see also Hassler, 2003).

In terms of shares of sales, US buyers (either branded marketers, retail chains or department stores) are most prominent, as their orders tend to be bigger.

Many manufacturers had relatively long standing relationships with their buyers, with approximately 62 percent having worked with one or more of the same buyers for 5 years or more. On average number producers had worked with the same buyers for about seven years.

### *Products*

Although most companies in the survey indicated to produce a variety of products in the mid-to-high-end market segments, most of these products were basic and casual wear products, with a predominance of knitwear. In other words, technical complexity and sophistication was not extremely high, nor was fashion content. This is partially because such complex products would require more skilled production workers, of which there is a lack in Singapore, and because of the kind of buyers Singapore manufacturers tend to work for: High-end basic and casual wear retailers and marketers, which require high-quality mass production. Quality and sophistication lie not so much in the technical complexity of products (as with e.g. ski-wear), but more in fabric use and what can be referred to as 'benefiting' (Meyer-stamer, *personal correspondence*, 2002). This involves special treatments, which can make all the difference in how long garments last, or may give a specific 'feel' to the fabric. There is in fact a large and renowned garment process finishing plant in Singapore, which can provide such benefiting services and is recognised by quite a few large buyers as a preferred supplier of such services. This designation has helped Singapore manufacturers as well and one member of the industry even attributed the industry's survival in part to the presence of this process finishing plant in Singapore (*-Interview manager Singapore garment company, 2003*). Thus despite the fact that Singapore garment companies still appear to produce very basic knitwear, they have in fact managed to develop into high-quality basic garments, for which they can command a higher price.

"It is costing top international fashion labels to produce their apparel here, but (...) manufacturers here are able to comply with their design demands. These requests range from making a shirt feel soft to sewing a skirt with a bias cut (.....) Such know-how is one reason American brand Eddie Bauer for example, is willing to pay 10 to 15 percent more to make its smart-casual outdoor wear for adults here rather than in places like Vietnam and Indonesia. (.....) (as) an account manager with the Singapore arm of Otto Versand (...) said 'Some countries don't know how to create the correct feel'" (*-Interviews in The Straits Times, January 17, 2003*)

A small group of OBM suppliers on the other hand was involved in the production of more fashion sensitive items, such as women's fashion wear, i.e. dresses and blouses.

### *6.1.3 Production Organisation*

As was illustrated in table 6.2, the majority of companies were part of multi-establishment companies. But even if they weren't, production often did not just take place in-house, but

rather was farmed out to subcontractors. Only three companies in the survey indicated to take care of all production in the interviewed establishment. Production organisation was generally more complex, as is illustrated in table 6.4. Often within this production organisation, there was a distinct division of labour between the different establishments and subcontractors, with production and non-production activities as well as lower and higher-end products being spread over different locations.

**Table 6.4 Production Organisation of Companies in the Survey (1998)**

| Production organisation  | No. of comp. | Share total | Average share output by this establishment | Average share output by other establishments | Average share output by subcontractors |
|--|--------------|-------------|--|--|--|
| All production in this establishment                                       | 2            | 3.5%        | 100%                                       | -  | -                                      |
| Production in this establishment and by subcontractors                     | 9            | 15.8%       | 62.5%                                      | -  | 37.5%                                  |
| Production in this establishment, and by subsidiaries/other establishments | 7            | 12.3%       | 34.8%                                      | 65.2%  | -                                      |
| Production in this establishment, by subsidiaries/other est. and subcontr. | 16           | 28.1%       | 35.5%                                      | 48.9%  | 15.6%                                  |
| all production by subsidiaries/other est.                                  | 6            | 10.5%       | -  | 100.0%                                       | -                                      |
| all production by subsidiaries/other establishments and subcontractors     | 10           | 17.5%       | -  | 70.8%  | 29.2%                                  |
| all production by subcontractors   | 7            | 12.3%       | -  | -  | 100.0%                                 |
| Total (N)  | 57           | 100%        | -  | -  | -                                      |

The last three columns in table 6.4 further illustrate the co-ordinating role of the Singapore establishment in the evolving division of labour in the regional networks they set up. In most cases the majority of output was taken care of outside the interviewed establishment.

#### *Production locations*

As indicated above, more than 70 percent of the interviewed companies had overseas investments, while almost 76 percent had overseas subcontractors. With large shares of total output being produced in other establishments or by subcontractors (see table 6.4), a substantial share of production output is in fact manufactured overseas. For 2001 it has been estimated that the value of total manufacturing output of Singapore owned textile and garment companies amounted to 4,2 billion Singapore dollars, of which approximately 3,15 billion dollars was generated by overseas factories (Straits Times, January 17, 2003). In other words, three-quarters of total output of Singapore garment companies is generated overseas.

In fact, only 6 companies had all output produced in Singapore. All of these companies were small-scale single establishment companies. Most companies (31) produced both locally and overseas while a substantial number (20) of companies only produced outside of Singapore (see table D in the appendix to this chapter). These figures support the production relocation observed in the official statistics in chapter 4. A shift of production out of the establishment almost automatically implies a shift of production overseas.

The first overseas investments by Singapore based manufacturers took place as early as the late 1960s and 1970s, when approximately 12 per cent of the multi-establishment companies indicated to have engaged in their first overseas investment. While more and more companies engaged in overseas investments during the 1980s (36 per cent of companies established their first overseas production location in this period) it wasn't until the 1990s that overseas investment became common. In this period 52 per cent of the multi-establishment companies in the survey indicating to have invested in their first overseas establishment in this period. This is in part consistent with what was observed in chapter 4 regarding the decline of local garment

production from the early 1990s. Obviously this was in part a consequence of the fact that production was increasingly shifted out and relocated to overseas locations.

Traditionally, preferred production locations included Malaysia and Indonesia, due to both the proximity and historical connection between Singapore and Malaysia, and the encouragement of the Singapore Government to relocate production within the SIJORI growth triangle. Especially investments in Malaysia tend to be older investments, with hardly any recent investments. Investments in Indonesia appear to be more recent, but this is probably not an accurate picture, as the non-response to this question (year of establishment of Indonesian facility) was relatively high. Other popular (older) production locations include Hong Kong (where some investments were in production co-ordination facilities overseeing actual production in both Hong Kong and China) and Fiji. The latter seems somewhat surprising, but can be explained by the fact that it had no quota restrictions (the same is true for Brunei) and the first overseas investments that took place in order to avoid quota limitations in Singapore were mostly destined for Fiji. The specific choice of location often had to do with the fact that one or two companies pioneered this location and the rest followed. More recently popular investment locations include China, Cambodia and Southern Africa (see table E in the appendix). By now production expansion all takes place outside Singapore and investment decisions do not so much involve relocation decisions (i.e. moving out of high-cost Singapore) but are more and more based on finding abundant labour sources to enable companies to expand. Although the difference seems trivial, it does mean investments are viewed in a different way. Not so much as an extension of production activities in Singapore, but as an expansion of a regional or international company. Proximity to Singapore has thus become a less important criterion.

Choices for the newer production locations were still motivated by their low cost, but especially by (the anticipation of) specific agreements and ongoing trade liberalization. Cambodia until recently was one of the few countries in Southeast Asia which was not burdened by quota or other forms of restrictions<sup>4</sup>. After years of conflict the international community applied very liberal trade policies to the country in order to help it recover. In addition, the establishment of garment factories was encouraged by Government to jump-start economic development. Southern Africa had a similar advantage, with abundant low cost labour and preferential access to the US market (see chapter 1).

China on the other hand has only more recently attracted investments from Singapore, which is due not just to the country's large reserve of low-cost and highly skilled apparel workforce but also to the country's pending accession to the WTO and the phasing out of MFA by 2005. Entry into WTO will make investments and regulations a lot more standardised and therefore transparent, while the phasing out of MFA has been predicted to bring about a further shift of production towards China.

### *Subcontracting*

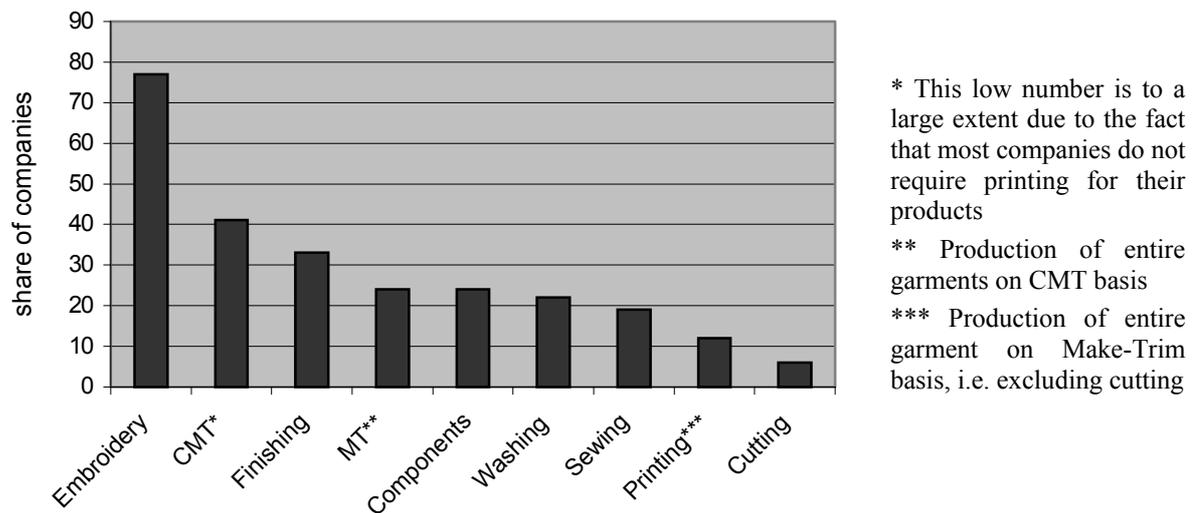
Subcontractors form an important part of the production organisation of Singapore garment companies. Companies engaged in subcontracting for three (often overlapping) reasons: to increase flexibility, to cut cost and to make use of specialised skills. The first reason usually leads to the outsourcing of entire garment production or component parts to local subcontractors. This allows producers to deal with fluctuations in orders without having to adjust their own production capacity. Only when the fluctuations are more structural (e.g. a structural increase in orders) will the manufacturer invest in expanding its own capacity.

Subcontracting for reasons of cost reduction were more likely to involve overseas subcontracting of entire garments (often including the cutting process) with fabrics being supplied by the Singapore establishment. Finally most companies subcontracted activities such

as embroidery, washing and dyeing. These kind of activities were outsourced locally, as they needed to be done fast and sometimes in small batches.

In total 52 companies (91 percent) indicated to subcontract certain production activities. On average they worked with 2 to 4 subcontractors and sourced out 2 to 3 activities. Figure 6.2 gives an overview of the kind of activities most commonly farmed out. Of the 33 companies that outsourced production of entire garments (sometimes excluding cutting), 25 indicated to do so - at least in part - overseas.

**Figure 6.2** *Activities Subcontracted Out by Companies in the Survey*



Preferred locations for such subcontracting were Malaysia and Indonesia, but China and Hong Kong were also popular. Only three companies indicated to subcontract in countries other than these four. Capacity subcontracting often took place locally or in nearby regions (Batam in Indonesia and Johor in Malaysia) and involved sewing or the production of components.

Subcontracting of specialised operations was also done predominantly locally or in nearby regions. Finally it is likely that overseas establishments/subsidiaries work with their own subcontractors locally for such activities as embroidery and perhaps even some sewing operations. This was however not included in our survey.

A more general look at sales orientation, overseas investment and subcontracting of companies in the survey combined, reveals a number of patterns (see table F in the appendix).

First, common combinations of production locations, regardless of sales orientation, include Malaysia, Indonesia and/or China. Second, the production networks of export-oriented companies tend to be more extensive, with 42 percent of these companies producing in three or more different locations. In addition their networks tend to spread out further, as is demonstrated by the fact that most of the companies producing outside of Southeast and East Asia fall in this category.

Third, only export-oriented companies had production in countries such as Brunei, Cambodia and Fiji. This is directly related to the quota advantages these countries have, which of course are of little concern to companies producing for local/regional markets.

Finally, for the domestically oriented companies China and Hong Kong are important production locations. This involved mostly production sourcing, as few had direct investments in these countries. It is likely that products sourced from Hong Kong subcontractors were in fact manufactured in China. Products for domestic markets tend to be lower to mid-end products<sup>5</sup>, which sell at low price points. China is the most competitive production location for such products, which are either directly imported through wholesalers in China, or sourced

from subcontractors/affiliate companies, in which case the Singapore establishment usually still adds some value to the product in Singapore (e.g. finishing, benefiting, packing, labelling).

### *Input supply*

Not surprisingly, Singapore garment companies sourced most of their fabrics as well as a large part of their accessories outside Singapore. Even if inputs were procured locally, this was usually through an importer of fabrics and/or accessories.

An overwhelming majority of companies (94 percent) sourced fabrics from the East Asian NIE's and/or Japan (see table G in the appendix), testimony to the strong position of the textile industries in Japan, Taiwan and South Korea and the trading centre function of Hong Kong (although Hong Kong itself does not have a very large textile industry, there is a large concentration of textile and accessories trading and merchandising companies located here). In addition many OEM producers worked with nominated suppliers, most of which were located in East Asia.

Remarkable is the still (relatively) strong position of Europe considering the fact that lead-times are such an important issue these days and fabric from Europe is often quite expensive. Fabric sourcing from Europe involved mostly high-end or special fabrics not found in Asia (or at least not the right quality). Again, OEM suppliers usually sourced inputs from Europe or the USA if these were nominated. However, the more expensive European, US, Australian, and Japanese fabrics were mostly sourced by local brand and label companies. Obviously for more fashionable special items, the developed countries still possess a strong advantage.

#### *6.1.4 Categorisation of Garment Companies in the Survey*

Based on the above given descriptions of the main characteristics it is possible to make a categorisation of the companies in the survey. In table 6.5 a description is given of the six different categories that were identified and the number of companies in each category

Categories are not always mutually exclusive, but group companies on broadly similar characteristics. As a consequence categories may overlap somewhat and particularly the 2nd (OEM II) and 4th (Local label) categories are in fact quite similar, with the exception of their export destinations and the fact that companies in the local label group claimed to have their own brand, which made up around 50 percent of their total output. These were mostly lower-end brands and labels sold in local department stores. None of these companies had own boutiques or outlets and none produced more than 50 percent of total output under their own brand name. This in contrast to companies in the OBM group

The OEM I category also includes a small number of foreign owned companies (4) and joint ventures (2), which may have slightly different set-ups than the locally owned companies. However, the joint ventures only had minority foreign participation and Singapore as the location of their headquarters. The majority of foreign owned companies considered the Singapore establishment as a main or independent unit within the entire company.

The Regional office category consists of different types of companies, which all have in common that they are part of manufacturing based companies and are in fact foreign owned subsidiaries (or in one case a joint-venture). They play a more or less independent role within the entire company, related to production co-ordination and planning, sales and marketing, etc. and not so much to production perse.

Obviously, the OEM I category is the biggest group of companies in Singapore. Its dominance becomes even clearer if we compare the relative size of the different categories by considering the share of each in total employment and total turnover (see figures D through F in the appendix). Thus although approximately 39 percent of companies in the survey can be considered large scale OEM suppliers, they account for more than 84 percent of turnover in

and almost 70 percent of total employment (i.e. including employees in other establishments and subsidiaries).

**Table 6.5** *Categorisation of Companies in the Survey*

| Category                       | Description  | No. of companies |
|--------------------------------|--|------------------|
| 1 OEM I                        | Medium to large scale OEM suppliers to Western buyers; multi-establishment companies, turnover > 5 million S\$ <sup>1</sup> ; export oriented (export share of output >75%), production takes place predominantly outside Singapore.   | 22               |
| 2 OEM II <sup>1</sup>          | Small/medium scale OEM suppliers (turnover < 5 million S\$ and employment < 100) for Western non-branded buyers (wholesale, import/export, smaller department stores or lowest tier brands) and/or local/regional department stores and non-branded buyers; often single establishments, working with sub-contractors; production takes place predominantly (but not exclusively) in Singapore | 9                |
| 3 OBM (local/regional)         | Local brand companies (OBM > 75% of output) marketing locally and regionally (export < 25%); little if any own production, usually small scale (turnover < 5 million, employment < 50)   | 11 <sup>2</sup>  |
| 4 Local label <sup>1</sup>     | Local (lower-end) brand companies and label supplier for local and regional department stores and non-branded buyers (approximately 50/50); SME (turnover 1-5 million S\$ and employment < 100); often single establishments, producing both locally and overseas  | 7                |
| 5 OBM/OEM                      | Local brand producer (with own outlets) and OEM supplier for Western brand companies; large scale, multi-establishment company with overseas production  | 1                |
| 6 Regional office <sup>3</sup> | Regional production co-ordination, sales & marketing office for regional OEM and OBM producers, using Singapore as base. Part of multi-national, multi-establishment companies; two types:<br>1) Subsidiaries/independent units of NIE companies, large scale with global reach;<br>2) Sales/marketing/retailing offices of Malaysian/Indonesian OEM suppliers.                                | 5                |
| 7 Other <sup>4</sup>           |  | 2                |

<sup>1</sup> These categories also include local license holders of lower-end Western and Asian brands/labels. Some companies considered this to be their 'own' brand, while others considered the license owners as their buyers. Both are not really accurate, however, we have decided to add them to these categories, as in terms of their basic set-up and performance they are quite similar.

<sup>2</sup> All of these companies have their own outlets/shops. For one company only 50 percent of output was OBM, however, it was included in this category because it did have own shops.

<sup>3</sup> Of manufacturing based company

<sup>4</sup> Companies that fit neither category, in both cases producers of uniforms for the local market

Average annual turnover for the OEM I category is also highest of all categories and its contribution to total turnover is more than double its contribution in terms of number of companies. However, this did not imply it was the segments with the highest value added or profit margins, as turnover per employee was in fact below the average of 42,989 dollar per employee per year. Unfortunately this is a very crude measure, as a large number of companies in the 2nd, 3rd and 4th category had substantial amounts of their outputs produced through subcontractors. The employment in these subcontractors is not included in the employment number and since turnover reflects sales but does not include cost (for instance of engaging subcontractors) turnover per employee for these establishments will be relatively high. It is therefore impossible to make any definite assertions as to value added and profit margins per category.

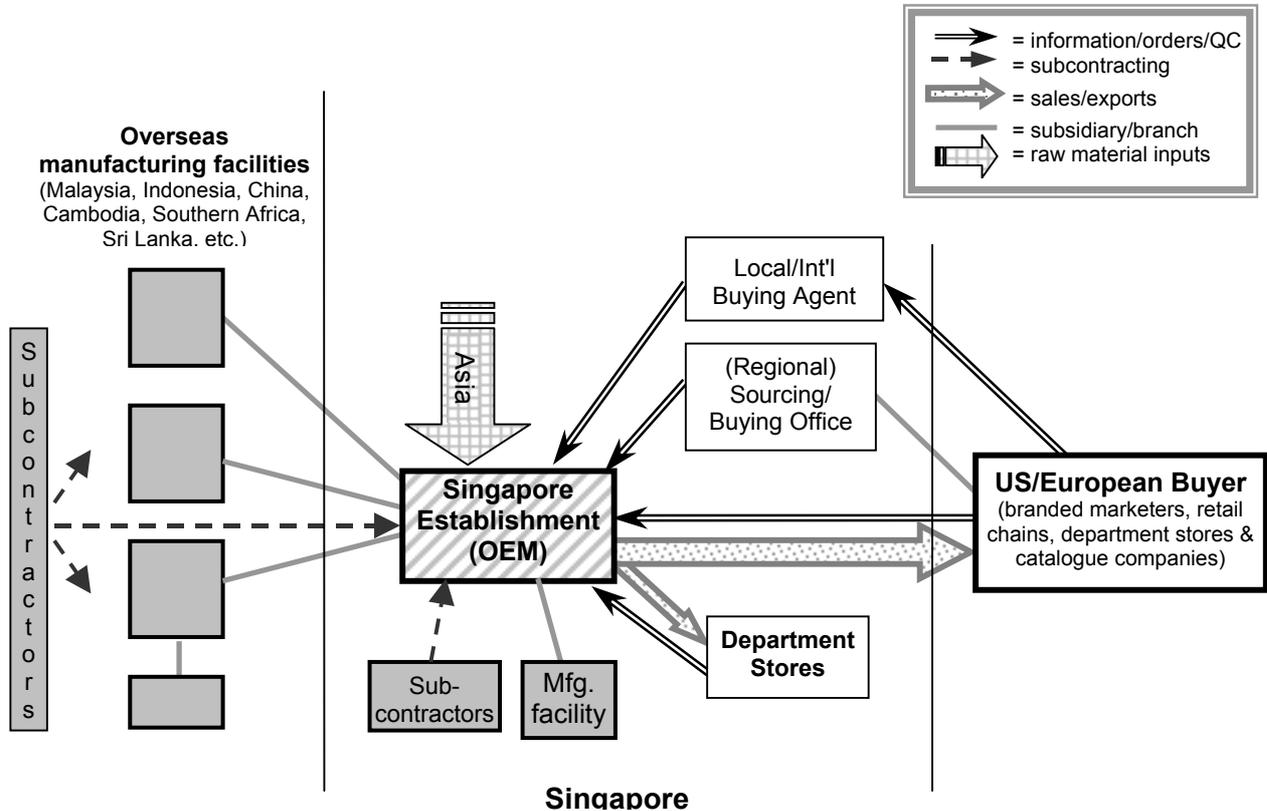
The fact that most other categories (i.e. OEM II, OEM/OBM and Regional offices) are also essentially rooted in OEM roles, further underscores the dominance of this company role.

The typical production organisation and distribution networks for companies in the OEM I category is depicted in figure 6.3.

It includes not just production linkages, but also linkages with regional offices and agents of European and US buyers located in Singapore. These offices and agents do not place orders or are directly involved in the management of production, yet they play an important role in the management of production networks (see chapter 1). In essence they function as translators of

the requirements and standards of their parent company or client (in the case of an agent), ensuring closer control over their networks. The role of these offices extends beyond Singapore and may include regional and even extra-regional vendors. We will take a closer look at the role and function of these offices and their connections to local garment producers in the last section of this chapter.

**Figure 6.3 Production and Distribution Networks of Singapore OEM I Suppliers**



The production and distribution networks of the companies in the other main categories are usually less complex and extensive (see figures G and H in the appendix), while those of companies in the regional office category are not centred in Singapore. This is also the case for a few of the foreign owned companies in the OEM I category (as was discussed above). However, the latter were primarily set-up as manufacturing branches, whereas companies in the regional offices category were part of manufacturing companies, but their set-up in Singapore was not manufacturing based and their core functions therefore often different (e.g. sales and marketing).

In the remainder of this chapter we will often group certain categories together, as separately their size often makes a relevant analysis difficult, while in many respects their characteristics are broadly similar. Thus we will often group together the OEM I and OEM/OBM category, as the latter only consists of one company (see box 6.2), which does not warrant separate analysis, while 75 percent of its business is OEM, making it on the whole quite similar to the OEM I segment. Similarly the OEM II and Local label categories will be taken together where possible.

The regional office category finally will usually not be considered separately due to the low number of companies in it and the differences among these companies, and because they form a rather distinct category. This group will be considered in more detail in the last section of this chapter.

Before turning to the competitive adjustment strategies, first changes and developments in the Singapore business environment will be considered. This is done from the perspective of the companies in the survey, i.e. their views on main issues and problems that have forced them to adjust and restructure their operation.

## 6.2 The Singapore Business Environment: Factors Impinging on Competitiveness and Major Problems Experienced by Singapore Garment Companies

All companies were asked about a number of factors and elements in their business environment and which they considered to be an issue or problem in terms of negative effects for their business. The findings are summarised in table 6.6 for all companies and by main company categories.

**Table 6.6 Issues and Problems in the Singapore Business Environment (1985/98)**

| Perceived issues and problems                                | Share all companies (N=57) | Share OEM I, Regional office & OEM/OBM (N=28) | Share OEM II & Local label (N=16) | Share OBM (N=11) |
|--|----------------------------|---|-----------------------------------|------------------|
| Labour availability and cost                                 | 95% 54                     | 93% 26  | 94% 15                            | 100% 11          |
| Other business cost  | 79% 45                     | 75% 21  | 88% 14                            | 73% 8            |
| Regional competition and/or competition from niche producers | 86% 49                     | 89% 25  | 75% 12                            | 91% 10           |
| Changes in markets   | 58% 33                     | 71% 20  | 44% 7                             | 55% 6            |
| Requirements buyers/clients/customers                        | 79% 45                     | 86% 24  | 81% 13                            | 64% 7            |
| Keeping buyers   | 58% 33                     | 57% 13  | 56% 9                             | 55% 6            |
| Production technology  | 25% 14                     | 36% 10  | 19% 3                             | 9% 1             |
| Local institutional context                                  | 60% 34                     | 54% 15  | 63% 10                            | 64% 7            |
| Trade regulations  | 49% 28                     | 75% 21  | 19% 3                             | 27% 3            |

Not surprisingly labour cost and availability (including wage increases, shortages of skilled and unskilled labour and labour turnover), as well as other cost of operating in Singapore (including cost of land, facilities and inputs) were seen by all companies in all categories as major factors impinging on their competitiveness. Shortages of labour concerned mostly skilled labour, which in the cases of the different segments implied different things. For the segments that were still involved in actual production (even if just pre-assembly processes), this shortage concerned skilled production operators, markers and graders, cutters, supervisors, etc., whereas for branded companies, the shortage concerned more design and marketing personnel.

A number of companies also indicated that it was hard to find competent people at the management level. This was especially true for companies that had expanded or were planning to expand overseas and thus needed managers capable of managing factories overseas or even relocating there. One managing director (MD) of a company argued that "one of the main issues (for our company) is the fact that both managers and workers are often unwilling to relocate overseas" (*-Interview manager Singapore garment company, 1998*).

Competition and particularly regional competition was also a factor of concern for many companies. For the export-oriented OEM I & OEM/OBM segment, regional competition referred to competition for buyer orders and export markets, whereas for domestically and regionally oriented segments, it referred to competition for local and regional markets. Producers for the domestic market in particular felt it was hard to compete with cheap Chinese, but also Indonesian and Malaysian imports. In addition, for local brand producers, competition from other designer labels and brands (niche producers) were also seen as an issue.

Changes in markets (more rapid fashion changes and less standardised products) seem to affect OEM I producers more than companies in the other segments. This is probably due to the fact that their large scale set-ups make quick changes and more special items or treatments within product lines harder and more costly to achieve. This is further reflected in the fact that 83 percent of companies in this category found demands for increased flexibility (smaller batch-sizes, more mid-season adjustments and re-orders, etc.) hard to comply with, although this didn't mean they *couldn't* comply with the demands. Buyer/client requirements (demands for higher quality, increased differentiation and flexibility and shorter lead-times) were seen as a problem or issue in the sense that they increased pressures and impinged on profit margins of producers. Not surprisingly this factors played a minor role for companies in the OBM category. A more pressing problem for them was the small size of the local market, as opposed to buyer/market requirements perse. However, the issue of managing to 'keep' buyers, was seen as a problem by more than half of the companies and this was true for companies in all three major groups. Although this may have been expected for the OEM segment, it is somewhat surprising in the case of companies in the OBM segments particularly. In these cases what was implied was either final customers and/or retailers such as department stores, whose requirements and demands have increased over the years as well (see Hassler, 2003 for the Indonesian case).

The limiting role of trade regulations and particularly quota restrictions weighed most heavily for large scale OEM exporters, while it played a minor role for the other segments. However, even some of the large scale OEM companies had a more 'positive' view of quota, in terms of their general effect. As one manager asserted:

“All in all the quota system has been positive, as it has assured a reasonably stable market, where supply and demand are kept in balance and there is little overcapacity” (*-Interview manager Singapore garment company, 1998*).

The issue of keeping up with the latest production technology, although generally not considered a major issue of concern, scored highest amongst OEM producers. This is understandable in the light of their larger scale production set-ups and organisation and their customer base. US and European buyers usually required quality standards and short lead times, which can often only be achieved through the use of certain technologies or advanced equipment. Examples include specialised machines for certain processes, computerised pre-assembly machines, which easily linked to the designs and specifications of buyers, transport systems for work in progress, increasing efficiency and speed and information technology for faster and easier communication and information flows. Most of these technologies require substantial investments and can thus potentially form a problem for the producer.

The fact that many of the smaller, domestically and regionally oriented companies did not see production technology as a problem was probably in part due to the fact that they subcontracted substantial parts of production (hence were not so much involved in the actual production process) and quality requirements were often less for their products. In addition, in case they did have in-house production their small set-ups made many of the newest technologies useless, as they required large scale manufacturing to even be efficient.

Approximately 50 percent of all companies cited the local institutional context (Government policies, quality, health and safety standards and labour unions) as an issue of concern. However, among companies in the OEM I segment this was not seen as a very important issue. Generally speaking it seems more of an issue for the locally and regionally oriented companies than for the large export oriented companies. Perhaps this reflects the perception of the small-scale, domestically oriented segment of being somewhat neglected by Government in comparison to the export-oriented segment. Finally it must be noted that implied here were Government policies outside the high wage/high cost policies (see chapter 4), which to most companies obviously were a major issue.

Finally respondents were asked to rank the five main issues in order of importance, which resulted in the following overall ranking:

1. Increasing wages
2. Shortage of skilled labour
3. Cost of land/facilities
4. Regional competition
5. Buyer demands regarding products and delivery times
6. Quota limitations
7. Government policies

In the following section we will take a look at the responses of companies to these imperatives in terms of competitive adjustment strategies implemented.

### 6.3 Competitive Adjustment Strategies and Main Outcomes

*Table 6.7 Competitive Adjustment Strategies by Singapore Garment Companies (10 years)<sup>6</sup>*

| Strategies  | Share all companies in % (N=57) | Share OEM I & OEM+OBM <sup>1</sup> in % (N=23) | Share OEM II & Local label in % (N=16) | Share OBM in % (N=11) |
|---|---------------------------------|--|--|-----------------------|
| <b>Labour</b>   |                                 |  |  |                       |
| (Increase) employment of foreign workers                                | 65 37                           | 78 18  | 56 9                                   | 45 5                  |
| (Increase) employment of female workers                                 | 67 38                           | 65 15  | 63 10                                  | 73 8                  |
| Increase labour flexibilisation (use of part-time or temporary workers) | 33 19                           | 17 4   | 50 8                                   | 45 5                  |
| Increase overtime work  | 68 39                           | 78 18  | 63 10                                  | 55 6                  |
| Change number of shifts   | 14 8                            | 13 3   | 6 1                                    | 27 3                  |
| <b>Outsourcing</b>  |                                 |  |  |                       |
| Increase subcontracting   | 42 24                           | 35 8   | 38 6                                   | 73 8                  |
| Subcontract overseas  | 58 33                           | 61 14  | 44 7                                   | 91 10                 |
| <b>Technology</b>   |                                 |  |  |                       |
| Introduction of labour saving technologies                              | 40 23                           | 57 13  | 19 3                                   | 36 4                  |
| Invest in space saving technologies                                     | 37 21                           | 43 10  | 38 6                                   | 36 4                  |
| Introduce new technologies  | 53 30                           | 70 16  | 38 6                                   | 45 5                  |
| <b>Location</b>   |                                 |  |  |                       |
| (Increase) investment in overseas establishments                        | 60 34                           | 83 19  | 32 5                                   | 45 5                  |
| <b>Markets/clients</b>  |                                 |  |  |                       |
| Produce for different market segments                                   | 44 25                           | 26 6   | 50 8                                   | 73 8                  |
| Search for/venture into new (geographical) markets                      | 68 39                           | 61 14  | 69 11                                  | 73 8                  |
| Secured new buyers  | 35 20                           | 26 6   | 44 7                                   | 36 4                  |
| Change buyer/client base  | 68 39                           | 65 15  | 63 10                                  | 82 9                  |
| <b>Production organisation</b>  |                                 |  |  |                       |
| Change procurement patterns   | 53 30                           | 39 9   | 44 7                                   | 73 8                  |
| Reduce lead-times   | 81 46                           | 87 20  | 81 13                                  | 73 8                  |
| Increase flexibility (smaller batches, more rapid changes)              | 81 46                           | 78 18  | 88 14                                  | 73 8                  |
| <b>Product</b>  |                                 |  |  |                       |
| Improve product quality   | 98 56                           | 100 23   | 100 16                                 | 91 10                 |
| Manufacture other products  | 70 40                           | 78 18  | 56 9                                   | 82 9                  |
| Differentiate products  | 68 39                           | 52 12  | 63 10                                  | 82 9                  |
| Manufacture new products/extend range                                   | 56 32                           | 43 10  | 63 10                                  | 64 7                  |
| Developed design capabilities   | 54 31                           | 39 9   | 63 10                                  | 82 9                  |
| Developed/introduced own brand  | 49 28                           | 17 4   | 67 11                                  | 100 11                |

<sup>1</sup> the OEM I category and OEM+OBM category are taken together here, as the latter has large scale own production and produces about 75 percent for export. Its strategic behaviour is therefore more strongly geared towards its OEM function than towards its OBM function.

All managers were asked to indicate which types of strategies had been implemented in the past ten years and subsequently to explain some of these strategies in more detail. For instance why and how they were implemented and what the outcomes or effects of these strategies were. Implemented strategies are summarised in table 6.7. Strategies were grouped under a number of broad headings, corresponding with the categorisation in table 3.2 in chapter 3.

### 6.3.1 *Defensive Strategies: Labour Intensification and Outsourcing*

#### *Labour strategies*

Labour strategies, especially the employment of foreign workers and having employees work overtime, were common measures among all companies to deal with the issues of labour shortages and cost.

Overtime work was not always structural, but more often was used to cover peaks in orders, enabling flexibility. This is in fact a very common strategy in the industry in general.

The OEM I group seemed slightly more inclined to hire foreign workers, probably because they require more workers and therefore applying for foreign workers makes sense as they can apply for a sizeable batch at once. In addition smaller companies in the other categories may have more problems paying the levies for foreign workers<sup>7</sup>. On the other hand companies in these categories were much more inclined to increase labour flexibilisation through the use of part-time or temporary workers.

Finally, a number of companies in the last two categories will not be involved in production directly, thus have no need for production workers (which foreign workers usually are).

Recruitment of foreign skilled non-assembly workers is less common, although many companies indicated they would like to apply for such workers. However, Government's policy of only allowing employment of foreign workers from so-called 'traditional sources' forms a limitation in this respect. For the garment industry traditional source countries include Malaysia and Indonesia. Skilled workers, however, are seen to come from non-traditional sources such as China and India.

Recent shifts in Government policies may enable such recruitment in the future though:

"... Government seems to be reconsidering its stance on the industry. Thus we just put in an application of 1000 foreign workers from non-traditional sources (Sri Lanka, India, China). These are higher skilled workers, i.e. not so much sewers, but for instance (embroidery) designers, etc. Government has reacted positively to this request" (*-Interview manager Singapore garment company, 2003*)

If recruitment of foreign workers is indeed aimed at acquiring higher skill levels among employees, this could in fact be considered more of an offensive than a defensive strategy.

However, overall labour strategies are still predominantly defensive, although they are obviously no longer seen as sufficient for survival. More than 68 percent of companies indicated that cost had increased in the past ten years, despite labour and other cost saving measures. Defensive strategies such as labour strategies are thus in part applied to limit the increase in cost but seem incapable of actually bringing them down or even retaining them.

#### *Outsourcing strategies*

Although most companies worked with subcontractors (91 percent), only 24 companies (42 percent) indicated to have increased the amount of outsourcing they engaged in over the past ten years. Especially companies in the OEM I group were less inclined to increase outsourcing, which is probably due to the fact that on the one hand requirements regarding outsourcing on the part of the buyers have become increasingly strict, and on the other hand many of the larger OEM companies opted for overseas investments instead of subcontracting.

Several OEM producers indicated that they preferred not to subcontract for fear of not being able to control quality and labour standards, which could get them in serious trouble with their buyers. Of the subcontracting that does take place most does not involve core activities, such as

the production of entire garments, but rather specialised activities such as embroidery, washing, etc. One producer argued that this was not just because of buyer requirements:

"We only subcontract production of components or things like washing and embroidery. We don't want to farm out the production of entire garments, because we would then in fact transfer our know-how to these subcontractors and what is to stop them from starting OEM themselves, and becoming our competitors?!" (-Interview manager Singapore garment company, 1998)

To which extent such considerations are more common is not clear, but it is obvious that the choice to subcontract - or not - is usually not based on cost considerations alone.

The fact that many OEM suppliers had overseas subcontractors, but were less inclined to increase subcontracting, indicates that outsourcing strategies used to be more popular, but have gradually become less so with increasing buyer requirements.

Local/regional OBM producers were more inclined to opt for outsourcing as a competitiveness strategy. In addition companies in this group had almost all engaged in overseas subcontracting, mostly of entire garments. As they lacked the capital to invest in overseas facilities, subcontracting was the best option for these companies to internationalise. Moreover, as they were probably never (substantially) involved in production to start with, their inclination to set up their own *production* facilities overseas was naturally less than for companies that were production oriented.

### 6.3.2 Offensive Strategies

#### *Relocation strategies*

Although relocation strategies can also be considered defensive, they may be part of an overall, more offensive strategy, involving a shift towards becoming an important intermediary and co-ordinator of regional production networks for Western buyers (c.f. the example of OEM+ in the East Asian NIEs, see chapter 3). Generally speaking it is somewhat hard to designate location strategies as solely defensive, or solely offensive.

Not surprisingly companies in the first category (OEM I and OBM/OEM) were most inclined to invest overseas, which is in part related to their overall larger size (all companies in this category had an annual turnover of more than 5 million dollars). But this group of companies, also required larger numbers of workers than small size companies, making labour shortages an even more pressing issue. The most important reason for engaging in overseas investments were lower wage cost, with all companies citing this as at least one of the reasons for the decision to invest overseas. Other important reasons were availability and lower cost of land/property and the availability of labour. A number of companies also indicated quota limitations as a reason for investing overseas. As buyers of companies in the first category were often US buyers, quota considerations were only an issue for this group, and not so much for companies in the second and third category, which mostly exported to (quota free) Asian countries. However, quota limitations have mostly been a consideration for investments undertaken in the late 1980s and early 1990s. With the consolidation of the industry since the early 1990s, quota utilisation rates were in fact quite low at the time of the survey, so for more recent investments, this was a less cited reason. Quota restrictions do however still play a role in the decision for the actual investment location, which explains the popularity in the 1990s of investment locations such as Cambodia.

In 13 cases did overseas investments also entail a downsizing of production capacity in Singapore, with the Singapore establishment focusing increasingly on head-quarter functions and other non-production activities such as design, merchandising and sample-making.

#### *Technology*

Relatively few companies had introduced new technologies as a means to increase their competitiveness. This is not strange considering the nature of the industry and the limited

possibilities for automation. As far as automation in the production process itself is possible, it usually requires large scale production and substantial investments, at least for an industry in which most companies have limited capital at their disposal. Moreover, a large share of companies only produced a small part of total output in Singapore, took care of all production in other establishments overseas, or outsourced all of their production. For these companies investments in production technology makes little sense. What investments have taken place in these companies usually involve computer aided design (CAD) and marker systems. These were also the most common investments among all companies (24 companies had invested in at least one of these technologies), whereas only a few large companies had invested in computerised cutting (7 companies) and 'transportation' systems (e.g. conveyor belt or unit production systems (UPS)).

Although it is possible that technology investments were made in overseas facilities, we did not ask managers any details about this.

### *Market/client strategies*

Market/client strategies involve strategies aimed at changing either clients, markets segments or market as a means to expand business or increase value added. For instance by moving from lower-end buyers to higher end-buyers a company is able to command higher prices for its products. This kind of move - referred to as the upgrading forward (marketing) linkages - usually implies some forms of product and process upgrading, as "the higher price points of fashionable retailers reflect more complicated products and differentiated styles" (Gereffi, 1999, p.4).

Moving into different market segments is often related to changes in the buyer/client base, although it may also be a strategy implemented autonomously by the producer, either to secure new buyers or as part of the (further) development of own brands and marketing.

Producing for different market segments thus entails some form of learning and is often also closely related to product changes, such as extending product range or diversifying. Extension of the product range may mean that a company which formerly only produced knitted tops, adds the production of woven tops or of bottoms/pants to its range, whereas diversifying refers to different markets segments, e.g. from sportswear to casual wear or street-wear or a focus on certain age and style groups of consumers. Again, buyer requirements and attempting a shift towards higher end buyers may play an important role in the implementation of these strategies for certain companies. Finally it is possible that a company decides to expand into different markets, e.g. moving from local/regional to European/US markets, but also searching for new, non-quota markets. This too can be related to either a company's own initiative, but often also involves other drivers such as buyers or the international trade regime.

All in all, market/client strategies rarely stand alone, but are often strongly related to one another and to product changes.

The most popular strategies in this market/client category appear to be changing the buyer/client base and searching for new markets, with 68 percent of all companies having engaged in at least one of these strategies. Of the companies that had changed their buyer/client base, almost 40 percent indicated this implied a move from lower-middle end buyers to higher-end buyers, whilst the rest had merely increased or decreased the number of buyers they worked for or had shifted towards own brand development. Approximately 64 percent of companies were actively trying to secure new buyers. On the one hand this was because most companies did not want to rely too much on just a few buyers/clients and on the other hand a single buyer often does not place a consistent amount of orders throughout the year.

Within the large scale OEM group (including the regional offices and the OEM/OBM company), virtually none of the interviewed companies still produced for the lowest end Western buyers anymore (discounters such as WalMart from the US or HEMA from the

Netherlands). It appears this shift towards higher-end buyers has taken place in the late 1980s as at the time of the survey, the majority of large OEM suppliers had been with the same main buyers for a substantial number of years and market strategies were thus often implemented while continuing to work with the same buyers.

Of all companies that said to have started producing for different market segments, 64 percent indicated this was because (new) buyers required such shifts. Similarly, of the 39 companies that said to have started production for new markets, two-thirds indicated the information necessary for this strategy was obtained through linkages and contacts with buyers.

Thus although market/client strategies can be seen as pro-active strategies, for a large number of companies they were necessitated or at least encouraged by buyer demands. The exception of course being the small group of OBM companies, which have engaged in marketing strategies as a fairly autonomous choice, determined more directly by market (consumer) demands and preferences.

### *Production organisation*

Due to market developments and buyer strategies (see chapter 1), producers are faced with increasing demands for shorter production runs and flexibility in production (i.e. smaller batch sizes, the capacity to produce re-orders in a very short time and supply mid-season if required, etc.). This necessitated strategies in the area of production organisation, these included most notably reducing lead-times and increasing flexibility in the production process. Both 'scored' high among all Singapore producers, although they were given form in different ways. For instance by sourcing inputs closer to home. However, this was only a small percentage, as quite a few key inputs suppliers were nominated and located in East Asia.

Other ways to increase flexibility included: increasing the skills and flexibility of workers (20 percent of companies said to have increased flexibility indicated this as the way they had achieved it); producing smaller batch-sizes (15 percent); introducing new machines or technologies (11 percent) and increasing the amount of outsourcing (7 percent). Unfortunately 46 percent of the companies that indicated to have increased flexibility, did not explain how this was achieved. It is likely that a lot of efficiency improvement and flexibility was also achieved through industrial engineering, i.e. improvement of the work-flow through time motion studies and perhaps a different layout of production lines.

Overall, based on the answers given in the survey, it is a little hard to judge whether flexibility has indeed increased and particularly to what extent. When some of the *buyers* were asked to comment on the flexibility of their Singapore producers, several indicated it was not the industry's strongpoint and lead-times could be better. This was attributed to the lack of local inputs, but also the inflexibility of production networks of Singapore producers, when compared to suppliers in e.g. Taiwan and Hong Kong. Singapore producers were thus seen more as 'followers', not pioneers. For instance, one of the buyers indicated that Taiwanese producers tend to work more through extensive subcontracting networks instead of setting up their own factories overseas. This, it was argued, made them more flexible and enabled quicker response to changes or certain requests from buyers, as setting up a whole new factory in a foreign country often takes up more time.

One of the large scale OEM suppliers with overseas production facilities more or less confirmed this issue of inflexible networks:

"large scale producers are less flexible. This is due to the increasing complexity of logistics in such a company, especially if different products are made in different locations, making it difficult to respond quickly to demands of buyers" (*-Interview manager Singapore garment company, 1998*).

On the other hand, own investments are also seen by buyers as more reliable and in some cases this advantage will outweigh lead-time considerations.

Generally speaking Singapore producers scored less than Hong Kong and Taiwanese suppliers in terms of flexibility and lead-times, while being slightly ahead or at the same level as producers in Malaysia and Indonesia. The biggest difference with these countries lay in reliability and added services.

### *Product*

All producers indicated to have increased product quality, but this seems to have been more of a general trend, in other words improving product quality was a minimum requirement for all companies in the industry. It is however likely, that such product quality improvements weighed much heavier for companies in the OEM I group, as their buyers will have been much stricter with regards to quality standards than for instance non-branded Asian buyers will have been. Also the consequences for non-compliance are often more serious for companies working with higher-end Western buyers. Product quality was improved in several ways;

- 1) Improvement of quality control (QC) (approximately 41 percent). Stricter and more comprehensive QC systems reduced the number of defects, thus reducing the risk buyer complaints or rejection of entire shipments.
- 2) The use of better, higher-quality fabrics (21 percent). In many cases this was directly driven by buyers as they specified the fabric quality and designated suppliers
- 3) The use of new, better machines
- 4) The use of more experienced workers
- 5) Through feedback of customers.

Product strategies have been implemented most frequently by companies in the OBM group. Not surprising considering their focus on branding, which revolves mainly around the product itself. For companies in the OEM I group product strategies (with the exception of quality improvement) were less common and often driven entirely by buyers.

The strategies implemented and discussed above were not all implemented at the same time but in most cases followed a certain sequence. Initial strategies often included the more defensive strategies such as labour intensification and relocation of production through subcontracting and overseas branch plants in Malaysia and Indonesia. The wage restraints advised by the National Wages Council in 1985 also provided some breathing space to the industry in terms of cost, enabling companies to continue their cost oriented strategies. From the late 1980s onwards, however, defensive strategies alone did not suffice and this is the first time major shifts within the industry and companies can be observed. Cost continued to increase and both buyers (directly) and the Government (mostly indirectly) put pressure on the industry to restructure and upgrade. It is therefore in the late 1980s and early 1990s that offensive strategies begin to take a more prominent place in overall company strategy. On the other hand, those companies that could not or did not want to further adjust beyond the low road strategic direction opted for exit strategies. This group included both foreign investors pulling out or selling their Singapore operations and local companies going bust or closing shop. Two trends are thus discernible from the early 1990s. At the industry level a strong consolidation of the industry and at the firm level the shift towards offensive strategies, such as internationalisation of production (as opposed to merely setting up branches in nearby Batam and Johor), the introduction of own labels and brands, a shift towards higher-end branded buyers and an increase in involvement and services to buyers. Other company categories, most notably the local label and OBM suppliers took advantage of the development of an increasingly fashion conscious and wealthy local population and Singapore's development into a regional shopping centre to successfully launch and develop their labels and marketing networks and started setting up own stores locally and regionally. Simultaneously, as far as they were involved in production to begin with, many started moving out of this completely.

As offensive strategies thus seem to be implemented once the limits of defensive strategies are reached, it is likely development trajectories will not always be smooth but may display more discontinuous patterns, a point we will return to in the following sections.

We now turn to the actual outcomes of strategies in terms of products, production and production organisation and functions of individual companies in the survey.

### 6.3.3 Outcomes of Competitive Adjustment Strategies

An overview of quantitative changes is given in table 6.8 below. The darker the colour of the cell, the higher the percentage of companies that indicated to have experienced the amount of change denoted by the column heading. Thus it is possible to visualise how most companies and the companies in each category have performed in terms of turnover, etc.

**Table 6.8 Indication<sup>1</sup> of Quantitative Changes in Singapore Establishment (1985-1998)**

| Change <sup>1</sup> | All companies <sup>2</sup><br>(N=57) |          |          |          |          | OEM I & OEM/OBM<br>(N=23) |          |          |          |          | OEM II & Local label<br>(N=15) |          |          |          |          | OBM<br>(N=12) |          |          |          |          |
|---------------------|--------------------------------------|----------|----------|----------|----------|---------------------------|----------|----------|----------|----------|--------------------------------|----------|----------|----------|----------|---------------|----------|----------|----------|----------|
|                     | 1                                    | 2        | 3        | 4        | 5        | 1                         | 2        | 3        | 4        | 5        | 1                              | 2        | 3        | 4        | 5        | 1             | 2        | 3        | 4        | 5        |
| Annual turnover     | 0.2<br>5                             | 0.3<br>2 | 0.1<br>8 | 0.1<br>4 | 0.1<br>1 | 0.2<br>2                  | 0.3<br>9 | 0.1<br>7 | 0.1<br>3 | 0.0<br>9 | 0.2<br>0                       | 0.3<br>3 | 0.2<br>0 | 0.1<br>3 | 0.1<br>3 | 0.3<br>8      | 0.2<br>3 | 0.2<br>3 | 0.1<br>5 | 0.0<br>0 |
| Sales               | 0.2<br>4                             | 0.3<br>2 | 0.1<br>4 | 0.1<br>8 | 0.1<br>1 | 0.2<br>2                  | 0.3<br>9 | 0.1<br>3 | 0.1<br>7 | 0.0<br>9 | 0.2<br>0                       | 0.3<br>3 | 0.2<br>0 | 0.1<br>3 | 0.1<br>3 | 0.3<br>8      | 0.2<br>3 | 0.1<br>5 | 0.2<br>3 | 0.0<br>0 |
| Value added         | 0.0<br>9                             | 0.4<br>6 | 0.2<br>8 | 0.0<br>9 | 0.0<br>7 | 0.1<br>3                  | 0.3<br>0 | 0.3<br>9 | 0.0<br>9 | 0.0<br>9 | 0.0<br>0                       | 0.7<br>3 | 0.2<br>0 | 0.0<br>7 | 0.0<br>0 | 0.1<br>5      | 0.4<br>6 | 0.2<br>3 | 0.1<br>5 | 0.0<br>0 |
| Fixed assets        | 0.1<br>6                             | 0.2<br>8 | 0.3<br>3 | 0.0<br>2 | 0.1<br>4 | 0.1<br>7                  | 0.3<br>0 | 0.3<br>3 | 0.0<br>0 | 0.0<br>3 | 0.1<br>3                       | 0.4<br>3 | 0.2<br>7 | 0.0<br>7 | 0.0<br>3 | 0.0<br>8      | 0.2<br>3 | 0.4<br>6 | 0.0<br>0 | 0.1<br>5 |
| Output              | 0.2<br>1                             | 0.3<br>3 | 0.1<br>6 | 0.0<br>7 | 0.1<br>9 | 0.2<br>2                  | 0.3<br>9 | 0.0<br>9 | 0.0<br>9 | 0.2<br>2 | 0.2<br>7                       | 0.2<br>7 | 0.2<br>7 | 0.0<br>7 | 0.1<br>3 | 0.1<br>5      | 0.4<br>6 | 0.0<br>8 | 0.0<br>8 | 0.1<br>5 |
| Employees           | 0.1<br>4                             | 0.2<br>1 | 0.1<br>8 | 0.1<br>2 | 0.3<br>2 | 0.1<br>3                  | 0.2<br>6 | 0.0<br>9 | 0.0<br>4 | 0.4<br>8 | 0.1<br>3                       | 0.2<br>7 | 0.2<br>7 | 0.2<br>0 | 0.1<br>3 | 0.1<br>5      | 0.0<br>8 | 0.2<br>3 | 0.2<br>3 | 0.2<br>3 |
| Profit margin       | 0.0<br>2                             | 0.2<br>6 | 0.3<br>3 | 0.2<br>6 | 0.0<br>9 | 0.0<br>0                  | 0.2<br>6 | 0.4<br>3 | 0.3<br>0 | 0.0<br>0 | 0.0<br>0                       | 0.2<br>7 | 0.2<br>7 | 0.4<br>0 | 0.0<br>7 | 0.0<br>0      | 0.3<br>8 | 0.2<br>3 | 0.0<br>8 | 0.2<br>3 |

<sup>1</sup> Managers were asked to give an indication of change on a scale of 1 to 5 ranging from 1 = substantially increased; 2 = increased; 3 = no substantial change; 4 = decreased; and 5 = substantially decreased

<sup>2</sup> Changes pertain to interviewed establishment

A white cell indicates ten or less percent of companies, the lightest shade of grey indicates 10-20 percent, the next shade 21-30 percent, while the darkest shade indicates more than 30 percent.

Most companies indicated to have experienced increases in turnover, sales, output, and value added, with especially the OBM segment having experienced increases in these numbers. This was also the only segment in which a large share of companies actually experienced an increase in the profit margin. Gross fixed assets on the other hand do not seem to have changed much and employment decreased especially in the OEM II & OEM/OBM segment. These quantitative changes give an indication of success in terms of growth, but say little about changes in terms of the production process and organisation or functions of companies.

### Changes in production

Respondents were also asked to indicate the main changes that had occurred in terms of production cost, quality and capacity, which were then related to implemented strategies.

Despite the fact that most companies had implemented strategies such as labour intensification, outsourcing and relocation, more than two thirds of the respondents indicated cost of production had increased in the past ten years. Of this group, 62 percent had, however, also succeeded in maintaining profit margins, suggesting many companies were able to compensate cost increases by moving to higher value added activities and products.

More than 80 percent of the respondents indicated they had managed to improve their product quality, while the rest said to have at least maintained quality standards. Strategies aimed at the improvement of product quality were thus successful, yet may have just resulted in maintaining (international) levels and standards.

Most companies still made use of full production capacity, yet almost 40 percent had decreased their capacity. Of the companies that still used full capacity, almost two-third had decreased the number of employees, which may imply an increase in labour productivity.

Finally, more than half (54 percent) of all respondents indicated they had reduced the number of employees working in the Singapore establishment, while the need for skilled workers had increased. This also points to a shift away from production (assembly) activities to higher value added production and non-production activities (see table H in the appendix).

Overall it is not really possible to draw hard conclusions from these observations, as there were also companies that seemed to have experienced contradictory changes, such as a decrease in cost, an increase in workers and not being able to maintain the profit margin. Moreover, to give a better insight into the outcomes of strategies in terms of functions, capabilities and competitive positioning a closer look at shifting emphasis and changing functions within companies is necessary.

#### *Shift in business emphasis and main functions*

Despite growth and changes in the production process and organisation, overall only a small number of companies had been able to substantially change their function to another role within the commodity chain. Thus 65 percent of all companies indicated they had not substantially changed the emphasis or function of their business beyond manufacturing for third parties. They had either remained OEM I suppliers (20), OEM II suppliers (7), or regional offices of foreign producers supplying on an OEM basis (5). However, more subtle changes may have taken place within these roles, which may still have had the effect of changing at least to some extent the functioning of the Singapore establishment. Listed in table 6.9 are a number of such changes (outcomes of strategies) that signify a shift in core functions.

**Table 6.9**

#### ***Changes in Emphasis and Functions of Singapore Garment Companies (1988-1998)***

|  | All companies  | OEM I & Regional office | OEM II | Local label | OBM |
|--|----------------|-------------------------|--------|-------------|-----|
|  | in percentages |                         |        |             |     |
| <b>Shift towards non-production activities (from production to co-ordination centre)</b> | 39             | 33                      | 29     | 56          | 55  |
| <b>Internationalisation</b>  | 65             | 89                      | 22     | 43          | 54  |
| Internationalisation & shift to non-production activities                                | 28             | 33                      | 11     | 29          | 36  |
| <b>Organisation structure changed</b>  | 51             | 67                      | 11     | 57          | 55  |
| New department added (sampling/marketing/sales/retailing)                                | 12             | -                       | -      | -           | -   |
| Production department abolished  | 30             | 33                      | 0      | 44          | 36  |
| Non-production department expanded (sales/marketing/merchandising/QC/admin.)             | 18             | -                       | -      | -           | -   |
| <b>Own brand development</b>   | 44*            | 15                      | 44     | 100         | 64* |
| Branding & move to non-production activities   | 19             | 7                       | 22     | 71          | 45  |
| Shift emphasis towards own brand development   | 5              | 0                       | 0      | 43          | 0   |
| Shift emphasis towards own brand development and distribution/marketing of this brand    | 25             | 4                       | 0      | 43          | 82  |

\* Four companies that have had brand since start of business were not included, since branding in itself did not really represent a change in the company's functions or operations.

Several companies indicated they had shifted the focus of their Singapore establishment away from production perse and were focusing more on production co-ordination and control activities. In addition, a total of 37 companies (65 percent of all companies) had internationalised their operations, either through investments or subcontracting. Of these 37 companies, 16 had also started moving away from direct involvement in production, shifting towards a focus on non-production activities, retaining higher skilled and higher value-added jobs in Singapore. In addition, a number of local label and OBM companies have also actively shifted production out, usually in combination with a shift in emphasis towards marketing and/or retailing of their own brands. These changes are also reflected in the organisational structures of companies.

Overall, only a very small number of companies had successfully attempted a shift of *emphasis of their entire business* towards the development of their own brand, or towards own brand development and distribution/marketing of this own brand. The highest share (19 percent) of companies that had introduced their own brand and shifted emphasis in this direction was among OEM II companies. However, this still only involved three companies. Not surprisingly companies in the OBM group (all of which had had their own brand from the start or had introduced it more than ten years ago) were most inclined to implement these kinds of strategies. More than half had shifted away from production and more than 80 percent had moved towards more (direct) involvement in the distribution and marketing of their own brand. Finally, table 6.10 presents the main competitive strengths of the companies in the survey, as viewed by the managers themselves.

**Table 6.10 Competitive strengths of Singapore Garment Companies**

| Main strength <sup>1</sup>  | Number of companies | Share |
|---|---------------------|-------|
| <b>Production process/organisation</b> (flexibility, lead-times, regional production network, technology, etc.) | 15                  | 26 %  |
| <b>Product</b> (quality, range, design, branding, etc.)   | 13                  | 23 %  |
| <b>Production process/organisation and Product</b>  | 10                  | 18 %  |
| <b>Low cost or good cost/quality ratio</b>  | 7                   | 12 %  |
| <b>Good management</b>  | 7                   | 12 %  |
| <b>Long standing buyer relationships</b>  | 4                   | 7 %   |
| <b>Other</b>  | 1                   | 2 %   |

Clearly for most companies competing on the basis of cost is no longer considered viable. Most companies saw efficiency in production processes and organisation and/or the quality of their products as the main

basis on which they were able to compete.

<sup>1</sup> Competitive strengths were grouped under these 6 main headings. Several companies mentioned more than one competitive strength.

There was little difference between the companies in the different categories, although there was a slight tendency for large-scale OEM suppliers to emphasise their competitive strength in production processes and production organisation and to consider management and relationships with buyers as competitive strengths.

#### **6.4 Firm Level Development Trajectories**

Based on the analysis of strategies and changes elaborated in the above, it was possible to identify a number of common development trajectories. Table 6.11 gives an overview of these different trajectories with a brief description.

Table 6.12 presents a cross-tabulation of the company categories identified in table 6.5 and the company development trajectories identified in table 6.11

**Table 6.11 Company Development Trajectories in the Singapore Garment Industry**

| Trajectory   | Description   | No. of companies | Share (N=57) |
|--|---|------------------|--------------|
| <b>A1) OEM I steady<sup>1</sup></b><br>(process & production organisation specialisation)<br><b>A2) OEM I → OEM+</b><br>(production organisation and buyer services specialisation)                              | Companies often started as local producers/trading companies, but entered into OEM supply at early stage of their existence, by-passing the OPT/CMT stages. Have stayed in this OEM role, upgrading products and processes within it. In some cases even operational excellence and internationalisation trajectory | 26               | 46%          |
| <b>B1) OEM II steady<sup>1</sup></b><br>(extra chain process & production organisation specialisation)<br><b>B2) Local label steady<sup>1</sup></b><br>(extra chain production and simple design specialisation) | Companies have started out in, and retained role as local/ regional supplier. Some have introduced their own brands and labels, but contribution of these local labels to total output has remained negligible and mostly lower end   | 11               | 19%          |
| <b>C) OBM (local/regional) steady<sup>1</sup></b><br>(product design and marketing specialisation)   | Company has started out with own brand and has retained this role, possibly expanding by setting up own retail outlets and marketing/retailing brand in other countries in the region   | 4                | 7%           |
| <b>D) OEM I → +OBM (Local/ regional)</b>   | Company has started out as contract manufacturer but has successfully added production and marketing of own brand to its activities. However, OEM supply remains main 'bread and butter'  | 1                | 2%           |
| <b>E) OEM II → Local label</b>   | Company has started out as local producer/trading company and has successfully added production and marketing of own brand/label, although it takes up less than 70 percent of production and company does not have own retail outlets  | 7                | 12%          |
| <b>F) OEM II → OBM (local/ regional)</b>   | Company started out as local producer/trading company and successfully added OBM; emphasis shifting towards production/marketing and retailing of own brand. Companies have own retail outlets, some have expanded regionally   | 6                | 11%          |
| <b>G) OBM (local/regional) → +OEM</b>  | Company started out as local brand producer with own outlets and has added OEM supply for large Western buyers.   | 2                | 4%           |

<sup>1</sup> Steady trajectories refer to staying within the same role, but do not imply companies following these trajectories do not shift within this role, as is demonstrated in figure 6.4.

**Table 6.12 Development Trajectories by Company Categories**

| Company category     | Company development trajectory |        |     |             |           |                 |       | Total |
|----------------------|--------------------------------|--------|-----|-------------|-----------|-----------------|-------|-------|
|                      | OEM I                          | OEM II | OBM | Local label | OBM + OEM | Regional Office | Other |       |
| OEM I steady         | 21                             |        |     |             |           | 5               |       | 26    |
| OEM II steady        |                                | 9      |     |             |           |                 |       | 9     |
| Local label steady   |                                |        |     | 1           |           |                 | 1     | 2     |
| OBM steady           |                                |        | 4   |             |           |                 |       | 4     |
| OEM I → +OBM         | 1                              |        |     |             |           |                 |       | 1     |
| OEM II → Local label |                                |        |     | 6           |           |                 | 1     | 7     |
| OBM → +OEM           |                                |        | 1   |             | 1         |                 |       | 2     |
| OEM II → OBM         |                                |        | 6   |             |           |                 |       | 6     |
| <i>Total</i>         | 22                             | 9      | 11  | 7           | 1         | 5               | 2     | 57    |

It gives an insight into the variation of development trajectories within the different company categories (which development trajectories are common for certain roles). In addition it may help put some of the earlier findings regarding strategies and imperatives in a broader perspective. The table illustrates that in terms of shifting positions, the OBM and local label categories appear to have followed the most dynamic trajectories, often coming from an OEM II basis.

Although a large number of companies in the OEM I category will also have started out as small-scale local producers, they shifted towards OEM for export supply at an early stage, and subsequently retained positions within this role, although within this role substantial changes and advancement can be made as well.

Development trajectories have been visualised in Figure 6.4. The arrows imply changes in time, while the horizontal lines demarcate transitions from one role into the other, which often imply a leap for individual companies. Some of these leaps, as we shall explain below, are apparently not always easy to make.

The trajectory letters in table 6.11 correspond with the trajectory letters next to the arrows in figure 6.4. Trajectories D) and G) were not included in the figure as only a very small number of companies (one and two respectively) had followed these trajectories. An example of trajectory G) is, however, depicted in figure 6.6 below.

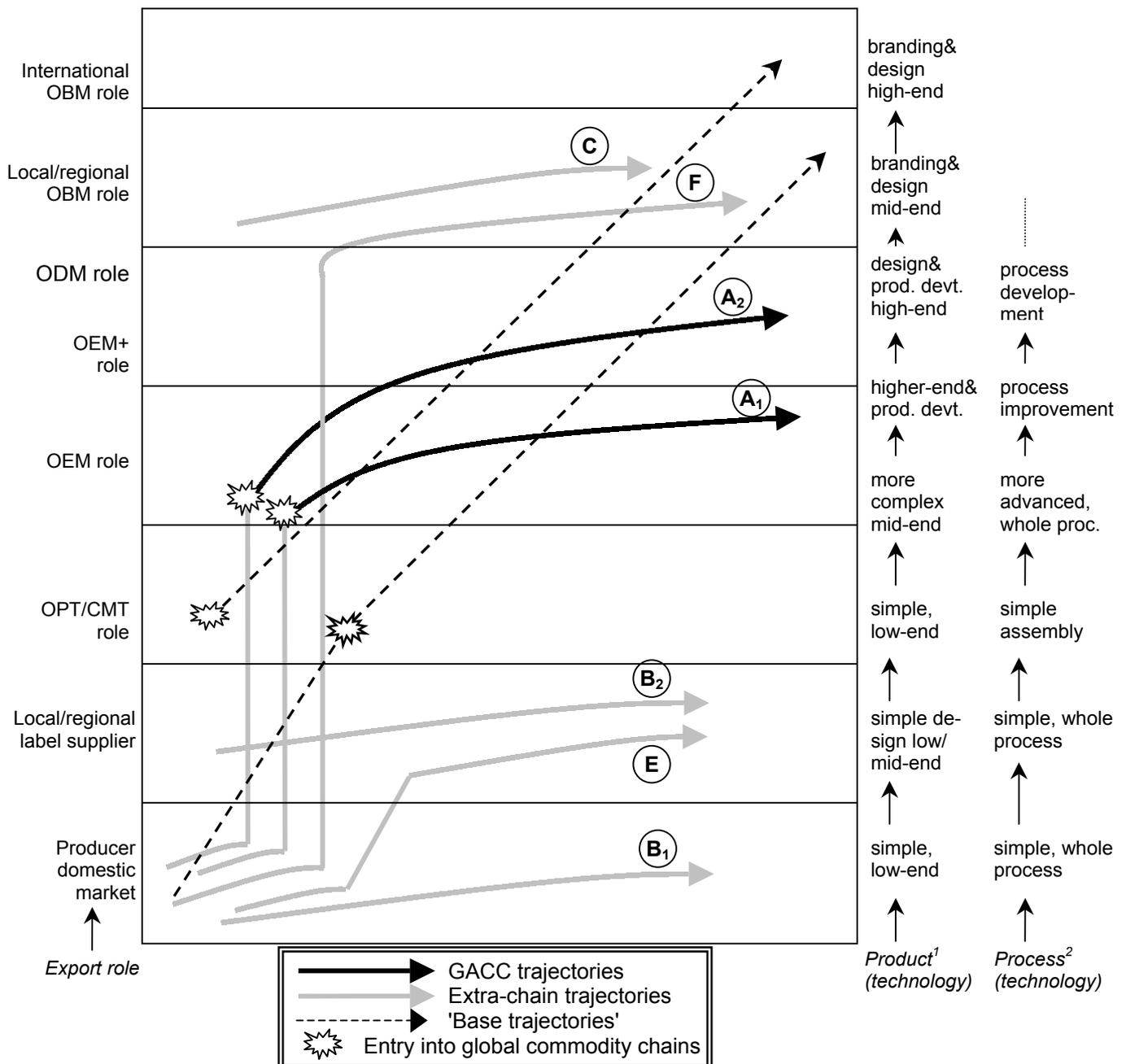
The dotted lines in figure 6.4 represent the 'base trajectory' that has often been suggested in the literature, although perhaps not in such a perfectly straight route (see chapter 2).

It must be noted that a distinction has been made between local/regional OBM and international OBM. In fact the latter has often been implied in discussions of OBM supply, but this has been achieved by only a handful of companies in the East Asian NIE's. Most own brand producers and marketers are still, however, very much locally/regionally focused, slowly trying to expand from there. It has been suggested that this local/regional OBM supply may precede entry into global networks and chains as an OEM supplier, but as we shall explain in more detail below, few if any companies in this category seem to have any plans of abandoning their own brand in favour of OEM supply.

The export roles depicted on the left hand side of figure 6.4 are based on the roles defined in chapter 1 (table 1.3). Different export roles imply different kinds of specialisations

- International OBM role: product & marketing specialisation
- Local/Regional OBM role: product & marketing specialisation
- ODM role: design, process & production organisation specialisation
- OEM+ role: process & production organisation specialisation
- OEM role: process & production organisation specialisation
- OPT/CMT role: process (assembly) specialisation
- Local/regional label supplier: extra chain product and production organisation specialisation
- Producer domestic market: extra chain production and production organisation specialisation

**Figure 6.4** *Company Development Trajectories in Singapore*



<sup>1</sup> Generally speaking these stages do not have to be linear, but there is a tendency for companies to 'catch up cumulatively' through time, with capabilities building systematically upon each other, especially once having entered into export networks, in which capability development is necessary to at least retain a position.

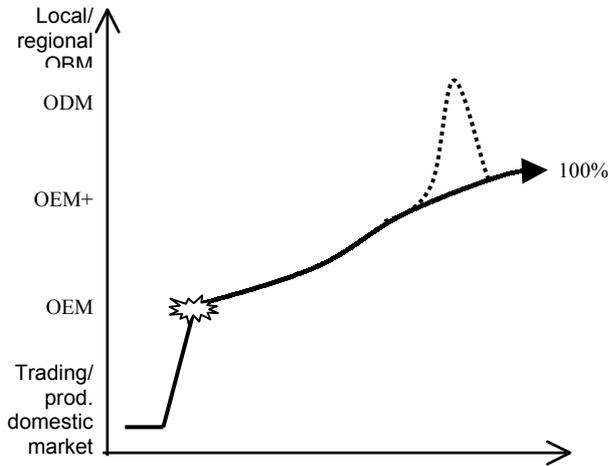
<sup>2</sup> Process technology tends to become less important when garment companies shift to OBM roles, as generally speaking production activities are (gradually) abandoned once a company enters these roles, to the point where they start functioning as buyers, leaving actual production up to contractors. In the case of the garment industry the term original brand *manufacturer* is thus technically incorrect.

The depicted generic trajectories, may in reality take different forms for individual companies. There are even cases where several trajectories are in fact embodied in one company. A few of these individual company trajectories are visualised in figures 6.5 through 6.8.

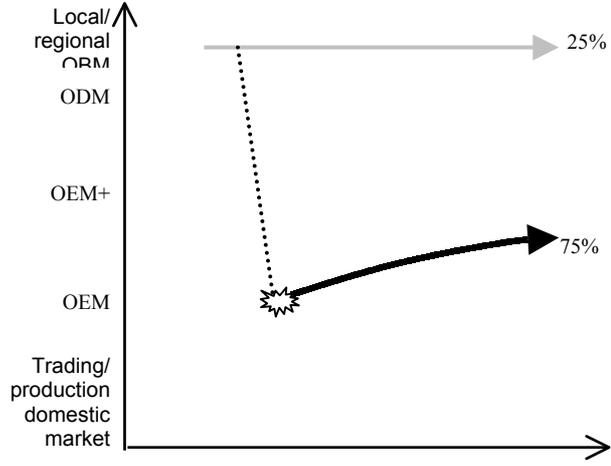
Thus, figure 6.5 illustrates the case of a company that has attempted a move into ODM, but was unsuccessful and returned to its OEM+ role (see box 6.1). Similar observations have been

made by Gereffi (1999) in the case of Taiwanese computer makers and Korean electrical appliance companies. Moving from OEM to ODM/OBM functions proves to be quite difficult for established OEM suppliers.

**Figure 6.5 Individual Company Trajectory I:  
OEM → OEM+**



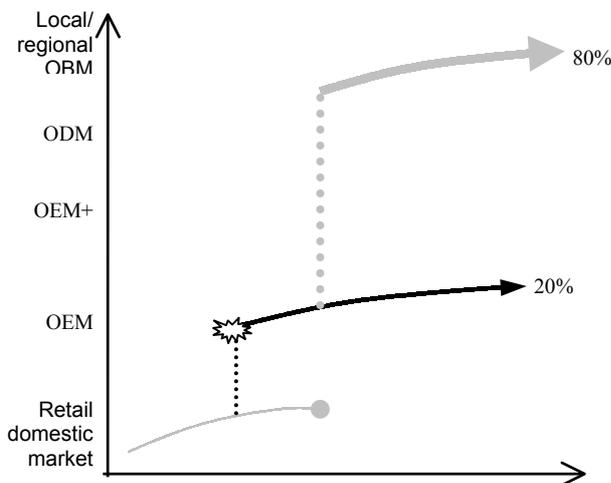
**Figure 6.6 Individual Company Trajectory II:  
OBM → +OEM**



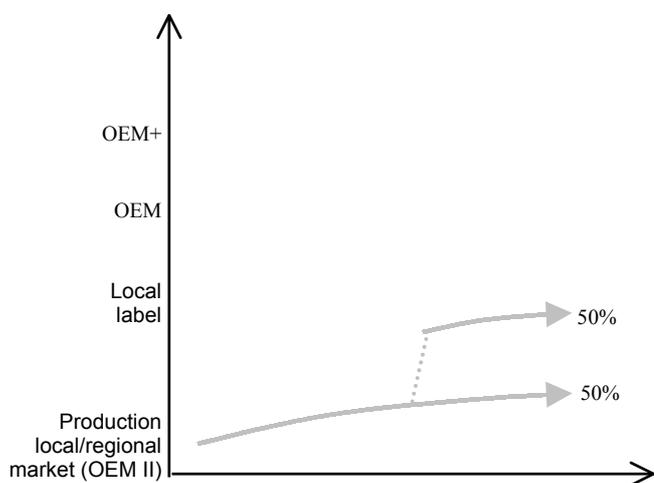
The percentages behind the arrows indicate the share of total output each of the 'roles' take up. Thus the company in figure 6.6 supplies 75 percent of its output on an OEM basis to Western buyers, while the remaining 25 percent involves its own brand, which is marketed and retailed through its own shops locally and regionally.

All figures demonstrate that shifts may initially be somewhat abrupt, but often do not imply that the previous trajectory is abandoned completely, or at least not immediately. The emphasis may shift gradually though. Figure 6.7 illustrates a case of a company that started as a local retailer, moved into OEM for lower end Western buyers and eventually set-up its own brand, which it now markets and retails in local and regional markets. It still supplies on an OEM basis, but only a small share of its output. In addition (and this is not visible in the figure, but is more common among OBM companies) the company has diversified into other, more or less related products (in this specific case beauty products, but often local brands will also start designing and marketing shoes, accessories, bags, etc.).

**Figure 6.7 Individual Company Trajectory III:  
OEM II → Local/Regional OBM**



**Figure 6.8 Individual Company Trajectory IV:  
OEM II → Local label**



In figure 6.4 the generic trajectories embody 'aggregate' trajectories, where company that have gradually shifted from one trajectory to the other with substantial shares (i.e. more than 70 percent) of its output now accounting for one specific role, are grouped under that role. Thus the company in figure 6.7 is considered a local/regional OBM supplier having followed a trajectory from OEM II (in this case embodying local retailing) to OBM, as OEM I (the second trajectory) has never represented a substantial part of its business.

#### **Box 6.1 Case Study: The Sing Lun Group**

##### **Company background**

Founded in 1951 by the Lee family, Sing Lun's initial business activities comprised of importing, exporting and wholesaling of textiles. When the eldest son returned from Japan with a diploma in textiles in 1968, he led the company in diversifying into garment manufacturing. That same year the first production plant was set-up in Singapore. The focus was on the production of bed sheets and knitted garments for the domestic market. Expansion continued and in 1971 Sing Lun was the first Singapore garment manufacturing to set up a plant in neighbouring Johor Baru (Malaysia). Products (knitted fabrics and garments) were still destined only for domestic markets. This changed in 1972, when the company managed to secure orders from a number of European mail order houses and retail stores, thus starting exports of its products to the European market. Soon the company was 100 percent export, however, exports were limited to European markets until 1982, when the company first started exporting to the USA. Its customers were major department stores and retail chains, such as Federated Department stores and the GAP. Exports to the US grew rapidly and eventually overtook exports to Europe, though exports to the latter still continued.

In 1985 Sing Lun diversified again, by acquiring a 50 percent share in Kaye Agencies (Pte) Ltd. Kaye agencies. This was seen as an extra service to existing European buyers, and in addition gave management of the group a better insight into 'what else was out there', i.e. the products and quality standards found in the market. This serves as a good benchmark for the company's own standards and capabilities.

Besides diversifying, the company also continued to expand its garment manufacturing operations. Although the Singapore establishment retained manufacturing activities, all expansion took place outside Singapore. In 1994 a large manufacturing facility was set up in Sri Lanka and in 1998 the group set-up sourcing operations in Cambodia.

In addition, in 1997, with the request of one of its buyers (Walt Disney), a separate embroidery unit, FCA Lanka, was set up in Sri Lanka. This unit was to provide embroidery services for other Walt Disney vendors as well.

Finally, in the late 1990s Sing Lun tried venturing into ODM supply, designing and producing an entire collection for its buyers. This was done on the company's own initiative. However, the response from buyers was not very enthusiastic. They requested so many adjustments and changes to the designs, that Sing Lun decided to stick with OEM supply. Although the company had introduced its own label (for local markets only), this only takes up about 1 percent of total output and is not seen as strategic to the company.

##### **Current structure and organisation of the company**

The core business of the company at this point consists of the manufacturing of knitted garments, buying house and distribution services and embroidery services.

Garment production takes place in four different locations, with the Singapore establishment taking care of the highest value added production processes and serving as a back-up facility to the other production locations.

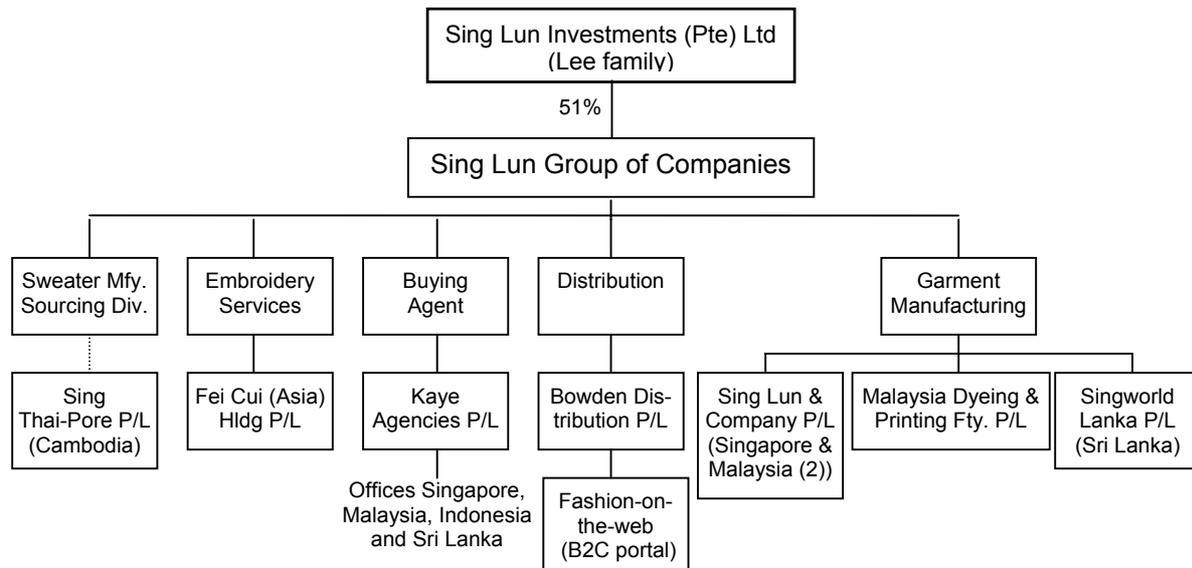
The table below gives shares of employment, value added and output per location.

***Employment, value added and output per production location (1998)***

| <b>Location</b> | <b>Number of workers</b> | <b>Value added</b> | <b>Share of total output</b> |
|-----------------|--------------------------|--------------------|------------------------------|
| Singapore       | 400                      | 52%                | 19%                          |
| Malaysia        | 600                      | -                  | 31%                          |
| Sri Lanka       | 1100                     | 40%                | 40%                          |
| Cambodia        | 400                      | 40%                | 10%                          |

In 1998, all output was exported to the USA (56%), the UK, Germany and France (40%) and Japan (4%). The company had a diverse buyer base including for instance department stores, retail chains and mail order houses such as Federated Department Stores, GAP Inc., Walt Disney, Eddie Bauer (all US), La-Redoute (French mail order house), Great Universal Stores (UK) and Otto Versand (a German mail order house). Relationships with buyers have often been long standing (up to 24 years with some) and working relationships, especially with the US buyers are close, as the establishment of FCA Lanka illustrates. None of the buyers take up more than 25 percent of production capacity. The figure below presents a schematic illustration of the group structure.

### **The Sing Lun Group Structure**



Agency and distribution services are conducted through Kaye Agencies and Bowen Distribution. Kaye Agencies is a sourcing company for garments and fashion accessories, managing the supply chain for its customers. Its functions include: conducting market research on the latest fashion and trends and most competitive rates; fabric and product sourcing; prototype product sample design; tracking of customers' orders; quality control inspection on behalf of customers; and documentation and logistics services.

Kaye agencies has offices in Indonesia, Malaysia, Sri Lanka and Singapore as well as customer services centres in the United States and Europe to keep communication lines with customers short. The company had plans to launch a web based sourcing and tracking system by 2002.

Bowen Distribution specialises in the sale and distribution of lifestyle products such as apparel and home furnishing products. The home furnishing products are distributed mainly under the company's own trademarks (labels) and sold in major department stores in Singapore. In addition the company has appointed distributors in Malaysia and Taiwan. Bowen Distribution also designs and manufactures various in-house labels for local department stores and retailers. In April 2000 a B2C portal (Fashion-On-The-Web) was set up for the sales and marketing of its products online.

In 2000 the company obtained a listing on the Singapore stock exchange, although the Lee family retained a 51% share in the company through an investment company and two of the sons still occupy key management positions.

### **Strategic focus and firm development trajectory**

Over the years Sing Lun has focused its strategies on developing into a large scale, reliable OEM producer of quality basic garments (knitted), while retaining cost and prices at a reasonable level. The implemented strategies included:

- \* Expanding overseas to avoid labour cost and shortages in Singapore
- \* Retaining higher-end production and implementing the most advanced technologies in Singapore (reflected in higher value added of production in Singapore establishment).
- \* Establishing long lasting and close relationships with buyers by
  - upgrading product quality and especially improving reliability and lead-times
  - making sure to keep up with the newest buyer requirements and demands

- providing additional services such as embroidery and buying house activities
- \* Diversify into sourcing agency and distribution activities, complementing manufacturing activities

These strategies have resulted in a trajectory set within an OEM role and process and production organisation specialisation, yet advancing substantially within this role towards and OEM+ function. As an OEM+ supplier, the company has become an important partner for some of its customers and can provide additional services that go beyond mere contract manufacturing.

Sources: *UU Producer Survey 98/99; UU Buyer Survey, 99; [www.singlun.com.sg](http://www.singlun.com.sg) (2003)*

Let us briefly consider the generic trajectories in more detail.

*1) Local OEM and Local label suppliers and entry into global production networks and chain*

It has been argued that local label and small scale local/regional OEM producers may learn basic capabilities from producing and marketing in local markets, which may eventually enable them to enter into GCCs (Gereffi, 1999). This is what has been referred to in chapter 2, as the basic upgrading needed for entry into networks and chains (Meyer-stamer, 2002). However, there is little indication that this is a logical trajectory for these companies. Most have been around for a while (established in the 1970s and 1980s) but have not made a shift towards OEM for US and European buyers yet, and do not seem overly eager to do so either. In part this may be a consequence of limiting factors, such as access to quota and lack of capital or the fact that few buyers are still looking for *new* vendors in Singapore, making it harder for Singapore garment companies to *enter* into networks at this point. This would imply it is harder for later entrants to the industry in a specific location to become incorporated into global chains and networks. However, there have been several cases of late entrants, which have in fact been very successful in following the OEM trajectory (see box 6.3), so late entry in itself cannot be the only issue. It seems more a question of how quickly after a company's establishment it attempts to enter into the global networks and chains of lead firms. In other words, companies that made deliberate efforts in early stages of their development to do so, appear quite successful whereas companies that don't make this shift early on in their 'life' may not be able, or willing, to do so later on.

The idea that production for the domestic and regional markets may serve chiefly as a stepping stone for entry into global networks and chains implies the risk of exclusion from chains and consequently not having access to resources, markets and sources for upgrading (Gibbon, 2000a; Dolan & Tewari, 2001). In other words, because these local producers are not incorporated their capacity for further development is also limited. Thus it is almost assumed that these 'excluded' companies would in fact want to be included, and that development within a chain is the only alternative available. However, not many companies in this category in fact had plans or ambitions to become export oriented OEM producers for Western buyers. Moreover, if any moves in other directions have indeed been chosen by companies in this category, it is more often towards a shift of emphasis from producing labels and non-branded products for local and regional buyers towards (further) developing their own brand or labels, thus following the OEM II → Local/regional OBM, or OEM II → Local label trajectories. In other words achieving upgrading towards more independent and higher value added roles without necessarily going through stages of incorporation.

When asked about plans for the future, the still remaining OEM II suppliers, however, seemed little inclined to make any fundamental changes to their business operations in the near future (e.g. new technologies, overseas investments and changes to the function of the Singapore establishment). In this respect the OEM II steady trajectory is indeed the most conservative trajectory found, as even within this role, not many changes take place.

## **Box 6.2 Case Study: The Clothing Company Pte Ltd**

### **Company background**

The Clothing Company was set-up in 1999 by the current Executive Director, who came from an advertising background. The story of the Clothing Company began earlier though, in 1997 when the current owner bought a local wholesaler, which also had 4 brands/labels (including its own), that was in trouble. The idea was to break the company up and sell it off in smaller parts. After having sold off part of the former company, it was deemed necessary to make the still remaining parts 'more attractive', in order to sell them off more easily and at a better price. Thus for instance, features were added (e.g. additional colours or styles) to the collection. Because of this the owner became more and more directly involved in garment business and finally decided to hold onto part of the company and establish it as Clothing Company (CC) in 1999.

With the increased involvement in the actual garment production process, the function of the company also started changing, from wholesaling to a contract manufacturer and supply chain manager for non-branded and lower-end brand customers and department stores. Production was not taken care of in-house, but further subcontracted, initially to Indonesia (1999), but due to political instability and unreliability of suppliers here, in 2001 production was shifted to China and to India (which had an advantage over China in terms of certain fabrics (rayon) and the capacity to produce smaller batches). In 2002 finally the Clothing Company also started working with subcontractors in the Philippines because of a favourable trade agreement between the Philippines and Europe: in this year the EU lifted quota for apparel from the Philippines. Usually only parts of the production process are outsourced to the Philippines, e.g. the adding of collars and buttons, which enables labelling of the products as 'made in the Philippines', granting it quota free access to the EU.

### **Current structure and organisation of the company**

Currently the company is involved in two (related) main activities: contract manufacturing and supply chain management. Contract manufacturing initially involved orders whereby detailed designs and specifications were provided by customers, while the Clothing Company organised manufacturing for these customers. The main customers for the company were B- and C-brand buyers from Europe (Germany) and Asia. Orders were subsequently farmed out to subcontractors. To ensure a certain capacity with its subcontractors, the Clothing Company buys a part of the subcontractor's production space/capacity, for instance on an annual basis. This capacity is then entirely dedicated to orders and products from the Clothing Company. Even though the company contracts out entire garments, its involvement in the actual production process may still be quite substantial. For instance the Clothing Company will often supply fabrics, if necessary will buy the required machinery and 'teach' subcontractors how to make products and live up to our quality standards.

As time to market considerations are becoming ever more important, even for the lower- and mid-end segments of the market, the Clothing Company felt that waiting for customer to come up with their designs and specifications took up too much time. Gradually the company therefore started pursuing clients by providing them with their own designs, leaving just very basic specifications to them. Thus the Clothing Company has essentially moved from an OEM to an ODM role.

Next to contract manufacturing, the Clothing Company is also involved in private label supply chain management, a role, which also evolved from its contract manufacturing role for local/regional retailers. Initially these customers placed orders with Clothing Company and specified which products to ship where. Again this system often took up too much time, so the Clothing Company decided to get in touch with local retailers directly and take charge of what to ship where at which time. This 'direct line' saves time and helps to avoid overstocking. In addition it enables the customer to concentrate on marketing, while the Clothing Company arranges manufacturing (sometimes with own designers) and logistics, and may even help with shop-floor layout, visual merchandising, etc.

Finally, from the leftover fabrics the Clothing Company also manufactures its own brands, under labels such as Royal Oxford and St Germain. These are sold to local department stores. However the company doesn't really (want to) focus on its own brands, as there are limited human resources available in Singapore and in addition the company faces capital limitations.

"If we wanted to get more involved in design and product development we would have to develop 'design and product development teams', made up of design, resources and production specialists (....) At this moment, however, finding good designers in Singapore that actually know something about production (i.e. can design and develop products for mass production) is difficult, making it hard to integrate them into the mainstream industry. At this moment we therefore do most of our (very basic) design and product development in China. (.....). With regards to own brand development this also poses limitations. In addition, brand development requires substantial investments and is not all that

profitable, also because in doing so we may risk losing our customers, which would consider our brands as directly competing with theirs. (...) There is, however, an increasing trend for branded companies to even outsource (parts of) the design (about 30%). This is especially true for c- and b-brands. In time developing our design and product development teams are therefore important objectives"

Most products are exported and sold through agents or distributors. 40 percent of total output is sold in Germany via a distributor, 30 percent in Russia via an agent, 20 percent in Taiwan and Korea via distributors and 10 percent in Singapore and Malaysia, where products are marketed by the Clothing Company or directly by its customers (local brand manufacturers such as Yangtzekiang and Casserini).

#### **Strategic focus and firm development trajectory**

In the 4 years of its existence, the Clothing Company has evolved from a wholesaler/contract manufacturer into a flexibly organised manager of front-end and back-end activities surrounding actual production. One of its main strategic focuses throughout this development (and the driver behind its diversification into other parts of the chain) has been on achieving highly competitive lead times and logistics. In addition it has focused on the higher value added, non-production activities, without necessarily moving, or wanting to move into own brand development and marketing perse, as it considers production and distribution organisation (from design to logistics) as its main strengths. The trajectory followed by this company is perhaps a good example of on the one hand an ODM trajectory, whereby the company may eventually move from the lower end B- and C-brands it works for now to higher end A- and even Boutique-brands. On the other hand it demonstrates the high value added that lies in between production and marketing/retailing. Organising production flexibly through subcontractors means the company did not have to invest in production capacity, while it also does not have to take the risk and cost involved in branding and retailing. Therefore it has achieved substantial growth with a relatively small number of employees. Sales value per employee in the Singapore establishment is therefore impressive.

Through its pro-active attitude towards its customers the Clothing Company has become more to them than just a contract manufacturer. Although its role is presently confined to lower-end segments and brands, its offensive strategies, incorporating and anticipating new trends and needs, in combination with low investments and risk, may enable the company to continue its rapid progress towards becoming a supply chain manager for more, higher -end and international brands (essentially an OEM+ role).

Again this trajectory demonstrates that moving towards a higher position in the chain (OEM+ and ODM) does not necessarily have to follow a logical smooth route. In this case, large scale OEM manufacturing was basically 'skipped' altogether.

*Source: Interview, 2003*

#### 2) OEM II to OEM I and OEM+

Over the past decades, among OEM suppliers extensive capability development in terms of quality and services has taken place and most Singapore garment companies by now command impressive regional and international production networks (reaching as far as Africa and Latin America). Although most of these OEM suppliers started as domestic producers, all of them shifted towards OEM supply at an early stage of their 'life', bypassing the simple assembly stages, moving directly to full packages supply. Exceptions were the companies that were set-up as branch plants of East Asian NIE producers. However, most of these have by now disappeared (closed, merged or sold to local investors). Subsequent changes and development of these companies have all essentially remained within an OEM trajectory and to date the majority of companies - and the largest contributors to the industry's performance in dollar terms - have remained firmly rooted in their OEM roles. The OEM trajectories may take different forms though, with some producers focusing on investments in technological upgrading, while others focus primarily on the development of extensive and flexible regional networks. The opportunities for moving towards other trajectories in the future must be seen in the light of these variations within the OEM trajectory, as they determine future strategies (path dependency). For instance, the OEM suppliers that has invested heavily in production technology is less likely to move out of production altogether.

Within the OEM steady trajectory a number of companies have however gradually moved from just an OEM role to an OEM+ role (as is illustrated by the case in box 6.1 and in figure 6.8), specialising and increasing services to buyers to include product development and design (though not necessarily ODM), sourcing, logistics, etc. These trajectories have proven to be successful in not just retaining buyers under increased competitive pressures but more importantly in increasing dependency of buyers on them by taking on more responsibilities within the chain.

Although only a handful can be said to have fully engaged in OEM+ trajectories, many OEM companies have implemented strategies that may eventually put them on such trajectories as well. This is particularly true since for most OEM companies, their development trajectories seem to inevitably have included extensive internationalisation. Internationalisation has become more than just a relocation strategy, but more and more a competitiveness strategy (see box 6.3), that may enable firms to eventually offer other services and advantages to buyers, outside just low cost production locations, thus making themselves less dispensable.

### **Box 6.3 Case Study: Ocean Sky Textile Pte Ltd/Ocean Sky International Ltd**

#### **Company background**

Ocean Sky Textile was set-up in 1995, when two brothers bought out a small Taiwanese owned factory. The company's total turnover was less than \$1.7 million at that time and was operating out of a single factory in Singapore. Ocean Sky's customers then were mainly local exporters. As business grew and the limitations of high costs of operations in Singapore became more pressing, the company started its regional expansion by setting up and acquiring cost-competitive production capacities in the region. In 1997, an operations base was set-up in Malaysia with the acquisition of a first subsidiary, Eng Soon, in Johor. Subsequently a subsidiary was established in Cambodia, which enabled expansion of production capacity by almost fourfold.

In 1998, in response to increased customer demand, the company expanded further into the region by incorporating two establishments in Brunei, increasing total capacity by more than 70%.

A sales and marketing subsidiary was set up in Hong Kong in 1999, giving the company a presence in the region's biggest apparel buying centre.

In 2000, a large factory building was established in Singapore, to house the company's management headquarters and production base in Singapore. Operations in this Singapore factory were upgraded, while production efficiency was increased through consolidating of operations.

In that same year the company established factories in El Salvador and Honduras in order to take advantage of the close proximity to the US market (which is the company's major market), reducing transport cost and shortening delivery times to major customers in the United States. In addition, the company was able to enjoy the tax- and quota-free benefits in these two countries.

In the first half of 2002, the company set-up a marketing- and sourcing office in Los Angeles, further increasing its foothold in the US market.

With the accession of the People's Republic of China (PRC) into the World Trade Organisation, the company wanted to position itself for (future) opportunities in the PRC and therefore began setting up subsidiaries in the PRC in 2002 (two subsidiaries) and an additional subsidiary in Hong Kong (also in 2002).

While continuing to concentrate on the core business of being a specialty garment manufacturer, the company is expanding into related activities, such as providing supply chain management (SCM) solution services ranging from sourcing of raw materials prior to the manufacturing process to logistic management. Since 2000 the offices in Singapore, Hong Kong and the US have started providing such services, mainly to customers served by the Central American operations. In FY2001, one quarter of sales generated from Central American orders included the provision of SCM services.

In addition Ocean Sky's management felt that the company would have better control over raw material supply if it produced these itself. Therefore the functions of the US marketing and distribution facility were expanded to include the manufacture of fabric. In October 2002 a knitting plant was set-up in the United States to provide knitted fabric to the Central American production operations. By operating its own knitting plant, the company is able to ensure consistent quality and timely delivery of fabrics.

Finally, in 2002, three more subsidiaries were set-up in El Salvador, the US and Honduras respectively, to facilitate the further development of SCM services in Central America.

In February 2003 Ocean Sky Textile Pte Ltd became a publicly listed company and changed its name to Ocean Sky International Ltd.

### **Current company structure and production organisation (2003)**

Within a period of 6 years, Ocean Sky managed to develop from a small OEM suppliers with one Singapore based factory and an annual turnover of approximately 1.7 million, into a globally operating large scale manufacturer and manufacturing services provider operating in nine different countries with twelve production and sourcing operations and approximately 6,900 employees. Total annual production capacity had reached 2.9 million dozens and annual turnover was almost S\$180 million in FY2001. The two brothers still run the Group, one as Executive Chairman, one as Manager Operations. By January 2003 the company had operations and subsidiaries in Singapore, Brunei, Cambodia, Malaysia, the PRC, El Salvador, Honduras and the USA. The sourcing and manufacturing bases in the three regions, namely, Southeast Asia, Hong Kong/China and Central America/US, complement one another in terms of competitive strengths (e.g. quota availability, market proximity, material sourcing, strategic information, low cost and direct services to customers)

Each of the Group's subsidiaries operates in close and constant consultation with one another to maximise business and cost efficiencies. An order taken in one country may be manufactured in another. All production plants and offices are integrated through an online computer system that allows for real-time tracking at every stage of production and operations, and are linked centrally to the headquarters in Singapore. The Singapore headquarters thus serve as the nerve centre for the entire company, providing management, financial, production, technological, logistics and SCM planning support. The company prefers not to subcontract production, so as to ensure quality levels and reliability.

Main clients include: Gap Inc., May Department Stores, Sears, Mervyn's, Target, Foot Locker, Inc., Phillips-Van Heusen and Eddie Bauer, Inc.

### **Strategic focus and development trajectory**

Ocean Sky's rapid growth and expansion are remarkable and resulted from a focus on:

- Aggressive internationalisation strategy.

Geographic expansion into global strategic locations has enabled the company to take advantage of lower labour, productions and transportation costs. Ocean Sky's sourcing functions are centered in the key hubs of the garment industry, Singapore, Hong Kong and the USA where quality raw materials can be sourced globally from for maximum cost efficiency. In addition, its global presence has allowed the company to shorten lead and delivery times by moving closer to final markets.

- Vertical integration and supply chain management services to clients

Expansion into related activities such as pre-manufacturing SCM services (e.g. design of garments and the sourcing of materials) as well as post-manufacturing SCM services (e.g. logistic management and customs declaration and documentation) and the integration of fabric production for the company's Central American operations has increased customer loyalty, reduced lead-times and increased value added. The company has moved beyond being an OEM suppliers and ventured into OEM+ where it controls a vast global networks and provides the kind of services that buyers are increasingly outsourcing to global agents or capable manufacturers. This results, in the company's own words "...in tangible benefits in terms of better margins, as well as intangible benefits in terms establishing closer working relationships with our customers. We will have better understanding of our customers' needs and more control over their logistic arrangement, all of which would in turn lead to improvement in delivery time and productivity. The SCM arrangement also strengthens the relations and mutual trust between our customers and us and enhances our competitive edge in the apparel industry" ([www.oceansky.com.sg](http://www.oceansky.com.sg), 2003)

The company has thus clearly chosen its strategic direction, competencies and core strengths, and defined strategies accordingly. Despite its relatively late entry into the industry it has thus been able to develop into one of the largest garment producers of Singapore

*Source: Interview, 1998; [www.oceansky.com.sg](http://www.oceansky.com.sg) (2003); The Straits Times (March 13, 2003)*

Further expansion seems to have been something all still existing OEM companies have been quite successful in achieving despite, or perhaps in part thanks to, the limitations of the local business environment. In fact companies, which have followed the OEM steady trajectory have achieved the highest turnover and growth, and this segment as a whole has made the Singapore

garment industry one of the most internationalised industries in the country, with investments in approximately 20 different locations world-wide. An impressive feat, which has turned (Government) attention back to an industry that by the mid-1990s had become "the forgotten industry" (*-Interview manager Singapore garment company, 2003*). The vast production networks of Singapore producers enable buyers to cover a large number of countries from Singapore, without having to engage in the scouting for these locations and the learning and other investments in the new producers in such locations.

## 2) From OEM to OBM?

As becomes clear from the trajectories described and visualised, the 'base trajectories' was not really found in Singapore. Firstly, most OEM suppliers had bypassed the OPT/CMT stage and had gone straight from local production into OEM. Secondly, the subsequent move from OEM into OBM obviously was a lot less easy than the first shift.

Some of the companies in the OEM I group had attempted to venture into ODM for Western suppliers, designing entire collections and presenting these to buyers. These attempts have not been very successful though, to the extent of the companies in question abandoning these trajectories again. They found that buyers were not very open to their designs and if they did accept suggested so many adjustments to them, the whole purpose of ODM was more or less defeated.

Another problem faced was the difficulty in finding suitable local designers, able to design and develop products for mass production (see box 6.2). The gap between local designers and local producers appears to be somewhat of a two-sided problem though. On the one hand local designers may not be interested in, or capable of, designing for mass production, on the other hand producers view on incorporating design and branding into their activities may be somewhat simplistic. Developing into an ODM or OBM supplier takes a substantial commitment in terms of investments, manpower and changes in the organisation (thus a commitment beyond just hiring a designer) while the effects (rewards) of are often not noticeable in the short term.

Moving into OBM has proven to be equally hard for large-scale OEM suppliers. Although many had introduced their own brands, these would have to be classified as labels in most cases, which are intended for local and regional department stores or non-branded buyers and often do not make up a substantial amount of business for the company.

There are several limitations to moving from large scale OEM supply to OBM supply:

1. It is hard for large scale manufacturers to go back to small scale production or small batch sizes and short runs, as they have often invested substantially in production capacity, hence sunk cost are high.
2. There is a substantial 'capability gap' within the GACC between design, marketing and retailing on the one hand and production on the other. Competencies in one area don't imply competencies in the other will come easy. A move from large scale production to design, marketing and retailing of an own brand to many producers therefore is somewhat of a quantum leap with substantial investments, learning and perhaps unlearning and risk. Although many producers will develop competencies in the area of design and product development, most don't see original designing, marketing and retailing as their core business and seem to prefer staying in dependent roles, while working towards a position where they form more of a partner than a dependent producers to the buyer.
3. Finally, as has been observed by Schmitz & Knorringa (1999) in the case of the footwear industry, buyers are usually not interested in assisting their suppliers to develop into OBM, as this goes against their own interest. In some cases they may even discourage such development. Some producers indeed mentioned they were afraid their clients would be upset if they introduced their own brands and effectively started competing with them.

One OEM manager summarised it well when he remarked:

"OEM suppliers and branded companies (OBM) are two very different and distinct groups. They (OBM suppliers) are aimed at (and appeal to) a relatively small number of people and are thus niche producers. OEM suppliers on the other hand are into mass production and are not too keen on high design content of their products. Although several OEM suppliers have tried to venture into design and OBM over the past few years, as of yet this has not been very successful. There are several reasons for this. First very different types of skills are needed and you cannot just hire one designer and expect to all of a sudden be able to supply OBM. You also need to invest in marketing, distribution, etc. These are long-term investments, with very little direct returns. Second, in the cases where companies have attempted ODM, this has been met by little enthusiasm from the buyer's side. Thirdly (OEM) companies often introduced their own brand or label (e.g. for local department stores) as a means of spreading risk. It provides them with something to fall back on. This has also meant they have engaged in it rather half-heartedly. Companies who have started out as OBM and put all their resources and heart and soul into it are much more successful"(-Interview manager Singapore garment company, 2003).

### 3) Alternative development trajectories

Only three companies seem to have been successful in combining OEM and local/regional OBM supply (for an example see box 6.4), yet this trajectory was not established by moving from OEM via ODM into OBM, but rather by starting with OBM supply and then moving into OEM supply. The two roles were subsequently maintained somewhat separate from one another. Although this may fit into idea of using local supply and brand development as a learning ground to eventually move into OEM, it does not appear that this move into OEM was seen as a shift into a different direction, merely as an addition to its business (and one that enabled scale production).

#### **Box 6.4 Case Study: Bodywork Concepts Pte Ltd**

##### **Company background**

Bodynits International was set-up in 1984 as a small family business, producing and marketing/retailing its own brands, Bods (for men) and Bodynits (for women). The brand started as a fitness and aerobics wear brand, but over the years has been extended and now also includes active and casual wear as well as underwear and swimwear. All products are knitwear.

Production was initially all taken care of in-house, but as the company grew, in-house production was insufficient to meet demand and part of production was outsourced to subcontractors.

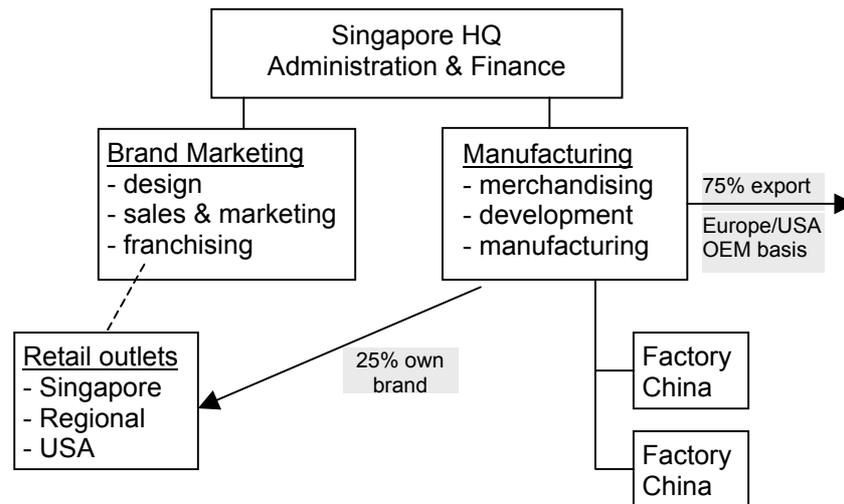
The Bods/Bodynits brand was initially sold in department stores, but in the course of the 1980s the company started successfully setting up its own retail outlets in Singapore, eventually even expanding regionally.

In the early 1990s the company also started contract manufacturing on an OEM basis for US and European sports brands such as Nike, Adidas and Puma as well as for retail chains such as the GAP. Orders and exports grew rapidly, necessitating a substantial expansion of production capacity. Due to the high wage cost and labour shortages in Singapore, the company chose to expand overseas and set up a factory in China in 1994.

Despite contract manufacturing having become more important in terms of share of output and sales, the company has firmly held on to design, production and marketing/retailing of its own brand and still sees this as one of the core businesses. In the late 1990s, with the assistance of the TDB, Bodynits started operating its retail outlets under a franchise. This implies the stores are no longer owned by the company, but by franchisees. Bodynits, which was subsequently renamed Bodywork Concepts Pte Ltd advises and assists with the selection of the site, the design concept and layout for the store and the setting up of merchandising and points-of-sales systems. In addition it provides training programs and ongoing support in the running of the store, which of course is only allowed to retail the Bods and Bodynits brands.

##### **Current structure and organisation of the company**

The core business of the company currently consists of two rather distinct activities: on the one hand design, production and marketing of the own brand sold in local and regional markets (25 percent of the business), and on the other hand contract manufacturing on a full package basis for Western sports- and casual wear buyers (75 percent of the business). The figure below gives a simplified illustration of the company structure

**Figure Bodvwork Concepts Pt Ltd**

The two activities do of course overlap (both the OBM and OEM products are manufactured in the same factories) and can also be leveraged to benefit one another. Thus information and knowledge of international quality standards through working for high-end Western buyers can be applied to the own brand, while the large scale OEM production allows for efficiency and productivity gains which can be leveraged for the own brand as well. At the same time, the intricate knowledge of design and branding allows the company to manufacture products with a relatively high design content enabling them to supply to higher-end buyers and the higher-end product lines of these buyers. The company's specialisation in sports and casual wear also pertains to both its OEM and OBM activities. Franchising retail operations enabled the company to focus on the development and marketing of the brand, while retaining control over shop layout and presentation, thus over the brand's retail image. In addition it is seen as a good way to expand internationally and the company opened its first franchise shop in the USA at the end of 1999.

#### **Strategic focus and firm development trajectory**

Bodywork Concepts is a design oriented company, which has however followed two distinct strategic directions and thus in fact embodies two different development trajectories at once: and OBM and an OEM trajectory.

At the time of the survey, there was no intention to give up either one of these roles, as they complemented one another. Instead of becoming incorporated into global networks and chains led by US/European buyers and subsequently moving into OBM, the company in fact started out with the latter and later added OEM supply. What Bodywork Concept's development trajectory illustrates is firstly that not all roles necessarily logically follow one another up in a specific order and secondly new roles do not always completely replace old ones. Bodywork Concepts thus in fact incorporated two different development trajectories within the same company and appears to have been quite successful at both.

Sources: UU Producer Survey 98/99; [www.franchisesingapore.com/happening/6sep1999.htm](http://www.franchisesingapore.com/happening/6sep1999.htm),

Another quick and relatively cheap way to start OBM, is by merging with an existing OBM supplier. It has the added advantage of enabling a company to use the expertise gained through OEM production for high-end western brands for the further development of its own brand. Some larger OEM suppliers also suggested such a strategy as a possible option for the future.

“Own brand development is still very hard, especially with such a small market. We see more opportunity in perhaps buying an existing brand company in e.g. Europe or setting up a joint venture. This would in fact be much easier and cheaper than developing know-how, image, networks, marketing, etc.” (-Interview manager Singapore garment company, 1998).

It is not exactly clear why more companies haven't already applied such a strategy, although the above made remarks regarding the core business of companies and reluctance to engage in direct competition with clients most likely are applicable here as well.

To the extent that successful alternative routes have been followed, this was usually by companies that did not start out as contract manufacturers to begin with. This is the case for most 'true' OBM producers (category 3). These companies either started as OBM producers or moved into this role soon after their establishment, coming from a position as a small-scale domestic producer or retailer. In terms of significance within the industry as a whole (turnover and employment) the contribution of this OBM group is still very modest though and growing beyond the limits of the local and regional markets has proven to be difficult (see box 6.5). However, it seems more likely that these companies will move towards international OBM supply, than companies currently in an OEM position.

#### **Box 6.5 Case study: Song & Kelly**

##### **Company background**

Song & Kelly was established in 1994 by designing partners Wykidd Song (Singaporean) and Ann Kelly (British). Song was educated in fashion design in London, while Kelly came from a graphic design background.

Originally they started a 'wholesale' clothing business, designing and producing their own collections. Actual production was subcontracted to a manufacturer in China.

Through contacts they managed to secure orders from a London based buyers in the first year. Unlike many other local design/brand companies, who's aim is to expand regionally before taking on the world, Song & Kelly thus leapfrogged local and regional markets and immediately moved into international markets. In the following years they managed to expand their customer base to include higher-end fashion buyers from Japan and the West. These were mostly high-end and exclusive department stores such as Neiman Marcus in the United States and Harrods in London.

In the mid 1990s the designer duo opened a flagship store in Singapore and became directly involved in retailing. In addition they opened showrooms in London and Italy and participated in fashion shows in London and New York - in part supported by local institutional and private sponsors - to try and establish their name in the major fashion capitals.

The story thus seemed one of great success, but turnover was not extremely high and the company hardly made a profit. Orders kept coming in, but capital and manpower constraints made it hard for the company to deliver. Administrative hassles multiplied, cash-flow was a perennial problem and although the company had hired 2 more designers, the owners still handled all administration, handling, documentation, etc. by themselves. They couldn't afford to hire separate staff for these functions. Moreover, the boutique operation could not produce in volume, as became painfully clear when they failed to deliver an order from New York's famed Barney's Department Store in 1999.

Therefore, in 2000 the company decided to restructure its operations, by selling a majority stake to Club 21, a lifestyle-products company owned by the wife of a major property tycoon. Club 21 provided necessary capital and in addition functioned as an agent, managing much of the overhead. Moreover, Club 21's owner had close contacts with other fashion brand owners, such as Giorgio Armani, for whom she operates stores in London, and Donna Karan, whose fashion empire she helped bankroll. In other words, she is well connected in the fashion world and thus may provide more than just capital for Song & Kelly.

##### **Current structure and organisation**

As part of the deal with Club 21, Song & Kelly closed their wholesale operations in Europe and instead focused on the local market first, opening a larger flagship store in Singapore. The idea is to expand again from there, but this time starting with regional markets, establishing retail operations in Kuala Lumpur and Bangkok. In addition wholesale offices will be set-up in Europe. The brand was renamed Song+Kelly21

Joining Club 21 has also meant Song & Kelly can focus on their core strength: design and product development, while leaving marketing and retailing up to management of Club 21. This has enabled them to further develop and extend the brand, introducing a shoe-line and fashion accessories under the same name and introduce new product lines (e.g. men's wear). The company plans to continue brand stretching and product line development, and develop Song+Kelly21 into a lifestyle brand.

Production is still all outsourced to China, while virtually all inputs are sourced from Europe, through agents and importers in Hong Kong. The higher-end and specialised fabrics and accessories needed for their products, the designers claimed, were not available in Singapore.

**Strategic focus and development trajectory**

Obviously the strategic focus of the company throughout has been on design and product development. In this role as OBM suppliers they managed to gain both local and international recognition. However, educated as designers, the owners soon discovered the difficulty of taking on different functions. In addition, the limitations of leapfrogging into international markets without establishing a certain productive capacity and capital base became clear when orders started growing.

The company therefore decided to go back to the basics, or rather its core competencies and back to establishing a solid base locally. From there it will attempt to venture out into the region. In international markets the company has toned down its ambitions somewhat, looking to focus initially on wholesale activities (essentially on an ODM basis).

While thus having remained in an ODM/OBM trajectory, within this trajectory, the companies has had to refocus its business operations, as an international OBM role was still essentially beyond the reach and capacity of the company.

Sources: *Interview (2003); Asiaweek (June 15, 2001)*

#### 4) (Partial) Exit Trajectory

Although not incorporated in figure 6.5 and not listed in table 6.23, quite a number of companies appear to have followed exit trajectories as well. This became clear when comparing lists of companies from 5 to 10 years back to current (i.e. 1998) lists and is also obvious from the fact that in our original database we found quite a few companies that were no longer in operation/not traceable. According to the industry association TaFF, in the late 1980s and early 1990s a large number of companies went bust, sold their Singapore operations or shifted all operations to other countries. Especially investors from the East Asian NIEs, which had originally set-up branch plants in Singapore moved out again in this period, selling their operations to Singapore owned companies, or just closing them, although some did retain a presence as a marketing and distribution office.

What took place was therefore a consolidation of the industry, resulting in a smaller, but reasonable stable number of larger manufacturers. This consolidation was also noticeable among small domestically oriented companies. Many of these were faced with continuity issues (no second generation to take over, retirement of owners) and increased competition from lower cost countries such as China and Indonesia. A large number either closed (exit trajectory) or became trading companies (partial exit trajectories) sometimes of more than just garments).

Looking at the overall picture, for all groups and trajectories, some form of lock-in into acquired role or path dependency is apparent, with the most obvious one being the OEM II steady trajectory. From the starting point of the local producer/trading company, basically three trajectories can be identified: the shift into OEM supply, into local/regional label supply and into OBM (local and regional) supply. In addition there are the steady trajectories. It appears that once a choice has been made for either of these three at an early stage in the company's development, shifting towards another trajectory becomes increasingly hard, and less likely over time.

This is illustrated in figure 6.3. Neither group appears very successful in fundamentally shifting roles or functions, nor very inclined to attempt such a shift. This does not necessarily mean being 'stuck' completely, as upgrading (towards higher value added and higher quality products) and improvement of capabilities and competencies are achieved *within* the main trajectories, especially the OEM trajectory. In addition a small number of companies do appear to have been reasonably successful in at least combining different trajectories.

For a complete picture of the development trajectories of the Singapore garment industry the last part of this chapter deals with developments at the industry level.

## 6.5 Singapore Garment Industry Development Trajectories

In the above an extensive overview was already given of the development trajectories of existing producer companies. As became clear the largest group of companies has remained rooted in (dependent) OEM roles, yet quantitative and qualitative analyses pointed to the fact that within these roles shifts have taken place. In addition a number of extra-chain trajectories were identified. Thus, although in production terms the development of the industry could be seen as characterised decline, from a commodity chains perspective the picture may in fact be more positive.

This may be further illustrated by the entry and development since the mid 1980s of two new segments within the industry, although it is perhaps too early to say whether they present viable new sources of growth and diversification for the industry in the future. These new segments include on the one hand companies performing functions in the core of the commodity chain (buyers, agents) and local design-oriented companies (e.g. local OBM producers and fashion retailers). In addition a number of garment or garment related companies from outside Singapore have located their regional co-ordination and control, sales & marketing or distribution centres in Singapore, enhancing the City State's regional hub function in relation to apparel, while local intermediaries too have played a role in this respect.

### 6.5.1 Buyers as Local Actors

#### *Presence*

Singapore's geographic location, infrastructure and accessibility, as well as its high quality human resources, bode well for a function as a regional trading and sourcing hub. Combined with the efforts of the government to promote and further develop Singapore as a hub, this has indeed encouraged a number of international buyers and agents to set up regional branch offices — buying houses or sourcing offices — in Singapore. At the start of our research, approximately 34 such companies were found to have offices in Singapore. In addition a group of locally owned sourcing agents was identified (consisting of approximately 20 companies). These agents function as intermediaries between regional producers and international buyers. Of these 54 companies, 26 were interviewed (for a detailed overview of database and coverage see annex A).

The international sourcing offices interviewed (11) included branded companies such as Polo Ralph Lauren (see box 6.6), retail chains such as Federated Department Stores and mail order houses such as Otto International. Nine of these offices were branches of US buyers<sup>8</sup> and only two were owned by European buyers. The group of international buying agents (9) included both companies involved in a variety of agency services to buyers, such as sourcing, distribution and marketing and agents which focused more exclusively on sourcing and purchasing services only. Examples include Danish owned Jebesen & Jessen, Li & Fung from Hong Kong, and Swire & McClain from the UK. Ownership in this group was more diverse, with 2 US owned, 3 European owned and 4 Asian (Hong Kong and Japan) owned companies. Companies in the third group - local agents - were generally smaller than companies in the first and second group. Their main clients (i.e. buyers) were lower-end brands, European department stores and discounters such as WalMart.

Most of the international buying offices (8) were set up between 1984 and 1994, whereas most of the international buying agents (8) had established in Singapore before 1988. The trend for setting up own facilities is thus a more recent one, which is in part explained by the fact that when a buyer first starts sourcing from a country or region it usually does so through agents (see also Gibbon, 2000b).

Establishment of agents from Northeast Asia moreover reflects changes in the industry in the East Asian NIEs from the late 1970s onwards, with production shifting out and local producers developing into co-ordinators of regional production networks.

Local agents were established during the 1980s, reflecting the tendency of an ever-growing number of garment retailers and even producers from the West sourcing products from Asia and Singapore's evolving role as a regional centre for such sourcing, as most of these 'new' buyers still lacked the knowledge and capital to engage in direct sourcing.

In addition to this group of local agents, another group of intermediaries can be distinguished, which was however not explicitly included in our database. This is a highly diverse and fragmented group consisting of local licensees, wholesalers and trading companies, which often form a link between regional producers (mostly Malaysian and Indonesian producers) and non-branded wholesalers and trading companies in the West (in turn distributing product to small local, lower-end retailers in their respective countries) or distribute products to regional markets. These constitute 'extra-chain distribution networks', which in fact form an important channel for small local and regional companies to engage in exports.

### *Size and functions*

Production or product sourcing was the main function of the companies in all three groups, although for the first group this was of course restricted to the own brand or stores/catalogue. Although some sourcing offices of branded buyers and department stores also engaged in third party sourcing activities, a general tendency of focusing on the core business, usually meant such activities were of minor importance or had even been cast off (see box 6.6).

Sourcing activities generally included: Vendor (manufacturer) selection and factory evaluations, order placement and negotiations (letter of credit, or L/C negotiations), follow up and quality assurance or control. Generally speaking, guidelines, designs and orders came from the headquarters (in the case of international buying offices) or from clients (in the case of agents, although for international agents sometimes via headquarters). Most of the companies that were part of larger organisations indicated that they functioned reasonably independently from their parent company. Strategic decisions and guidelines were set by the HQ, but selection of vendors for instance, was often left to the discretion of the regional offices. In the case of agents approval by the buyer was of course still required.

Functions of these buying offices were reflected in their employment, which consisted mainly of skilled personnel, such as technical and professional staff (mostly quality assurance officers) and merchandisers. Although highest management functions in the buying offices were often still filled by expatriates, this picture seems to be changing and for all other functions locals are employed. On average the interviewed companies employed about 32 employees and altogether the 26 interviewed companies employed 844 people in Singapore. However, the sales value of products sourced through these companies averaged S\$140.4 million and totalled more than 2.53 billion in 1998. This is of course in stark contrast with turnover of companies in the producer survey, which averaged approximately 30.8 million and totalled over 1.63 billion<sup>9</sup> in 1997 and illustrates the higher value added in upstream activities. It must be noted that the international buying offices, were not considered profit centres and numbers only indicated value of sales been sourced through these offices.

**Table 6.13 Contribution to Company Turnover and Sourcing of Singapore Office (1998)**

| <b>Share Singapore office:</b> | Share | No. of relevant companies (N) |
|--------------------------------|-------|-------------------------------|
| - in total company turnover    | 18%   | (12)                          |
| - in all sourcing from Asia    | 36%   | (13)                          |
| - in world-wide sourcing       | 27%   | (10)                          |

Finally, table 6.13 pertains to international buying offices and agents and gives an idea of the importance of these offices within the entire company.

## **Box 6.6 Case Study: Polo Ralph Lauren's Global Sourcing Office**

### **Company background, structure and organisation**

#### *General*

See chapter 1, box 1.1

#### *Singapore establishment*

The Polo Ralph Lauren (PRL) Corporation established its Singapore subsidiary in 1989 as a quality control office. At that time, the Hong Kong office was the regional headquarters of the corporation and Asian sourcing predominantly took place through this office. However, as the company's sourcing base shifted towards Southeast Asia, sourcing activities also started gravitating towards Singapore. This shift was also caused by a number of location specific circumstances in Hong Kong, such as higher cost of business and the turnover of Hong Kong to China in 1997. By 1998, the Singapore office employed 200 people (against 50 in Hong Kong) and approximately 60 percent of all products were sourced through the Singapore office.

Initially the Singapore office also sourced products for third parties, through its sourcing agent arm, Mountain Rose. However, as part of a global philosophy of centralisation and focus on the core business, the company reduced this sourcing for third parties and the Mountain Rose office was no longer active by 1998.

As part of this same global philosophy, Singapore became the global headquarter for manufacturing, implying it managed the global sourcing network of PRL. This strategy was to maximise efficiency and seize the best opportunities globally available.

### **Functions of the Singapore establishment**

Polo Ralph Lauren (Singapore) Pte Ltd takes care of regional sourcing, quality control, monitoring of compliance with the company's own requirements regarding labour, environmental and human rights issues as well as with local legal frameworks, and most importantly regional production co-ordination and planning, co-ordinating schedules, shipping, etc. to ensure smooth and timely product flow and delivery. In addition the Singapore establishment is involved in the sourcing, screening and selection of new vendors, in which it has a relatively high degree of autonomy from corporate headquarters.

Products are sourced from more than 15 different locations spread over Asia and the Pacific. To protect the image of the brand, the company is generally speaking cautious and somewhat conservative as to its sourcing locations in the sense that it will not source from countries it considers too risky in terms of political instability or human rights violations. Such countries include for instance Myanmar, Bangladesh, Pakistan, Cambodia, Laos and even Vietnam.

Relationships with most vendors have been reasonably long and the Singapore establishment is actively involved in production through specifications, quality control, approval requirements for subcontractors and stipulation of input suppliers. It has been a policy of the company to establish partnerships with its vendors, so as to be able to achieve shorter lead-times and more consistent quality levels, reduce risk of human rights violations and overcome problems regarding quota limitations. Only a very small share of total products is sourced directly from Singapore vendors, but PRL does look at Singapore as an important logistical base, a function, which it does not think will change anytime soon.

### **Views on Singapore and Southeast Asia as sourcing locations**

Obviously Singapore is seen by PRL as a major hub in its global production and distribution network, given its development into the global sourcing office for the entire company. Approximately 60 percent of all products (in units) are handled through the Singapore office, with the remaining 40 percent of products being sourced within North America.

PRL's positive view on Singapore is centred around the country's function as a strong logistical base, not as a manufacturing base. However, the company has retained its Singapore vendors and follows a global philosophy of consolidation, implying it will work with existing producers to obtain the kind of quality, price and efficiency levels desired.

Although all its vendors must pass the same stringent quality controls, PRL does admit there are still vast differences in competencies between producers in different regions. Sourcing will thus take place according to particular strengths of the region. For Singapore this includes mostly knitwear, while more sophisticated products, such as outerwear and other specialised products tend to be sourced from the Northeast Asian region, which is generally seen as the region furthest ahead in terms of export competitiveness.

*Source: Interview (1999)*

### *Sourcing base*

Illustrating the sourcing base of buying offices and agents in Singapore, table 6.18 presents an overview of the main sourcing regions and countries covered from Singapore.

On average, companies sourced from 6 different locations, with half of the companies sourcing from 7 or more different locations. Not surprisingly the main sourcing region covered from Singapore is Southeast Asia. As such Singapore can still be seen as a sub-regional hub, functioning as a centre for Southeast Asia, but not necessarily Asia as a whole. However, more than 40 percent of the interviewed companies also indicated to source part of their products from South Asia. Not all companies were capable (or willing) to indicate exact shares of products sourced from each location, but it was clear that even if companies did source outside the Southeast Asian region, the largest share was still sourced within the region (see table I in the appendix).

The most important sourcing countries, outside Singapore itself, are Malaysia, Indonesia, Thailand and Cambodia in Southeast Asia and Sri Lanka in South Asia. Although as a whole this group of countries has more or less retained its global export position, the regions share in global exports is modest at 6 to 7 percent (see table J in the appendix). Moreover, other regions have far outstripped Singapore's sourcing base in terms of share of world exports. Thus China increased its share from 9 percent in 1990 to 16.2 percent in 1999, and together with Hong Kong exported 21.3 percent of total world exports in 1999 (WTO, 1999).

Singapore's sourcing base is thus neither big, nor particularly a growth region. Cost and labour shortages in Malaysia have been increasing rapidly in recent years, reducing the country's attractiveness as a production sourcing location. Although Indonesia still has an abundance of cheap labour, the country's political instability has made many buyers somewhat hesitant of sourcing here. Cambodia, although only quite recently having entered into global production networks and chains, seems to be losing its attractiveness already. The country has had quota limitations imposed on its exports as well (part of the country's initial attraction was the fact it had no quota limitations), but more serious in the longer run is the country's limited population base, implying labour shortages are likely to form an obstacle in the near future. In addition, political instability is an issue for Cambodia as well, scaring away potential investors and buyers. With Thailand's share declining and Sri Lanka's tapering off, the outlook for Singapore's position as a sourcing hub thus seems somewhat gloomy. Particularly with China's entry into WTO and the pending abolishment of the global quota system, which is likely to cause an even greater shift of gravity towards China and Northeast Asia as the main sourcing region in Asia and the world.

### *Singapore's position in global production and distribution networks*

The main advantages of setting up an office in Singapore were seen by buyers to include most notably the geographical location and the high quality and efficient physical (port facilities) and communications infrastructure in place. In combination with a highly educated, multi-lingual labour force, and political and economic stability this made Singapore an attractive location for the kind of activities performed in regional sourcing offices, involving a skilled workforce and frequent travel throughout the region. In addition, with the increasing internationalisation of Singapore producers, dealing with them implied buyers were able to cover a large region from the (comfortable) Singapore base. Direct Government incentives and schemes on the other hand played a less important or even negligible role (only one garment company and one textile company had made use of the OHQ scheme).

Several buyers (buying offices) played an active role within the Singapore garment industry. Many were members of the industry association and participated in seminars, workshops and other initiatives, working together closely with their local vendors and looking for ways to

improve products, efficiency and compliance, in partnership with local (and regional) producers. As was observed before, US buyers were often most involved.

Buyers' sourcing networks extend well beyond Singapore and for most buyers only a relatively small share of total product is sourced locally from Singapore producers. Buyers therefore often have extensive knowledge of the capabilities and competencies of companies in the region and, through their linkages with other parts of the company, international standards. As such they may thus form a valuable source of information regarding strengths and weaknesses of countries and regions (see also Schmitz & Knorringer, 1999, for similar observations in the case of the footwear industry).

Singapore's strengths were usually seen in quality and reliability, specialisation in knitwear, capabilities in terms of finishing and spread of producer's regional production networks. Lead times and flexibility were considered reasonable, yet not as strong as compared to the East Asian NIEs (most notably Taiwan and Hong Kong). Moreover, opinions about flexibility varied somewhat, as some buyers argued Singapore producers tended to operate more rigid networks (investments instead of subcontracting), making them reliable, yet not necessarily fast or flexible. Not surprisingly high prices were seen as a major problem for sourcing from Singapore. As to the sourcing base covered from Singapore, quality levels of producers in Malaysia and Indonesia was also considered good, although several buyers mentioned quality varied between countries in the region. Prices were much better than those of Singapore producers, yet they were often higher than prices in China, while lead-times, flexibility and reliability in general were considered less (although this was more true for Indonesia than for Malaysia).

To which extent the location of this segment of buying offices in Singapore will help transform the City State into a regional sourcing and trading hub is as of yet unsure. In recent years, a number of buyers have in fact pulled out or reduced their presence in Singapore, usually in favour of Hong Kong. These include for instance Tommy Hilfiger (pulled out completely), Land's End (back to sourcing through agent), Phillips & van Heusen and Liz Claiborne (reduced presence from regional sourcing to QC office; all regional sourcing now through Hong Kong). It seems Singapore is struggling to compete with Hong Kong (see also Gereffi, 1996) for the function of regional trading/sourcing centre. Most buyers – and producers for that matter – still see and use Hong Kong as their main regional base for Asia (either through presence or representation) and consider Singapore a sub-regional hub.

On the one hand this is due to the relatively limited sourcing base covered from Singapore (see above), which also does not stand out particularly in terms of speed, flexibility and prices when compared to East Asia (especially China). On the other hand trends of network consolidation strategies of buyers do not seem to benefit Singapore. Increasingly (although this doesn't apply to all types of buyers) buyers seem to operate through a few central nodes instead of through networks of global, regional, and sub-regional nodes (see also Gibbon, 2000b). With the gravity of production sourcing now in Northeast Asia, many buyers looking to reduce presence in the region will probably close down Singapore operations.

Although most buyers indicated they would keep sourcing from Southeast Asia in the near future, its relative importance in global sourcing patterns is decreasing. None of the buyers considered expansion of sourcing activities in Southeast Asia, although some hinted at the potential of Indonesia if the social and political situation would become more stable there. Although most claimed to maintain their offices in Singapore, even in the course of the research a number of offices did in fact close down or reduce their functions and presence. All in all Singapore's role as a sourcing and trading hub seems somewhat volatile.

In addition it is a somewhat 'one-sided' trading hub, as there are relatively few sales and marketing offices of regional producers located in the City-State. Only a few such companies were identified in our survey (the Regional office category). No specific incentives exist for such offices, while they could greatly contribute to Singapore's role as a hub and attraction of

buying offices. For a market place to work, both buyers and sellers are needed, or as the Secretary of the industry association put it "It takes two hands to clap" (*Interview*, 1998). Most regional producers still seemed more inclined to opt for a sales and marketing office in Hong Kong, also because Hong Kong has the added advantage of being host to a large number of suppliers, meaning regional producers could do both their merchandising and input sourcing as well as their sales and marketing from these offices. Thus the lack of local linkages and specialised input suppliers and support services also negatively affected Singapore's function as a sourcing and trading hub (see box 6.7).

#### **Box 6.7 Case Study: Converse Incorporated Singapore Representative Office**

##### **Company background, structure and organisation**

###### *General*

Converse Inc. is a US sportswear brand, established in 1908 and mostly known for its All Stars basketball shoes. However, in recent years changes in markets and consumer preferences have caused a shift in the focus of both products and markets. First of all there was a shift from emphasis on shoes alone, to one including apparel. Thus, where the business used to consist for 90 percent of shoes, currently shares have changed to approximately 60 percent shoes and 40 percent apparel.

In addition there was a shift in emphasis from just sportswear (e.g. basketball shoes) to a lifestyle brand (skate, outdoors). This strategy was adopted in response to market trends: increasingly, what people wear is considered an image statement, at least in certain segments of the market. Because of this shifting emphasis on lifestyle and image, technical finishing, (synthetic) fabrications and accessorising are becoming more and more important.

Converse works through licensing agreements, i.e. does not source and distribute directly and centrally, but selects licensees in different countries and regions, which pay a royalty for the right to produce/source, market and retail products under the Converse brand in specific markets. Licensees are overseen by representative offices, of which there are usually one or two per region. Asia has two: one in Japan and one in Singapore.

##### **Functions of the Singapore establishment**

Converse's Singapore representative office was set up in 1994, to oversee licensing activities in the region. It provides licensees with information and guidelines regarding corporate standards and general company directions, and with seasonal designs. In addition it is involved in the approval of licensee designs.

Converse licenses its products from Singapore to 7 licensees, who cover 11 countries in Asia Pacific. Licenses are given to both producers and wholesalers, who then take care of production or sourcing of the products and marketing and sales in local markets. Converse receives royalties and supplies designs, although in some case licensees come up with their own designs/samples, which Converse may then approve. Converse's designs thus come both from the US office, the representative office (externally hired free-lance designers) and licensees.

Licensing has both positive and negative sides. On the positive side, there are little overhead costs and in rough times the biggest blows are taken by the licensees. In addition, because the licensees operate close to their markets and are local/regional it's easier to get access to markets and to adjust products to local taste and requirements (regional focus).

On the negative side, control of quality and standards is harder and global sourcing is not possible. This means all orders are relatively small, which puts you at a disadvantage both in terms of price and in terms of competing for orders with the large corporate buyers, such as Nike etc.

The Singapore office is mainly involved in footwear (80%) and very little in apparel (20%). However, in the future shares should be in the range of 60 and 40 percent respectively.

##### **Views on Singapore and Southeast Asia as sourcing locations**

Due to its set-up and organisation, sourcing and marketing through licensees, Converse views Asia more from the perspective of a market than from the perspective of sourcing region, although a large share of its products is also made in Asia. Sourcing for Converse involves sourcing for licensees though and not directly for products.

Although originally a US brand, European and especially Asian (including Australia) markets have grown in importance relative to US. At this moment 42% of Converse's total income is generated in Asia. Japan in particular is a very important market and the representative office there is very

successful (licenses directly to manufacturers and these have great marketing and distribution capabilities). Success in Asia and Europe is contributed to management and regional focus, while the one sided concentration on just a few products in the United States, has led to a marked decline in this market.

Considering the entire company's performance and its increasing concentration on Asian and Australian markets, Singapore is considered an important location, although in comparison to Japan only of secondary importance.

However, some drawbacks of Singapore's business environment were noted by management. Thus it was argued that:

"The Singapore workforce is well educated, but not very pro-active. They just do what you tell them to do, but display very little own initiative. .... (we) have to go to HK for designers, as we can't find the right people here.(....) Singapore is very small market, thus in that sense not very important for our company. (Finally) there is little vertical integration and only knits are made here, so the rest has to be imported. Malaysia and Indonesia are a lot more aggressive in this respect." (*Interview manager Singapore garment company, 1999*)

Moreover, with the increased emphasis on technical finishing, (synthetic) fabrications and accessorising, the lack of local specialised input suppliers presents a disadvantage vis-à-vis countries like China, Korea and especially Taiwan, which are way ahead in terms of such capabilities.

*Source: Interview (1999); [www.converse.com](http://www.converse.com) (2003)*

### 6.5.2 Development of a local fashion industry

Although few of the existing production companies were successful in establishing their own brand and moving towards an OBM role, the survey results indicate that companies starting out as design and brand companies may play a more important role in this respect. Institutional and media-attention for this group has also increased substantially over the past decade, although ideas and claims for that matter regarding the development of a local fashion industry date as far back as the early 1980s<sup>10</sup>. However, not until the early 1990s did attention for this segment become more focused. This was due to the fact that it fitted the image Singapore was trying to create for itself from the early 1990s onwards, as a centre of fashion and lifestyle industries. Recent years have thus for instance seen a surge in fashion shows and festivals

An inventory of this segment<sup>11</sup> (limited to *garment* designer labels and branded retailers), revealed as many as 70 local designer/label companies selling their product in Singapore and sometimes even regionally, through own boutique or outlets, retail chains or department stores. Many were centred on one or two local designers. However, the actual size of this segment in terms of output and turnover is in fact limited, with some companies reporting an annual turnover of just S\$ 3000

The limited size of the fashion segment is also reflected in the fact that although local design and boutique companies by 2002 formed the biggest membership group within the industry association TaFF, their monetary contribution to the association (which is proportionate to size) was far less than that of the large export OEM members. This in fact posed a bit of a dilemma for the industry association, as demands from producers companies was often different than demands from designer companies and TaFF was thus faced with the difficulty of dealing with this split in interest between the largest group in numbers and the largest group in terms of contribution.

To which extent this segment will be able to make a real difference in the broader industry development remains to be seen, due to a number of limiting factors both within these companies and in the national business environment. An issue we will return to in more detail in the case study of the local fashion industry segment in chapter 8.

## Conclusion

In this chapter, the structure and characteristics of the Singapore garment industry, competitive adjustment strategies and firm and industry development trajectories were outlined based on the results of a survey conducted between the end of 1998 and June 1999.

As to the *structure and characteristics of the Singapore garment industry*, what stands out most are:

- the relatively small average size of companies (locally) and the predominance of local ownership;
- the dominance, in numbers, but particularly in shares of total turnover and employment of OEM suppliers and the strong export orientedness of most companies;
- the relatively small shares of output produced in the Singapore establishments, while status within larger companies is usually that of HQ or parent;
- highly export oriented, with USA as main destination and US branded marketers and department stores as main buyers
- despite high export orientedness, quite a few OEM suppliers have introduced own labels, which they sell to local department stores or retailers
- true OBM segment still relatively small though
- extensive internationalisation, particularly, yet not exclusively among export oriented OEM suppliers
- local backward linkages are virtually absent, and only a few vertical set-ups exist (in which textiles production usually does not take place in Singapore).

An analysis of *firm competitive adjustment strategies and development trajectories* revealed that although most companies still apply defensive strategies, these no longer form the core strategies. Rather a distinct sequencing was observed, where defensive strategies have given way to more offensive strategies such as internationalisation and increasing services and responsibilities towards buyers, particularly from the early 1990s onwards. Although most OEM suppliers have remained firmly rooted in their OEM roles, Singapore's high cost environment and general hub function have encouraged a number of OEM suppliers to reconfigure their production organisation to the extent of moving out of production locally and towards OEM+ roles built on the management of regional and increasingly global production networks. Such strategies entailed not just relocation of production but the development of internationally operating corporate structures with headquarter and strategic functions in Singapore, while at the same time setting up factories, service centres, and other facilities in different locations to take advantage of specific strengths of different locations, including not just low cost, but also market access, proximity to buyers and final markets, etc.

Thus a number of OEM companies have not just upgraded products and processes, yet have started to move in the direction of upgrading their roles within networks and chains, indicating a move beyond achieving mere operational efficiency, towards real upgrading.

However, the shift towards fundamentally different roles, most notably OBM, but even ODM, has proved to be difficult for companies that had assumed OEM roles. In fact, moving to OBM roles, essentially to extra chain positions, was mostly achieved by companies starting out from extra-chain positions.

Finally, the relatively pro-active strategies and the fact that several upgrading trajectories were indeed observed, was most likely also a result of the fact that many companies that had followed steady and exploitative trajectories had in fact already exited the industry in the early 1990s, when an acute competitiveness crisis made defensive strategies redundant. The decline of the production segment in the early 1990s was thus a result of both extensive internationalisation and exit of existing companies. The surviving companies were obviously

the ones with the more pro-active attitudes that had succeeded in shifting their bases of competitiveness.

At the industry level, the entry of two new segments, buying offices and a local fashion segment, appear to present new sources of industry growth and diversification. However, although these new entrants have to an extent changed the face of the industry, their role should not be overestimated, as their presence is on the one hand volatile and circumscribed by external factors such as the sourcing base (buying offices), while on the other hand their growth potential is limited (fashion segment). Moreover, policy initiatives to encourage these segments appear less successful than the restructuring and adjustment policies of the past.

Before analysing the dynamics behind the observed strategies and development trajectories more closely, in the next chapter we first consider the characteristics and development in the Malaysian garment industry in the basis of survey results, enabling the analysis of dynamics in a comparative perspective in chapter 8.

## Notes

<sup>1</sup> All data presented in this chapter were derived from the producer- and buyer surveys conducted by the main researcher in Singapore between September 1998 and June 1999, unless otherwise noted.

<sup>2</sup> The main producer survey was completed in January 1999, and results presented in this chapter thus pertain to the period up until 1998. 'Current' implies as of 1998, and in the past ten years implies the period from 1987/1988 till 1998, unless otherwise noted.

<sup>3</sup> In addition intra-EU trade is high and European companies often source from Eastern European and Northern African countries as well as Turkey, leading to a lower share of sourcing from Asia in general (see chapter 1)

<sup>4</sup> Myanmar still presented problems in terms of its political situation, which made Western buyers weary of allowing their contractors to produce here, while Vietnam until recently did not fall under the US General system of preferences scheme. Laos on the other hand lacked the people and infrastructure to support large-scale production.

<sup>5</sup> With the exception of a small segment of high-end international fashion brands sold in the main shopping areas and malls and catering to the affluent local population and tourists

<sup>6</sup> Due to the small number of companies per category, it was not possible to test whether observed differences were statistically significant. However, the differences were double checked and confirmed through qualitative data, such as the observations made by the main researcher in the different companies, conversations and interviews with important industry members and representatives (e.g. those with years of experience and active participation in the industry), garment buyers, institutional representatives, etc.

<sup>7</sup> Due to these levies foreign workers were on average not that much cheaper to employ than local workers, and served mainly to solve the labour shortage problem. However, it has been argued that the use of foreign labour has kept wages artificially low and although many companies (approximately 75 percent) had increased wages over the past ten years, the industry average was still low by manufacturing sector standards and companies were not willing to pay wages above the industry average to attract labour.

<sup>8</sup> These nine included AMC from the USA, a co-operative between a number of smaller US retailers, serving as a sourcing agent for the group. This co-operative is a non-profit organisation, which is why it was included under buying offices rather than agents. Buying offices are usually not profit centres, whereas agents are independently operating, profit driven companies.

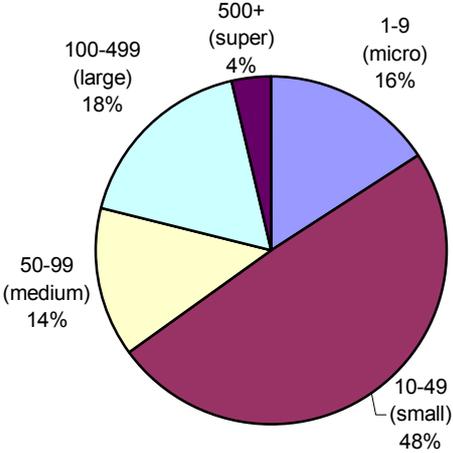
<sup>9</sup> Differences become even more pronounced if one considers that the number for buyers was based on only eighteen companies (unfortunately these were the only ones willing or able to provide turnover or sales value data), while the number for producers is based on 53 companies.

<sup>10</sup> For instance, newspaper clippings on the industry from the late 1970s onwards strongly reflected policy directions of the time. Throughout the eighties therefore, trade related and restructuring/upgrading issues often surface in articles on the industry. However, fashion designers, fashion shows and the development of a fashion centre are also recurring themes in these newspaper articles.

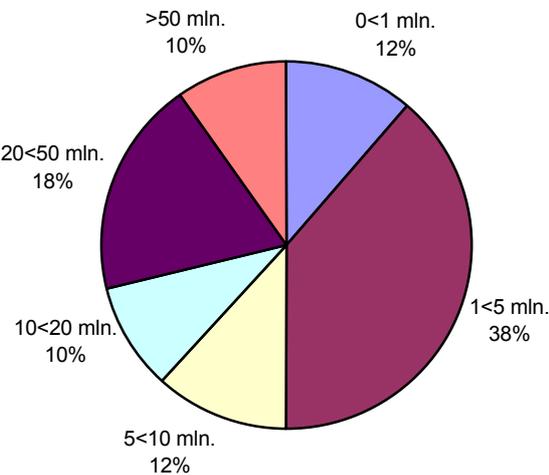
<sup>11</sup> Although many OBM suppliers were already included in the original database set up, an additional inventory of the fashion segment was deemed necessary for a complete picture, as not all of these design oriented companies were included in the initial database, either because they were not listed under apparel or clothing companies, or because they were very small, non-incorporated business companies

**Appendix I: Additional Figures and Tables Singapore Survey**

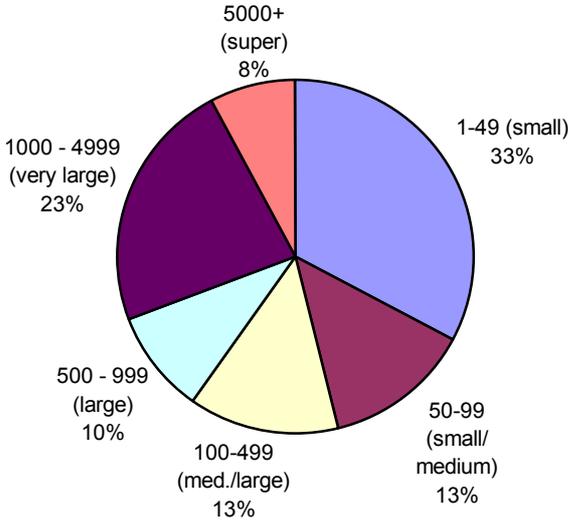
**Figure A**  
*Establishment Size by Employment*



**Figure B**  
*Company Size by Annual Turnover (S\$)*



**Figure C** *Company Size by Total Employment<sup>1</sup>*



<sup>1</sup> Non-response is 5

**Table A Average Employment Numbers and Ratios (1998)**

| Employees                           | Average for all multi-establishment companies |
|-------------------------------------|---|
| No. of employees this establishment | 120 (N=42)                                    |
| No. of employees entire company     | 1774 (N=36)                                   |
| <i>Ratio</i>                        | 1:15  |
| No. of employees Singapore          | 116 (N=37)                                    |
| No. of employees overseas           | 1469 (N=37)                                   |
| <i>Ratio</i>                        | 1:13  |
|                                     | Average for Singapore establishment           |
| No. of non-production employees     | 19 (N=51)                                     |
| No. of production employees         | 69 (N=51)                                     |
| <i>Ratio</i>                        | 1:3.6   |

**Table B Export Destinations and Average Shares per Destination (1998)**

| Export destinations           | No. of comp. | Valid percentage (N = 50) | Average share exports to Asia | Average share exports to Europe | Average share exports to North America |
|-------------------------------|--------------|---------------------------|-------------------------------|---------------------------------|--|
| Asia                          | 15           | 30.0%                     | 100.0%                        | -                               | -                                      |
| Europe                        | 1            | 2.0%                      | -                             | 100.0%                          | -                                      |
| North America                 | 1            | 2.0%                      | -                             | -                               | 100.0%                                 |
| Asia & Europe                 | 4            | 8.0%                      | 37.5%                         | 62.5%                           | -                                      |
| Asia & North America          | 1            | 2.0%                      | 2.0%                          | -                               | 98.0%                                  |
| Asia & Europe & North America | 10           | 20.0%                     | 7.4%                          | 18.9%                           | 73.7%                                  |
| Europe & North America        | 18           | 36.0%                     | -                             | 27.3%                           | 72.6%                                  |
| not applicable <sup>1</sup>   | 4            | -                         | -                             | -                               | -                                      |
| non-response                  | 3            | -                         | -                             | -                               | -                                      |
| Total                         | 57           | 100.0%                    | -                             | -                               | -                                      |

<sup>1</sup> Companies not involved in exports

**Table C Buyers and Export Destinations**

| Number of buyers | No. of comp. | Valid % (N=48) | Export Asia | Export Europe | Export USA | Export Asia/Eur | Export Asia/USA | Exp. Asia/Eur./USA | Export Eur./USA |
|------------------|--------------|----------------|-------------|---------------|------------|-----------------|-----------------|--------------------|-----------------|
| 0                | 4            | -              | -           | -             | -          | -               | -               | -                  | -               |
| 1 – 2            | 6            | 13 %           | 4           | -             | 1          | 1               | -               | -                  | -               |
| 3 – 9            | 13           | 27 %           | 3           | 1             | -          | 1               | -               | 2                  | 3               |
| 10 – 24          | 19           | 40 %           | 2           | -             | -          | 1               | 1               | 6                  | 11              |
| 25 – 99          | 6            | 13 %           | 1           | -             | -          | -               | -               | 2                  | 3               |
| 100+             | 4            | 8 %            | 2           | -             | -          | 1               | -               | -                  | 1               |
| non-response     | 5            | -              | -           | -             | -          | -               | -               | -                  | -               |
| Total            | 57           | 100 %          | 12          | 1             | 1          | 4               | 1               | 10                 | 18              |

**Table D Production Organisation and Location of Companies in the Survey (1998)**

|  | All production | Production locally | All production |
|--|----------------|--------------------|----------------|
|--|----------------|--------------------|----------------|

| Production organisation   | locally | & overseas | overseas | Total |
|---|---------|------------|----------|-------|
| All production in this establishment  | 2       | -          | -        | 2     |
| Production in this establishment and by subcontractors                                    | 3       | 6          | -        | 9     |
| Production in this establishment, and by subsidiaries/other establishments                | -       | 7          | -        | 7     |
| Production in this establishment, by subsidiaries/other establishments and subcontractors | -       | 16         | -        | 16    |
| All production by subsidiaries/other establishments                                       | -       | 1          | 5        | 6     |
| All production by subsidiaries/other establishments and subcontractors                    | -       | -          | 10       | 10    |
| All production by subcontractors  | 1       | 1          | 5        | 7     |
| Total (N)   | 6       | 31         | 20       | 57    |

**Table E Production Locations Singapore Garment Manufacturers (1998)**

| Production location                     | No. of companies with production in this location | Share of total (N=42) <sup>1</sup> | (Average) age of establishments (years) |
|---|---|------------------------------------|---|
| Malaysia                                | 22  | 52%                                | 11                                      |
| Indonesia                               | 16  | 38%                                | 4                                       |
| Cambodia                                | 9   | 21%                                | 1-2                                     |
| Southern Africa <sup>2</sup>            | 8   | 19%                                | 4-5                                     |
| China                                   | 6   | 14%                                | 2                                       |
| Hong Kong                               | 5   | 12%                                | 9                                       |
| Fiji Islands                            | 4   | 10%                                | 13                                      |
| Sri Lanka/Brunei                        | 3 (each)  | 14%                                | 2/6                                     |
| Thailand/Philippines/Taiwan/Macao/India | 1 (each)  | 12%                                | -                                       |

<sup>1</sup> Of all companies with overseas production in own facilities (i.e. excluding subcontractors)

<sup>2</sup> Including South Africa (5), Swaziland (1), Zambia (1) and Mauritius (1)

**Table F Production Locations by Orientation**

| Orientation   | Domestic (15)  | Export oriented (31)  | Domestic & Export oriented (3)   |  |
|---|--|---|--|--|
| <b>Production locations</b><br>(including subcontractors) | <ul style="list-style-type: none"> <li>* Indonesia</li> <li>* Hong Kong</li> <li>* China</li> </ul>  | <ul style="list-style-type: none"> <li>* Indonesia (2)</li> <li>* Malaysia (2)</li> <li>* Sri Lanka</li> <li>* India</li> <li>* South Africa (2)</li> </ul>   | <ul style="list-style-type: none"> <li>* China + Malaysia (2)</li> <li>* Malaysia + Sri Lanka</li> <li>* Singapore + Indonesia</li> <li>* Indonesia + China (2)</li> <li>* Indonesia + Fiji</li> <li>* Indonesia + Hong Kong</li> <li>* S. Africa + Hong Kong</li> <li>* Cambodia + Philippines</li> </ul> | <ul style="list-style-type: none"> <li>* Malaysia</li> <li>* Indonesia</li> <li>* China</li> </ul> |
|   | <ul style="list-style-type: none"> <li>* Singapore + Hong Kong</li> <li>* Hong Kong + China (2)</li> <li>* Hong Kong + Indonesia</li> <li>* China + Indonesia</li> <li>* China + Malaysia</li> <li>* China + USA</li> <li>* Malaysia + South Africa</li> </ul> | <ul style="list-style-type: none"> <li>* Singapore + Malaysia + Indonesia</li> <li>* Singapore + Malaysia + Cambodia</li> <li>* Singapore + Malaysia + China</li> <li>* Indonesia + Malaysia + Cambodia</li> <li>* Malaysia + Sri Lanka + Cambodia</li> <li>* Malaysia + Indonesia + China</li> </ul> |  |  |
|   | <ul style="list-style-type: none"> <li>* Singapore + Indonesia + Malaysia + Hong Kong</li> <li>* Singapore + Thailand + Malaysia + Hong Kong</li> </ul>  | <ul style="list-style-type: none"> <li>* Singapore + Malaysia + Brunei + Cambodia</li> <li>* Hong Kong + Malaysia + Fiji + Brunei</li> <li>* Malaysia + Macao + Cambodia + China</li> <li>* Malaysia + S. Africa + Zambia + Cambodia</li> </ul>   |  |  |

|  |   |
|--|---|
|  | * Singapore + Indonesia + China + Cambodia + Swaziland<br>* Malaysia + China + Fiji + Hong Kong + USA + Taiwan<br>* Malaysia + Brunei + Mauritius + Cambodia + Fiji + Indonesia |
|--|---|

**Table G Fabric Sourcing Locations (1998)**

| Sourcing location            | No. of companies | Share of total (N=52) |
|------------------------------|------------------|-----------------------|
| East Asian NIEs <sup>1</sup> | 37               | 71%                   |
| Singapore                    | 15               | 29%                   |
| Southeast Asia <sup>2</sup>  | 14               | 27%                   |
| Japan                        | 12               | 23%                   |
| Europe <sup>3</sup>          | 9                | 17%                   |
| China                        | 7                | 13%                   |
| South Asia <sup>4</sup>      | 4                | 8%                    |
| USA                          | 3                | 6%                    |
| Australia                    | 3                | 6%                    |

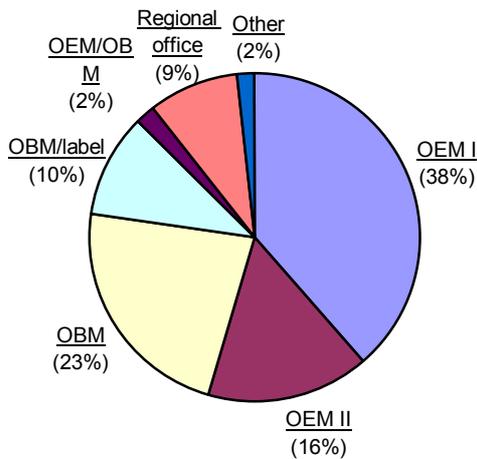
<sup>1</sup> Hong Kong, Taiwan & South Korea

<sup>2</sup> Indonesia, Malaysia & Thailand

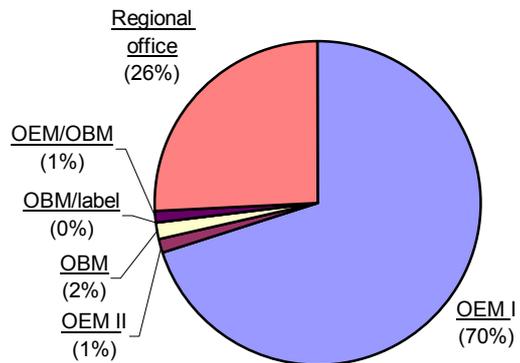
<sup>3</sup> Italy, Germany, UK, France, Denmark, Austria & Switzerland

<sup>4</sup> India & Pakistan

**Figure D Company categories: Share in total number of companies<sup>1</sup>**

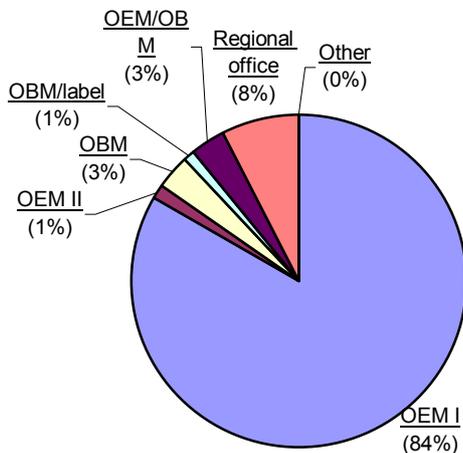


**Figure E Company categories: Share in total employment<sup>1</sup>**

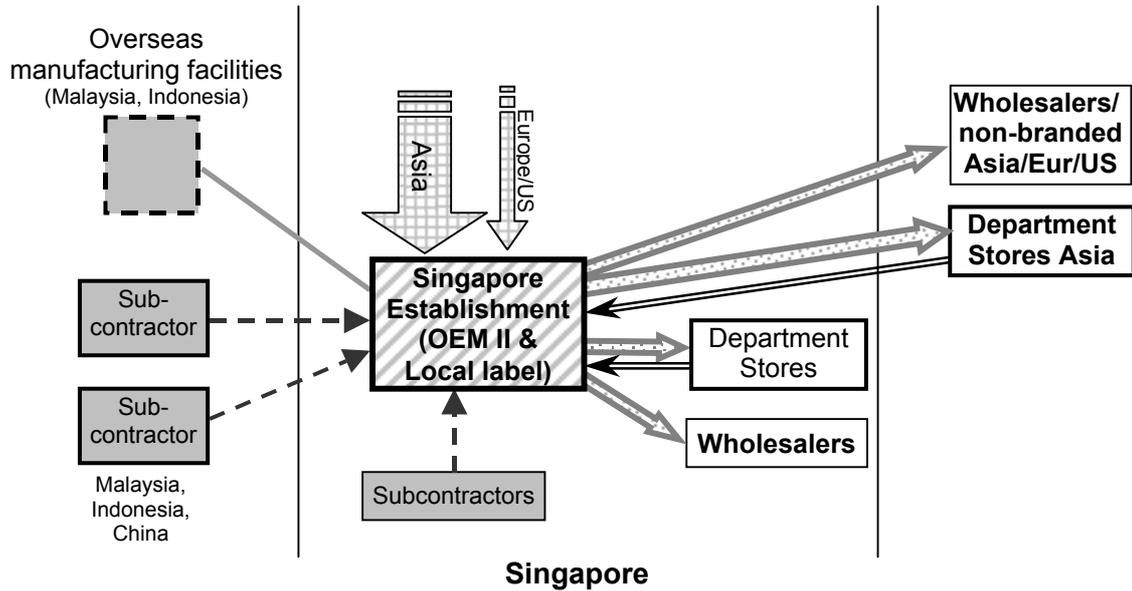


<sup>1</sup> Refers to employment for entire company including other establishments/subsidiaries

**Figure F Company categories: Share in total turnover**



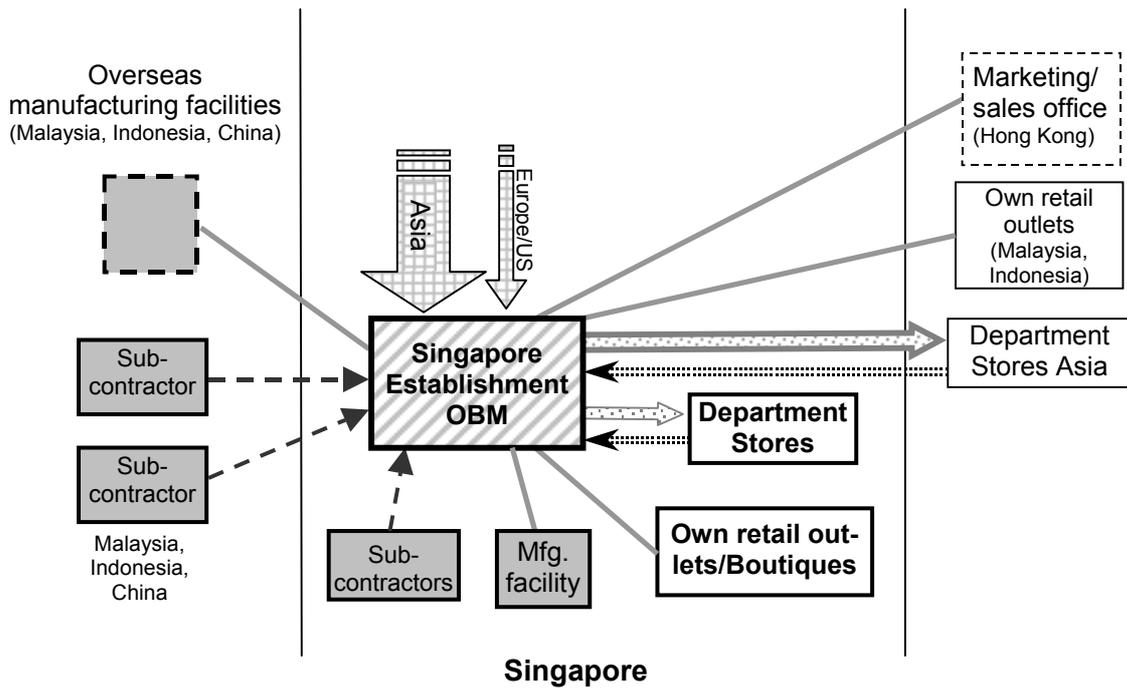
**Figure G** *Production and Distribution Networks of Singapore OEM II Suppliers and Local label manufacturers*



\* Thickness of arrows gives an indication of relative volume

\*\* Dotted lines indicate this form of organisation or relationship is found within the group, but not very common

**Figure H Production and Distribution Networks of Singapore OBM Suppliers**



\* Thickness of arrows gives an indication of relative volume

\*\* Dotted lines indicate this form of organisation or relationship is found within the group, but not very common

**Table H Changes<sup>1</sup> in Production (1988-1998)**

|                                 | Increased                                | No substantial change | Decreased |  |
|---------------------------------|--|-----------------------|-----------|--|
| Production cost (N=57)          | 68%                                      | 9%                    | 23%       | Of companies that indicated to have experienced increases in cost, 24 (62%) succeeded in maintaining profit margins, suggesting higher value-added |
| Product quality (N=57)          | 82%                                      | 18%                   | 0%        |  |
| Profit margin (N=54)            | 67% (maintained profit margin)           |                       | 33%       |  |
| Production capacity (N=51)      | 61% (still use full production capacity) |                       | 39%       | Of companies that still used full production capacity 10 (32%) had decreased number of employees, implying an increase in labour productivity      |
| Number of employees (N=56)      | 25%                                      | 21%                   | 54%       | In 70% of the cases, employment reduction was the result of deliberate strategies (i.e. relocation, labour saving technologies, down-sizing, etc.) |
| Need for skilled workers (N=50) | 42%                                      | 54%                   | 4%        |  |

<sup>1</sup> The percentages in the cells refer to the share of companies, which indicated to have experienced the kind of change denoted in the column headings

**Table I Sourcing Regions and Locations Covered from Singapore**

| Sourcing regions <sup>1</sup>      | Sourcing countries | No. of companies | Share of total (N=26) (in %) |
|------------------------------------|--------------------|------------------|------------------------------|
| <b>Southeast Asia</b><br>100%      | Singapore          | 22               | 85 %                         |
|                                    | Malaysia           | 26               | 100 %                        |
|                                    | Indonesia          | 18               | 69 %                         |
|                                    | Thailand           | 12               | 46 %                         |
|                                    | Cambodia           | 7                | 27 %                         |
|                                    | Brunei             | 6                | 23 %                         |
|                                    | Philippines        | 3                | 12 %                         |
|                                    | Myanmar/Vietnam    | 2                | 8 %                          |
| <b>South Asia</b><br>42%           | Sri Lanka          | 11               | 42 %                         |
|                                    | Bangladesh/India   | 7                | 27 %                         |
|                                    | Pakistan           | 3                | 12 %                         |
| <b>Africa &amp; Pacific</b><br>19% | Fiji/Mauritius     | 5                | 19 %                         |
|                                    | South Africa       | 4                | 15 %                         |
| <b>Northeast Asia</b><br>19%       | China              | 5                | 19 %                         |
|                                    | Taiwan             | 4                | 15 %                         |
|                                    | Hong Kong          | 3                | 12 %                         |
|                                    | Korea              | 1                | 4 %                          |

<sup>1</sup> Percentages refer to share of companies sourcing from this region

**Table J World Export Share of Singapore's Main Sourcing Base (1990-1999)**

|                  | 1990          | 1997               | 1999          |
|------------------|---------------|--------------------|---------------|
| <b>Indonesia</b> | 1.5 %         | 1.6 %              | 2.1 %         |
| <b>Malaysia</b>  | 1.2 %         | 1.3 %              | 1.2 %         |
| <b>Singapore</b> | 1.5 %         | 0.08 %             | 0.09 %        |
| <b>Sri Lanka</b> | 0.06 %        | 1.1 % <sup>1</sup> | 1.2 %         |
| <b>Thailand</b>  | 2.6 %         | 2.1 %              | 1.9 %         |
| <b>Total</b>     | <b>6.86 %</b> | <b>6.15 %</b>      | <b>6.49 %</b> |

<sup>1</sup> 1996

Source: WTO (1997, 1999)

## 7 The Malaysian Garment Industry: Competitive Adjustment Strategies and Development Trajectories

### Introduction

The focus of this chapter will be on the empirical data gathered on the Malaysian industry<sup>1</sup>. The set-up will be roughly the same as the previous chapter on Singapore, with slight differences in detail and emphasis, due to the different characteristics of the industry such as the fact that the production segment and actual manufacturing still play a much bigger role in Malaysia than in Singapore (see chapter 5).

In section 7.1 a general outline of the characteristics, structure and organisation of companies in the survey will be given. In view of the geographical spread of the industry in Malaysia, regional differences will also be considered. Based on the characteristics a categorisation of companies will be presented. Subsequently we take a closer look at the main problems and issues identified by producers, or the imperatives stemming from their business environment (section 7.2). In section 7.3 the strategies implemented by the companies in the survey over the past 10 years will be analysed and the main effects of these strategies in terms of company's functions, capabilities and competitive positioning illustrated. In section 7.4 the main firm level development trajectories will be identified and discussed. The chapter will be concluded with a consideration of industry development trajectories.

### 7.1 Structure and Characteristics of Garment Companies in the Survey<sup>2</sup>

#### 7.1.1 Ownership, Set-up and Size Distribution of Companies in the Survey

As becomes clear from table 7.1, most companies were established from the late 1970s onwards. Although foreign ownership had been between 40 to 65 percent in the 1970s and 1980s, by the time of the survey it was less than 15 percent and approximately 30 percent if majority foreign owned joint ventures are included.

**Table 7.1 Year of Establishment by Ownership**

| Year of establishment | Ownership |         |               | Total | Share |
|-----------------------|-----------|---------|---------------|-------|-------|
|                       | domestic  | foreign | joint-venture |       |       |
| >1971                 | 2         | -       | 3             | 5     | 4%    |
| 1971-1980             | 28        | 1       | 1             | 30    | 26%   |
| 1981-1990             | 33        | 10      | 10            | 53    | 45%   |
| 1991-1998             | 20        | 5       | 4             | 29    | 25%   |
| Total                 | 83        | 16      | 18            | 117   | 100%  |
| Share                 | 71%       | 14%     | 15%           | 100%  |       |

Ownership differs substantially per region (see map 1 in chapter 5), with a relatively high share of foreign ownership and majority participation in the Southern and Northern regions (see figure A in the appendix to this chapter). The higher share of foreign joint-ventures as compared to Singapore is probably a result of Malaysian

ownership requirements for companies not located in EPZs.

A relatively large number of companies, especially when compared to Singapore, have obtained public listing and are registered on the main or second board of the KLSE. In total, 19 textile and garment companies were listed on the KLSE as of August 2003. Most of these were integrated set-ups, involved in different activities in textile and apparel (e.g. knitting, garment manufacturing, retail operations, trading, dyeing, etc.) and sometimes also in property development. Two of these were large conglomerates that also had garment operations (New Straits Times, August 2, 2003).

Table 7.2 gives an overview of the set-up of companies in the survey. As was the case in Singapore, the majority of companies had multiple establishments. However, the status of the

interviewed establishment within these multi-establishment companies was more often that of subsidiary than was the case in Singapore. This was obviously a direct consequence of the higher share of foreign ownership in Malaysia.

**Table 7.2 Ownership, Set-up and Status of Companies in the Survey (1998-1999)**

| Ownership                 | Set-up                            | no. of comp. | Share | Status                        | no. of comp    | Share  |
|---------------------------|-----------------------------------|--------------|-------|-------------------------------|----------------|--------|
| <b>Domestic (83)</b>      | single establishment              | 24           | 28.9% | parent/main                   | 24             | 100.0% |
|                           | multi-establishment               | 59           | 71.1% | branch/subsidiary             | 18             | 30.5%  |
|                           |                                   |              |       | parent/main                   | 35             | 59.3%  |
|                           |                                   |              |       | independent unit              | 6 <sup>1</sup> | 10.2%  |
| <b>Foreign (16)</b>       | single establishment              | 1            | 6.3%  | parent/main                   | 1              | 100.0% |
|                           | multi-establishment               | 15           | 93.8% | branch/subsidiary             | 12             | 80.0%  |
|                           |                                   |              |       | parent/main                   | -              | -      |
|                           |                                   |              |       | independent unit              | 3              | 20.0%  |
| <b>Joint-venture (18)</b> | single establishment              | 2            | 11.1% | parent/main                   | 2              | 100.0% |
|                           | multi-establishment               | 16           | 88.9% | branch/subsidiary             | 5              | 31.3%  |
|                           |                                   |              |       | parent/main                   | 5              | 31.3%  |
|                           |                                   |              |       | independent unit              | 6              | 37.5%  |
| <b>Total (117)</b>        | <i>total single establishment</i> | 27           | 23.1% | <i>total parent/main</i>      | 27             | 100.0% |
|                           | <i>total multi-establishment</i>  | 90           | 76.9% | <i>total subsidiary</i>       | 35             | 38.9%  |
|                           |                                   |              |       | <i>total parent/main</i>      | 40             | 44.4%  |
|                           |                                   |              |       | <i>total independent unit</i> | 15             | 16.7%  |

<sup>1</sup> This included one so-called appointed manufacturer of a local/regional brand

In the cases of multi-establishment companies, the average number of *other establishments* and the average number of *subsidiaries/branches* (annex B) was roughly the same at 4.3 and 4.4 respectively. As to size, the picture differs somewhat from Singapore in terms of number of employees. The average number of employees in the interviewed establishments was 234. Based on employment numbers, the majority of companies in the Malaysian survey would in fact fall into the medium to large-scale company category. In terms of annual turnover this picture appears to be the same<sup>3</sup> (see figures B and C in the appendix). However, turnover was measured in local currency, i.e. Singapore Dollars (S\$) in Singapore and Malaysian Ringgits (RM) in Malaysia. Thus although it would seem a larger number of companies falls into the medium to large-scale category (turnover > 10mln.) in Malaysia than in Singapore, measured in similar currency the picture changes dramatically, with the average number of employees in Malaysia being higher, while the average turnover, at RM 31.1 million in 1997, is in fact lower.

Although this in principle does not say much about productivity (a large share of turnover in Singapore is in fact generated outside of Singapore), it would appear Singapore garment companies are on average bigger than Malaysian ones. Consider, for instance, the sum of turnover in Malaysia, which is RM 3.32 billion, generated by 106 companies. The sum of turnover in Singapore is S\$1.63 billion, generated by 53 companies<sup>4</sup>. The exchange rate RM:S\$ is approximately 2:1. Thus Malaysian turnover in S\$ is roughly 1.66 billion. This means 53 companies in Singapore generate almost the same turnover as 106 companies in Malaysia.

Next to number of employees and turnover, companies were also asked about other size and profitability indicators, such as value of fixed assets, share of value added and gross profit margin. Table 7.3 gives an overview of the averages of these values.

**Table 7.3 Size Distribution Per Region**

|                                    | Malaysia<br>(117) |     | Central<br>(35)   |    | North (30) |    | South (21) |    | Southwest<br>(31) |    |
|------------------------------------|-------------------|-----|-------------------|----|------------|----|------------|----|-------------------|----|
|                                    | valid             |     | valid             |    | valid      |    | valid      |    | valid             |    |
| Average number of employees        | 234               | 116 | 168 <sup>1</sup>  | 34 | 266        | 30 | 169        | 21 | 319               | 31 |
| Average annual turnover (RM mln.)  | 31,3              | 106 | 18,8 <sup>1</sup> | 30 | 37,0       | 30 | 34,8       | 18 | 36,5              | 28 |
| Average share of value added       | 34.9%             | 58  | 34.8%             | 10 | 39.3%      | 13 | 23.7%      | 10 | 37.1%             | 25 |
| Average profit margin              | 15.2%             | 101 | 18.9%             | 27 | 14.3%      | 26 | 13.7%      | 18 | 13.7%             | 30 |
| Average value fixed asset (RM mln) | 6,8               | 87  | 5,8               | 25 | 7,2        | 24 | 8,0        | 15 | 6,6               | 23 |

<sup>1</sup> These averages are somewhat distorted by the presence of one very large company, with 1600 employees, and an annual turnover of 100 million. If this company is excluded, the average number of employees for the Central region drops to 125 and the average annual turnover drops to 16.0 mln RM.

In addition it gives an overview of size distribution per region, which clearly differs substantially. The differences suggest that the Central region has the highest concentration of small companies. Size differences are, however, not directly reflected in profit margins and shares of value added as these are average or even above average in the Central region.

These numbers must be considered with some caution though as response to the question on value added was low and companies were asked for their *gross* profit margin. Average gross profit margin was around 15 percent, however net profit margins usually fell below 10 or even 5 percent, which is in fact a very small margin.

Finally, it is unclear to which extent companies exaggerated these figures. A number of companies (approximately 15 percent) reported a gross profit margin of 25 percent or more, while almost 30 percent of all companies reported a margin of 20 percent or more. Based on general industry data, such profit margins are relatively high and thus perhaps unlikely.

From the interviews it became clear that smaller companies and specifically smaller domestically oriented companies were less willing, or just not able to give accurate numbers, either because these figures were not exactly known or measured (e.g. in the case of value added and profit margins) or because of distrust.

Size did not just differ by region, but also by ownership and set-up. Of the 83 domestically owned companies, 65 had a *wholly local set-up*, i.e. all parts of the company were located in Malaysia and all production was carried out in Malaysia. The average annual turnover for this group was RM 15.9 million, while the average value of fixed assets was approximately RM 4 million, significantly lower than the average for all companies (see table 7.3). The average number of employees for this group of fully locally operating companies on the other hand was higher than average at 303 employees.

Of the 90 identified multi-establishment companies, 51 had an overseas presence. Of these companies 35 were part of a company that also had overseas establishments (mostly foreign owned or foreign joint-venture companies) and 16 had their own overseas subsidiaries/branches. Of all domestically owned companies, only 10 (i.e. 9 percent of all and 12 percent of domestically owned companies) had overseas subsidiaries.

All in all, the Malaysian garment industry is thus more 'locally rooted' in terms of its production than is the case in Singapore. Thus in the case of multi-establishment companies, for every employee working in Malaysia, 2,5 were working overseas (in Singapore this ratio was 1:13). These numbers included the employment numbers of foreign owned companies. If these are excluded the ratio drops even further to 1:1.6.

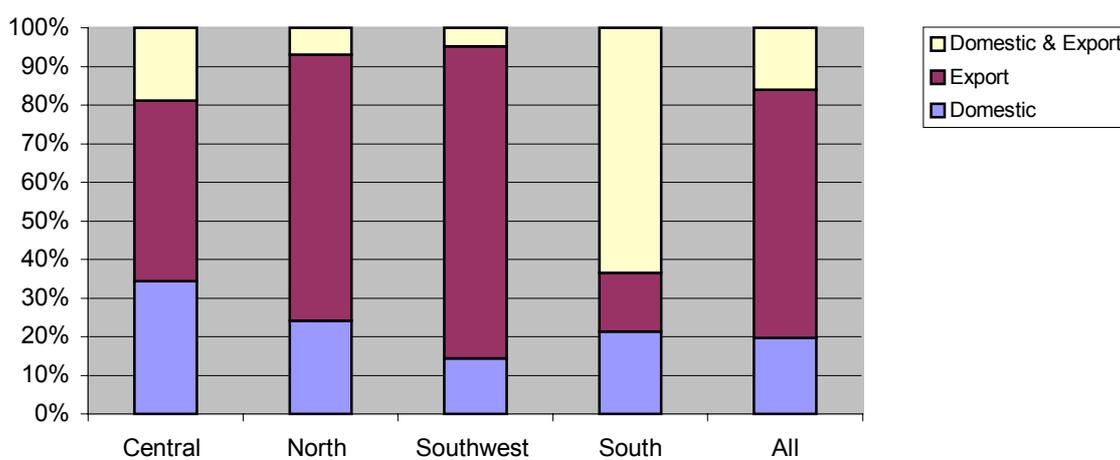
Malaysian garment companies generally have a stronger production orientation than their Singaporean counterparts, with an average non-production to production worker ratio of 1:5.6 (compare this to the average ratio in Singapore of 1:3.6) (see table A in the appendix to this

chapter). A more detailed look at the production organisation of companies in the survey is taken in section 7.1.4

### 7.1.2 Markets, Buyers and Products

The Malaysian garment industry as a whole, is strongly export-oriented and this was reflected in the survey as well (see figure 7.1). More than half of the companies (52 percent) were completely export oriented and only 7 percent of all companies did not engage in any exports at all. Again there are marked differences between the four regions, with the Central region being more domestically oriented in terms of its sales and markets. In addition, exports of companies in this region were more often destined for Asian markets or sold to non-branded buyers.

**Figure 7.1 Sales Orientation of Garment Producers per Region (1998-1999)**



#### Notes:

- Pertains to sales of entire company, including other establishments and/or subsidiaries
- Domestic: 70 percent or more of output sold in domestic markets; Export: 70 percent or more of output is exported; Domestic & Export: both domestic sales and exports, but both less than 70 percent

Generally speaking, companies with low export shares tend to export to regional markets, while companies that were 100 percent export oriented usually exported to Europe or North America. In terms of average shares of export to specific destinations, the picture is roughly similar to that in Singapore, although a smaller share of all companies exported to Asian markets. The focus in Malaysia was even stronger on the US market in terms of number of companies exporting to this market, yet average shares to this market were slightly smaller (as compared to the Singapore case) in case a company exported to several markets. Overall, average shares of exports to North America were highest in Malaysia as well though (see table B in the appendix).

The average number of buyers companies in the survey worked with was 11, while the average share of output sold to buyers was 91 percent, with 78 companies even selling 100 percent of their output to buyers. Malaysian garment manufacturers seem slightly more dependent on a smaller number of buyers than Singapore garment manufacturers were, with just over 6 percent of garment companies in Malaysia working with 25 or more buyers as opposed to more than 20 percent in Singapore (see figure D in the appendix).

Unlike in the case of Singapore, there does not appear to be a strong relationship between the number of buyers worked with and export destinations. Thus exports to Asia did not necessarily imply a smaller number of buyers than exports to North America or Europe, as was the case in Singapore.

As to the type of buyers produced for, similar buyers as in Singapore were found in Malaysia, but as a whole there was a wider variety of buyers sourcing from the country (see table 7.4).

**Table 7.4 Type of Buyers of Malaysian Manufacturers (1999)**

| Type of buyer                                  | No. of comp. | Share (N=109) |
|--|--------------|---------------|
| Local/regional department store                | 12           | 11.0 %        |
| US <sup>2</sup> department store               | 19           | 17.4 %        |
| European department store                      | 13           | 11.9 %        |
| US/European mass merchandiser/discounter       | 17           | 15.6 %        |
| US branded marketer/fashion retailer           | 61           | 56.0 %        |
| European branded marketer/fashion retailer     | 37           | 33.9 %        |
| Asian branded buyer                            | 10           | 9.2 %         |
| Malaysian brand                                | 18           | 16.5 %        |
| Local/regional licensee of international brand | 8            | 7.3 %         |
| US Mail order                                  | 4            | 3.7 %         |
| European mail order                            | 8            | 7.3 %         |
| Local/regional non-branded                     | 10           | 9.2 %         |
| US/European non-branded                        | 12           | 11.0 %        |

Lower-end buyers such as mass merchandisers and discounters as well as non-branded buyers were more common in Malaysia, as price levels here are still lower than in Singapore.

Branded US and European buyers were among the most prominent ones, and included most notably international sports wear brands such as Nike, Adidas, Fila, Puma and Reebok. Approximately 40 percent of all companies in the survey produced to the order of

such buyers.

<sup>1</sup> slash (/) denotes and/or

<sup>2</sup> Including Canadian buyers

The wider variety of buyers was also reflected in the combinations of different buyer types individual Malaysian garment companies worked with (see table 7.5).

**Table 7.5 Buyer Combinations of Malaysian Manufacturers (1999)**

| Buyer combinations   | No. of comp. | Valid percent (N=107) |
|--|--------------|-----------------------|
| US/European branded buyers   | 30           | 28.0 %                |
| US/European branded & department stores / discounters / catalogue companies / non-branded                                | 25           | 23.4 %                |
| Local/regional brand / department stores / licensees / non-branded   | 13           | 12.1 %                |
| US/European branded & local/ regional branded / department stores / licensees  | 10           | 9.3 %                 |
| US/European department stores / discounters / catalogue companies / non-branded  | 8            | 7.5 %                 |
| Local manufacturers / non-branded  | 7            | 6.5 %                 |
| Local/regional department stores / supermarkets only   | 6            | 5.6 %                 |
| US/European / local/regional non-branded   | 4            | 3.7 %                 |
| US/European department stores / catalogue companies / non-branded & local/regional department stores / brands / licensee | 4            | 3.7 %                 |
| not applicable <sup>1</sup>  | 7            | -                     |
| non-response   | 3            | -                     |
| Total  | 117          | -                     |

<sup>1</sup> Companies not producing to the order of buyers

A distinct group of 'buyers' was formed by the so-called local/regional licensees of regional or international brands. These were granted the right to develop, manufacture and market specific brands under license in exchange for a royalty payment to the license holder. The latter are often

so-called B-brands, which do not have the capacity to set up their own international/global sourcing and distribution networks, especially not where individual markets are relatively small. Even some A-brands engage in these kinds of arrangements, although there seems to be a general tendency for brand holders to want to regain control of their brands again.

Licensing has both advantages and disadvantages (see box 6.7 in the previous chapter). For the licensee it has the advantage of allowing a great deal of freedom and responsibility in terms of product development, design and marketing. Production is either done in-house or further outsourced to local/regional manufacturers (for instance, many licensees are centrally located in Singapore, but source products from Malaysia). The downside of licensing is that it only allows the licensee to distribute products to a limited number of markets, sometimes even just the local one. In addition, it involves mostly lower end-brands<sup>5</sup>.

### *Products*

The increasing focus of the Malaysian garment industry on knitted products (see chapter 5) is reflected in the survey, with more than 85 percent of interviewed companies involved in the production of knitwear.

This number is likely to be even higher, as other commonly produced product categories, such as sportswear, are likely to be knitted as well. A second important category of products was children's wear (see table C in the appendix). The importance of each type of product can, however, not be gauged from number of companies producing them alone, as shares of each product type in total output differed substantially. In general, a large number of companies produced a wide range of products, with an emphasis on knitwear. For instance, even though 45 percent of companies produced children's wear, in most cases this amounted to less than 25 percent of total output. On the other hand a specialisation in sportswear could still imply a range of products (e.g. woven and knitted shorts, knitted shirts, track-suits, etc.)

In total, 33 companies (28 percent) had specialised in one specific product, i.e. 75 percent or more of their output consisted of this specific product. Specialisation involved products such as undergarments (7) children's wear (7) or socks and jeanswear (2).

### *7.1.3 Production Process and Organisation*

#### *Technology*

Generally speaking, the level of technology in Malaysian garment manufacturing companies is relatively low and equipment used often old. Although many companies had replaced machines in the last few years, few had invested in completely new and advanced technologies (see table D in the appendix).

Moreover, as a sales representative of a company providing IT and Computer-aided-design and Manufacturing (CAD/CAM) solutions<sup>6</sup> for Fashion and Apparel industries in Singapore and Malaysia confirmed Malaysian garment manufacturers are not only fairly conservative in their adoption of new technologies, they also do not use the machines and new technologies they do invest in to their full extent (e.g. CAD systems are often only put to limited use).

The more advanced technologies that can be adopted include CAD/CAM systems, hanger systems, computerised/laser cutting and QR systems with buyers. A company that has introduced at least 2 of these technologies could be considered technologically advanced. Only 17 companies in the survey could be classified as technologically advanced according to this definition. All companies that had introduced computerised or laser cutting fell into this category, as this technology is usually integrated in a larger system including CAD/CAM and hanger systems. Table 7.6 gives an overview of the characteristics of these technologically advanced companies.

**Table 7.6 Characteristics of Technologically Advanced Companies**

| <b>Group (N=17)</b>                           |                             |      |
|---|-----------------------------|------|
| Average annual turnover (RM mln.)             |                             | 81,8 |
| Average value added (RM mln.)                 |                             | 35,9 |
| Average value fixed assets (RM mln.)          |                             | 21,6 |
| Average profit margin                         |                             | 13%  |
| Average number of employees                   |                             | 650  |
| Average share of output exported <sup>1</sup> |                             | 89%  |
| <i>Geographical spread</i>                    | - Central                   | 1    |
|   | - North                     | 5    |
|   | - South                     | 5    |
|   | - Southwest                 | 6    |
| <i>Ownership</i>                              | - Locally owned             | 13   |
|   | - JV majority locally owned | 3    |
|   | - Foreign owned             | 1    |

Although this group included only 17 companies, representing almost 15 percent of all companies in the survey, they had a 42 percent share in total turnover and 41 percent in employment. Obviously this group involves the largest companies in the survey and probably in Malaysia. A statistically significant relationship was in fact found between how technologically advanced companies were and their annual turnover (chi-square = 25.592, df = 14 and  $\alpha = 0.029$ ), i.e. technologically advanced companies tend to have an above average turnover.

<sup>1</sup> 14 companies were 100% export oriented

An interesting phenomenon is that these most highly automated companies had below average gross profit margins (13 percent compared to the average of 15 percent), implying the newest technologies do not necessarily ensure the highest profit margins (see also Taplin & Winterton, 1997). These companies, however, produced on a very large scale so total profit was very high.

A statistically significant relationship was also found between how technologically advanced companies were and sales orientation (chi-square = 48.858, df = 7 and  $\alpha = 0.00$ ), i.e. technologically advanced companies are usually export oriented.

Not surprisingly, hardly any of these technologically advanced companies were located in the Central region, confirming once more the rather conservative nature and small-scale of companies in this region. Surprising, however, is the fact that most of the technologically advanced companies are (majority) locally owned. This seems to suggest that foreign owned companies are in fact less likely to invest in new and advanced technologies, which is contrary to what is sometimes argued in the literature and what is in fact one of the rationales behind Malaysia's FDI policy, namely that foreign owned companies are more technologically advanced than locally owned companies.

#### *Production organisation and networks*

Just as in Singapore, most interviewed establishments were part of a multi-establishment company. However in Malaysia, a much larger share of these establishments still produced in-house. Only in 11 cases was output produced outside the interviewed establishment (table 7.7).

In comparison, in Singapore more than 40 percent of the interviewed establishments did not (or no longer) have any in-house production. The share of companies producing all output in-house or in-house and through subcontractors was higher in Malaysia than in Singapore.

Several divisions of labour were found between the different units of multi-establishment companies, depending on their general set-up. First, a substantial number of companies had other establishments overseas, which took care of sales and marketing or headquarter functions. In these cases the Malaysian establishment was mainly concerned with production. Companies with own subsidiaries or producing through subcontracting often still performed a substantial part of the production in-house, as these subsidiaries usually were manufacturing branches (i.e.

factories in another location) responsible for assembly or CMT functions. The same was true for most subcontractors. In addition a large number of companies indicated the division of labour was mostly a division between different types of products, enabling specialisation and productivity increases.

**Table 7.7 Production Organisation of Companies in the Survey (1998)**

| Production organisation   | No. of comp. | Share total | Average % of output this establishment | Average % of output other establishments | Average % of output sub-contractors <sup>1</sup> |
|---|--------------|-------------|--|--|--|
| All production in this establishment  | 17           | 14.5%       | 100.0                                  | -  | -  |
| Production in this establishment and by subcontractors                                    | 24           | 20.5%       | 85.4                                   | -  | 14.6   |
| Production in this establishment, and by subsidiaries/other establishments                | 16           | 13.7%       | 23.7                                   | 76.3                                     | -  |
| Production in this establishment, by subsidiaries/other establishments and subcontractors | 49           | 41.9%       | 36.0                                   | 40.6                                     | 23.4   |
| All production by subsidiaries/other establishments                                       | 3            | 2.6%        | -                                      | 100.0                                    | -  |
| All production by subsidiaries/other establishments and sub-contractors                   | 2            | 1.7%        | -                                      | N.A.                                     | N.A.   |
| All production by subcontractors  | 6            | 5.1%        | -                                      | -  | 100.0  |
| Total (N)   | 117          | 100.0%      |  |  |  |

<sup>1</sup> In several cases this implied sewing only and average shares thus essentially refers to actual assembly activities

Before moving on to the geographical spread of production networks of Malaysian garment companies, some remarks must be made on the general nature of these networks. In fact it was often harder than expected to uncover their exact configuration, as they were somewhat in-transparent. For instance two establishments would not formally be part of the same company, but the owners of the establishments would have a partnership, sometimes even with cross ownership shares in one another's companies. Thus they were neither really subcontractors, nor related companies. Such informal and to an extent in-transparent networks based on business contacts and family relations can be considered characteristic of Chinese family businesses (CFBs) and indeed they were mostly found among the smaller family owned businesses. Overall it sometimes made it hard to categorise companies in terms of single or multi-establishment companies. In addition it made it hard to get a clear insight into the exact production organisation of companies. Also because the interviewees in these smaller companies were not always willing to explain and often rather secretive about it.

#### *Production locations*

As was mentioned in section 7.4.1, approximately 44 percent of companies (51) in the survey had other establishments or subsidiaries overseas. However, only in 37 cases (32 percent) did this involve establishments/subsidiaries involved in production activities. The degree of internationalisation as well as the geographical spread of production of Malaysian garment companies was thus considerably less than what was found in Singapore. In addition foreign presence often didn't involve investments by the Malaysian establishment, but rather by headquarters located elsewhere. Thus only approximately 10 percent of all companies in the survey had invested in overseas subsidiaries themselves. These investments are still mostly limited to the Southeast Asian region (see table E in the appendix).

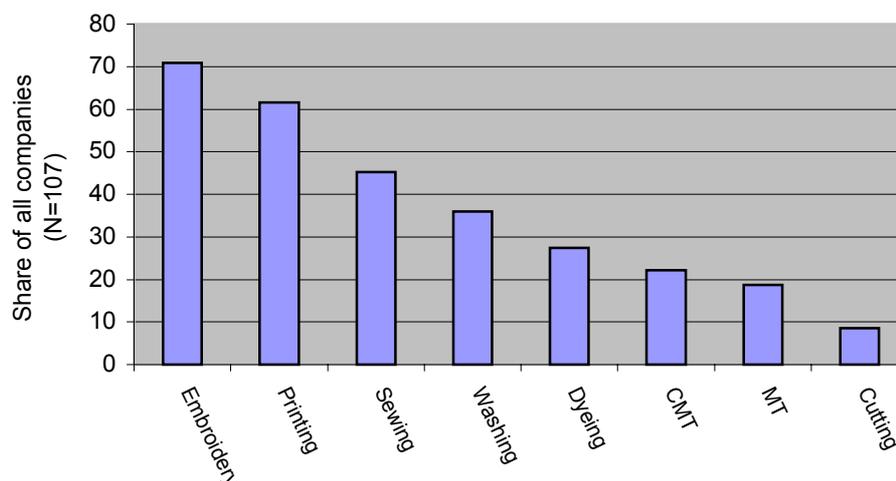
However, these numbers concern production facilities only. Many multi-establishment companies in fact had other establishments or subsidiaries that were not directly involved in production, but performed other activities within the chain. In total 98 companies (84 percent)

had such investments/establishments in non-production activities. They included sales and marketing offices (27), trading (16), upstream activities (11), or parent companies/headquarters (12). Sales and marketing offices as well as HQs were predominantly located overseas, whereas trading companies, retail outlets and upstream activities (in case of diversified or vertically integrated local companies) were more often located within Malaysia (see table F in the appendix).

### *Subcontracting*

As was the case in Singapore, many Malaysian garment producers outsource part of their production to subcontractors. This involved both capacity and specialisation subcontracting. In total, 107 companies made use of subcontractors and on average they worked with about 9 or 10 different subcontractors, which were usually located in the same city or region as the company. Figure 7.2 gives an overview of the activities most commonly outsourced, including most notably embroidery, which requires specialised skills and machinery. Remarkable is the large number of companies outsourcing printing activities. This is most likely due to the predominance of sports- and casual wear products, which often have prints on them.

**Figure 7.2 Main Activities Subcontracted by Garment Producers in Malaysia (1998-1999)**



### *Input supply*

In contrast to Singapore, Malaysia still has a reasonably sized textile industry and approximately 64 percent of companies indeed indicated that they sourced fabrics locally, while more than 75 percent sourced accessories locally (see table G in the appendix). However these numbers are somewhat deceiving and in reality a substantial share of inputs is imported, either directly or indirectly.

First of all, the average share of inputs sourced locally is relatively low and secondly the value of inputs sourced locally relatively low. Thus 'primary' inputs such as fabrics were mostly imported, while 'secondary' or lower-end inputs such as poly bags, carton for packing and hangers as well as lower-end fabrics were sourced locally, as were some accessories such as thread and zippers or buttons. In addition, 'local' accessories suppliers were often of foreign origin though. For instance thread suppliers Coats-Tootal from the UK and American and Efird (A&E) from the US have factories in Malaysia, as does YKK zips from Japan. These are all nominated suppliers. Other accessories, such as buttons are hardly produced locally, but supplied by local importers, who mostly import from Hong Kong and Taiwan.

On average, companies indicated to source as much as 42 percent of their inputs locally. As mentioned, the share was much lower for fabric and textile inputs. In addition, the average share of locally sourced inputs differed significantly between export oriented and domestically oriented companies<sup>7</sup>, with export oriented companies sourcing a much smaller share of their inputs locally (see table 7.8).

Approximately 91 percent of companies sourced part of their inputs from overseas and 66 percent even imported at least half of all their material inputs<sup>8</sup>.

With lead-times becoming increasingly important, most garment producers indicated they would prefer sourcing their inputs locally, but were limited by a number of factors, such as inadequate quality and variety locally and the fact that buyers had not nominated any local suppliers (see table 7.9). Companies engaged in both domestic sales and exports mostly exported to Asian markets or sold to lower-end Western buyers. For these markets and buyers, supplier nomination is usually not an issue, but input sourcing is left entirely to the producer.

**Table 7.8**

**Share Local Inputs by Sales Orientation**

| Sales orientation               | Average share of local inputs |
|---------------------------------|-------------------------------|
| Domestic (≥70%)                 | 55%                           |
| Export (≥70%)                   | 33%                           |
| Domestic (<70%) & export (<70%) | 66%                           |

**Table 7.9**

**Main Reasons for Not Sourcing Inputs Locally**

| Main Reason                                       | No. of comp. | Share (in %) |
|---|--------------|--------------|
| Availability/variety inadequate                   | 65           | 63.1         |
| Quality inadequate                                | 51           | 49.5         |
| Prices relatively high                            | 28           | 27.2         |
| Local suppliers not nominated/ approved by buyers | 21           | 20.4         |
| Delivery times/flexibility inadequate             | 9            | 8.7          |

The choice of input sourcing locations was however also driven by more general competitiveness considerations. Thus producers indicated to source from Taiwanese and Hong Kong input suppliers because of their competitiveness in terms of price-quality ratio and availability and variety of specialised inputs. This has not gone unnoticed by buyers either, which often nominated these input manufacturers for supply to their vendors in the entire region. Although both Taiwan and Hong Kong are important fabric and accessories suppliers, Taiwan seems to have a slight competitive advantage in terms of fabrics, whereas Hong Kong is stronger in accessories.

Sourcing of inputs from Europe, the USA/Canada and Japan was done mostly because of quality, although in some cases it was also because of buyer nomination of special input suppliers in these regions.

For sourcing of inputs from Malaysia, pricing, delivery times, proximity and related to this easier communication and a better ability to control and solve problems played an important role. However, another important reason seemed to be the fact that these inputs were produced in another part of the same company. In other words, integrated firms (logically) sourced larger shares of inputs locally.

#### 7.1.4 Categorisation of Garment Companies in the Survey

Based on general characteristics as described in the previous sections, a categorisation of garment companies was made, which is presented in table 7.10.

The variety of companies found in Malaysia appears bigger than in Singapore and generally speaking, the Malaysian garment industry is more diverse and more fragmented than the Singapore garment industry, with a larger number of smaller companies and a larger variety in types of companies. The first two categories include the export-oriented companies incorporated into global production networks and chains driven by US and European buyers. The difference between the companies in categories 1a, 1b, and 2 is their mode of incorporation. Thus the first group includes local companies that have developed the competencies to be incorporated as OEM suppliers. The second group consists of investments by MNCs from the Asian NIEs and thus represent the so-called second tier suppliers, or the 'third corner' of the triangle in so-called triangle manufacturing arrangements. The third group, the companies in category 2, are direct investments by US and European branded manufacturers and thus represent the TNC driven version of incorporation into global networks and chains. This latter group can be most directly associated with the idea of the branch-plant economy. As becomes clear though, this concerns only a small section of the industry. Together these three groups account for almost 55 percent of all companies in the survey and form an even more dominant segment than in Singapore.

**Table 7.10 Categorisation of Companies in the Survey**

| Main company category              | Description   | No. of comp.   | Share (in %) | Cumulative % |
|------------------------------------|---|----------------|--------------|--------------|
| <b>1 OEM I</b>                     | 1.a) OEM for export, locally owned  | 42             | 35.9         | 35.9         |
|                                    | 1.b) OEM for export, foreign owned subsidiary/establishment or joint venture with $\geq 50\%$ foreign participation   | 17             | 14.5         | 50.4         |
| <b>2 OBM mfg.</b>                  | Manufacturing subsidiary/establishment of foreign brand manufacturer/supplier (OBM)   | 5              | 4.3          | 54.7         |
| <b>3 OEM I &amp; OEM II</b>        | OEM for export (US/European markets) & local/regional OEM   | 5              | 4.3          | 59.0         |
| <b>4 OEM II</b>                    | OEM for domestic/regional markets or manufacturing arm of local label/licensees   | 14             | 12.0         | 71.0         |
| <b>5 Local label</b>               | Producer selling own label through local/regional distribution channels such as department stores and retail/ supermarket chains, or licensee of international/regional brand with right to produce/source and market/retail brand in local/ regional markets with permission of license holder | 9              | 7.7          | 78.7         |
| <b>6 OBM</b>                       | OBM for local/regional markets; own brand accounts for 75 percent or more of total output; own retail outlets   | 6 <sup>1</sup> | 5.1          | 83.8         |
| <b>7 ODM/OBM</b>                   | ODM/OEM for Western buyers combined with local/regional OBM, including marketing  | 2              | 1.7          | 85.5         |
| <b>8 Textile based</b>             | Textile producers, which have ventured into garment supply, but outsource actual garment assembly/production to sub-contractors. Garment production small, non-strategic part of business. Sales orientation both domestic and export; ex-ports to Asian and European markets                   | 2              | 1.7          | 87.2         |
| <b>9 Subcontractor<sup>2</sup></b> | 9.a) Subcontractor for local garment manufacturers  | 3              | 2.6          | 89.8         |
|                                    | 9.b) Still some subcontracting for local garment manufacturers, but also direct OEM supply  | 2              | 1.7          | 91.5         |
| <b>10 Other<sup>3</sup></b>        |   | 10             | 8.5          | 100.0        |
|                                    | Total   | 117            | 100.0        |              |

<sup>1</sup> Including 1 company producing 60 percent of its total output under its own brand, yet selling through own outlets.

<sup>2</sup> This is not a representative number (representative for the total number of subcontractors in Malaysia) as we chose deliberately to include as few subcontractors as possible in our survey.

<sup>3</sup> This category is quite varied, including for instance manufacturers of uniforms for the local market, producers of promotion shirts and suppliers to very specific clients such as holiday resorts or golf clubs.

On the other hand, the OBM and Local label categories are of less importance in Malaysia than in Singapore (where the OBM category accounted for almost 20 percent of all companies). Moreover, the majority of companies in the local label category produced lower-end products such as men's briefs under their own label, which was sold in local supermarkets and department stores. Only one of the companies in the OBM category sold its brand in the mid to high-end segments of the market and had ventured beyond the Malaysian market, with retail outlets in Singapore, Brunei and the Middle East. The rest of the companies in this category all sold their products only in the low- to mid-end segments of the local market, although one also specialised in festive wear (i.e. clothes worn with certain celebrations, such as Christmas and specifically the Chinese New Year).

As was the case in Singapore, the OEM I category is the biggest group of companies in Malaysia, whose dominance becomes even clearer if the relative size of the different categories is compared by considering the share of each in total employment, total turnover and total value of fixed assets. Thus although approximately 53 percent of companies in the survey can be considered OEM suppliers (OEM I a, OEM I b and OBM Mfg.), they account for almost 85 percent of total turnover and value of fixed assets and approximately 67 percent of employment (see figures E through H in the appendix).

Average size measured in terms of profit margins, shares of value added, annual turnover and number of employees differed substantially per category (see figures I through L in the appendix).

Profit margins were lowest in the foreign owned companies in category 1b and 2. This is most likely because companies in these categories are not always profit centres. Their shares of value added were also generally below average. On the other hand high average profit margins and shares in value added were achieved by companies in the OEM I & OEM II category and in the ODM&OBM category. However, their average turnover was amongst the lowest in the industry, at 5.9 million RM/annum and 19.2 million RM/annum respectively. This implies total profits in these groups are likely to be low, while companies in the OEM I a group, with an average profit margin of just over 14 percent, but an average annual turnover of more than 52 million RM, achieve substantial total profit levels.

Finally, the companies/groups that foreign owned establishments were part of, were substantially larger than locally owned multi-establishment companies, confirming the relatively small size of Malaysian garment companies when compared to their Asian NIE counterparts.

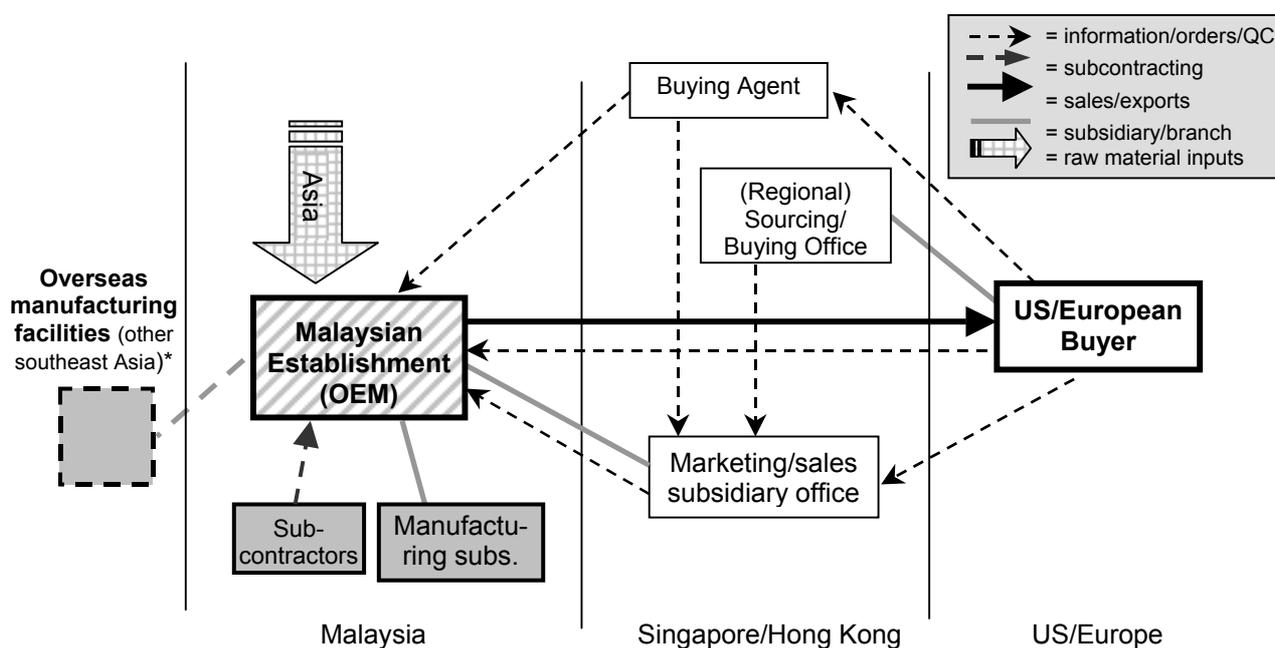
The different categories are also spread differently over the regions (see table H in the appendix). Not surprisingly companies in the export-oriented OEM categories are concentrated mostly in the Northern and Southern regions, while the domestically oriented OEM II category as well as the local label and OBM categories are more concentrated in the Central region. The concentration of the latter in the Central region is logical considering companies in this category are often marketing oriented and will thus want to be closer to the main market for fashion goods: Kuala Lumpur. Subcontractors finally were mostly found in the regions where the export oriented OEM suppliers were located, as these were their main clients and subcontracting mostly takes place close-by.

In general the production and distribution networks of which Malaysian garment companies are part are less complex and extensive than those in which Singapore garment companies operate. Domestically and regionally oriented companies tend to have completely local set-ups, while foreign owned companies see Malaysia purely as a manufacturing locations and Malaysian establishments are accordingly positioned in the regional production networks (see figures M

and N in the appendix). But even the locally owned OEM I suppliers have not (yet?) expanded overseas to a significant extent (see figure 7.3).

In the remainder of this chapter we will often group certain categories together, as separately their size often makes a relevant analysis difficult, while in many respects their characteristics are broadly similar. Thus the OEM I and OBM Mfg. categories will often be grouped together, as will the OEM II and the OEM I & OEM II categories and the OBM and ODM & OBM categories.

**Figure 7.3 Production and Distribution Networks of Malaysian Owned OEM Suppliers**



\* Dotted lines indicate this form of organisation or relationship is found within the group, but not very common

Before taking a closer look at the competitive adjustment strategies the companies in these different categories have implemented in the past ten years, first the (changing) business environment from the perspective of the companies in the survey will be considered.

## 7.2 (Changes in) the Malaysian Business Environment as Experienced by Malaysian Garment Companies

### 7.2.1 Imperatives in the Business Environment: Factors Impinging on Competitiveness

Table 7.11 gives a detailed overview of some of the main issues in the business environment companies may face and whether they are indeed perceived as problems. These perceived issues are considered for all companies and by four main groups of companies.

Overall a similar picture emerges as in the case of Singapore. Labour cost and specifically labour availability are pressing issues for Malaysian garment manufacturers, regardless of which category they fall into, although the cost aspect of doing business in Malaysia seemed to be more of an issue for domestically/regionally oriented companies. These companies also had more of a problem with high labour turnover, which is probably due to the fact that they are less

capable of providing the kind of fringe benefits and extra incentives larger, export oriented companies could afford to provide.

Regional competition was also perceived as a problem and one that would only be getting bigger in the future. At the time of the survey it wasn't necessarily considered the most pressing problem, but there was general recognition of the future threat of several developments such as the entry of China into WTO, the abolishment of the quota system by 2005 and the regional trade liberalisation under the ASEAN Free Trade Agreement (AFTA).

Changes in markets were considered less of a problem than the issues of cost and competition, although specifically for the export oriented OEM producers, keeping up with buyer requirements regarding quality standards and the demand for shorter lead times and flexibility was often considered problematic. Retaining buyers was not generally seen as an issue, which is probably reflects the fact that prices in Malaysia are still reasonably competitive, especially when compared to Singapore. Several producers even remarked that they sometimes had to turn buyers down, due to quota or capacity limitations<sup>9</sup>. However, there are some signs that it may become harder in the future to retain buyers and particularly for companies in export-oriented and Western buyer/market oriented categories, 'keeping buyers' scored above average as an issue of concern.

**Table 7.11 Issues and Problems in the Malaysian Business Environment (1988/1999)**

|                                       | All comp.<br>(N=117)       | OEM I &<br>OBM Mfg<br>(N=64) | OEM II<br>(N=19) | Local<br>label (N=9) | OBM &<br>ODM/ OBM<br>(N=8) |
|---------------------------------------|----------------------------|------------------------------|------------------|----------------------|----------------------------|
| <b>Perceived issues and problems</b>  | <i>share in percentage</i> |                              |                  |                      |                            |
| Labour cost                           | 59.0                       | 54.7                         | 57.9             | 77.8                 | 75.0                       |
| Shortage of labour                    | 96.6                       | 96.9                         | 100.0            | 88.9                 | 87.5                       |
| - skilled                             | 95.7                       | 96.9                         | 100.0            | 88.9                 | 87.5                       |
| - unskilled                           | 52.1                       | 54.7                         | 21.1             | 88.9                 | 50.0                       |
| Other business cost                   | 65.8                       | 60.9                         | 73.7             | 100.0                | 62.5                       |
| Labour turnover                       | 52.1                       | 45.3                         | 63.2             | 77.8                 | 37.5                       |
| Regional competition                  | 80.3                       | 81.3                         | 84.2             | 66.7                 | 75.0                       |
| Changes in markets                    |                            |                              |                  |                      |                            |
| - rapid fashion changes               | 41.9                       | 50.0                         | 26.3             | 44.4                 | 50.0                       |
| - less standardised products          | 36.8                       | 39.1                         | 36.8             | 44.4                 | 50.0                       |
| - higher quality                      | 61.5                       | 67.2                         | 57.9             | 44.4                 | 50.0                       |
| - differentiation                     | 50.4                       | 59.4                         | 36.8             | 33.3                 | 37.5                       |
| - flexibility                         | 62.4                       | 73.4                         | 47.4             | 33.3                 | 37.5                       |
| - quick response/delivery times       | 70.1                       | 76.6                         | 57.9             | 55.6                 | 62.5                       |
| Keeping buyers                        | 26.5                       | 35.9                         | 15.8             | 22.2                 | 12.5                       |
| Production technology                 | 27.4                       | 29.8                         | 10.5             | 33.3                 | 37.5                       |
| Institutional context                 | 55.6                       | 48.4                         | 52.6             | 77.8                 | 62.5                       |
| - government policies                 | 32.5                       | 25.0                         | 36.8             | 66.7                 | 37.5                       |
| - labour regulations/standards/unions | 22.2                       | 18.8                         | 15.8             | 55.6                 | 50.0                       |
| - market regulations                  | 19.7                       | 25.0                         | 10.5             | 0.0                  | 25.0                       |
| Trade related issues                  | 90.6                       | 89.1                         | 94.7             | 88.9                 | 75.0                       |
| - quota                               | 68.4                       | 76.6                         | 57.9             | 44.4                 | 62.5                       |
| - regional integration                | 29.9                       | 26.6                         | 26.3             | 55.6                 | 37.5                       |
| - currency fluctuations               | 53.8                       | 51.6                         | 52.6             | 88.9                 | 62.5                       |

Keeping up with technological changes was generally not considered an issue as most companies simply did not see the need to invest in the newest technologies.

As was the case in Singapore, the local institutional context and specifically the role of Government is mostly seen by domestically oriented companies as an issue. Trade related issues are considered problematic by most companies in the survey, although the precise issues differed per company category. Thus quota limitations were mostly a problem for export

oriented companies, although a number of domestically oriented companies cited the difficulty of obtaining quota if a company had no export performance records was limiting their ambitions to engage in exports. On the other hand regional integration and currency fluctuations were of lesser concern to the OEM I categories than to domestically/regionally oriented companies and specifically those carrying their own brand or label. The companies in these categories are more likely to feel threatened by the increased competition for local markets such regional integration and currency fluctuations<sup>10</sup> may entail.

As most companies cited a whole list of perceived issues and problems, they were also asked to list the most pressing three in order of importance. This resulted in a list of main problems:

1. Labour shortages general (43% of all companies cited this as most important issue)
2. Quota availability (25%)
3. Shortage of skilled labour (21%)
4. Institutional environment including inconsistent and/or unclear government policies, uncertainty over future after 2005, uncertainty over currency peg, etc. (15%)
5. Increased regional/international competition (12%)

### *7.2.2 The Local Institutional Context*

Since the Malaysian Government has so explicitly developed policies and incentives for the manufacturing industry in general and sometimes even for the garment industry specifically under the IMP-2 (chapter 5), companies were asked about their opinion of Government and its policies and whether they actually made use of any of the incentives programs available.

Almost half of all companies (49 percent) saw Government's role/attitude towards the industry as positive, 27 percent of companies saw it as of little to no relevance to their business, while only 17 percent saw it as downright negative. Opinions varied little per company category, although companies in the local label category seemed slightly more inclined to have a negative view of Government and its policies, while more than 62 percent of all OBM companies had a positive view. A number of companies (13) indicated that Government's attitude was in principle positive, but actual support was limited, inconsistent or weakly implemented. The problem lay thus with the actual implementation process, not so much with policies at the macro-level. Asked if recent changes in Government policies had directly affected business, most companies indicated this was not the case. However, a number of companies (approximately 24 percent of total) did mention the constant changes in foreign worker policies (or rather in height of annual foreign worker quota and levies) the quota allocation system, and general inconsistency in policies as issues creating uncertainties for individual companies.

Almost all companies (89 percent) made use of at least one Government incentive program (see table I in the appendix). The most commonly used programs were the exemptions on import duties, excise duties and sales taxes and funding for training of employees under the HRDF (see chapter 5, section 5.5). Exemptions are granted to export oriented companies (>80 percent export) importing their inputs, while more recently even companies producing for domestic markets were eligible for such exemptions under certain conditions. As contribution to the HRDF was compulsory for all companies, many (although surprisingly not all) made use of it, so as to at least 'get their money back'.

Approximately 15 percent of all companies made use of investment or re-investment tax allowances, however, other incentives programs were hardly used (see table I in the appendix). In other words, the most popular programs were cost based programs or more or less enforced programs. The programs aimed at upgrading and high-road strategy development were not very popular, indicative of the rather conservative nature of the industry in general. Even when free funding and support is offered, companies seem hesitant to participate. For instance MATRADE has substantial funds available for export promotion, but while membership is free, only 60

garment companies, or approximately 6 percent of total<sup>11</sup>, in Malaysian are MATRADE members.

### 7.2.3 Industry Association and Co-operation

Some 80 percent of companies in the survey were a member of at least one of the main industry associations. It must be noted that this is probably not representative for the industry as a whole, as members of MTMA and MKMA were generally more approachable and willing to co-operate (see annex A)<sup>12</sup>. Approximately 62 percent (73 companies) was a member of MTMA, 9 percent (10 companies) of MTMA and MKMA, 5 percent (6 companies) of MKMA, while 3 percent was a member of another organisation. The remaining 24 companies were not members of any organisation. This group consisted of on the one hand small, domestically oriented companies (18) and a number of foreign owned subsidiaries (6), which are perhaps less locally embedded. Asked why they weren't members, the former usually indicated not to see the use of an industry association, as many were of the opinion that the main associations MTMA and MKMA were focused on protecting the interests of large, export oriented companies.

Most members made use of services such as information on trade regulations and quota allocation as well as the general information exchange that took place through newsletters. Two thirds also (occasionally) participated in seminars or training programs provided by the associations. Generally speaking, however, only a relatively small group of companies was actively involved in the industry associations, for instance through the sponsoring of certain events or seminars, the fulfilling of positions within the organisation, active lobbying with the Government, etc. Both with regards to the MTMA and MKMA, 'outsiders' remarked that it was hard to get into the 'old-boys network', although these sentiments seemed to be stronger in the case of the MTMA. The strongly involved companies on the other hand argued that these 'outsiders' just didn't take enough initiative and they didn't deliberately 'keep them out'.

Similar patterns and arguments seem to apply to the general issue of cooperation among garment companies. In total, 81 companies (almost 70 percent) engaged in some form of co-operation with other garment companies (mostly other garment manufacturers). Cooperation differed substantially by company size and orientation though, with large and export oriented companies being much more inclined to cooperate with other companies than small and domestically oriented companies. These proved to be statistically significant relationships<sup>13</sup>.

In addition, and related to these company characteristics of size and sales orientation, cooperation between companies was weakest in the Central region (only 46 percent of companies cooperated with other companies) and strongest in the Southwestern region (86 percent of companies), with the North and Southern region also scoring high (both approximately 77 percent).

However, as to the actual form this cooperation takes, it must be noted that few companies engage in more than rather informal and relatively simple forms of cooperation (see table 7.12)

**Table 7.12 Forms of Cooperation of Malaysian Garment Companies (1999)**

| Forms of co-operation   | No. of companies | Share (N=81) |
|---|------------------|--------------|
| • (Informal) exchange of information on markets, investment opportunities, contacts, technology, etc.   | 56               | 69%          |
| • Help one another out with (big) orders/share orders or perform certain activities for other companies | 49               | 60%          |
| • Borrow/lend machines  | 14               | 17%          |
| • Joint FDI or R&D and product development  | 5                | 6%           |

In the remainder of this chapter the focus will be on the competitive adjustment strategies implemented by Malaysian garment companies and resulting company and industry development trajectories.

### 7.3 Competitive Adjustment Strategies and Main Outcomes

Implemented competitive adjustment strategies of garment companies in the survey are summarised in table 7.13. In general, the most popular strategies appear to have been: labour intensification strategies such as hiring foreign workers and having workers work overtime to meet delivery times; increasing flexibility through a reduction of lead times; and the (gradual) improvement of product quality. In addition a majority of firms had changed its client base, moving towards higher-end buyers and/or had assumed more responsibilities in the production process (e.g. increased QC, logistics, product development, etc.).

**Table 7.13 Competitive Adjustment Strategies in the Malaysian Garment Industry (1989-99)<sup>14</sup>**

|  | No. all comp.              | Share (in %) | OEM I <sup>1</sup> (N=64) | OEM II <sup>2</sup> (N=19) | Subcontractors (N=5) | Local label (N=9) <sup>3</sup> | OBM <sup>4</sup> (N=8) |
|--|----------------------------|--------------|---------------------------|----------------------------|----------------------|--------------------------------|------------------------|
| <b>Company Strategies</b>                | <i>share in percentage</i> |              |                           |                            |                      |                                |                        |
| <b>Labour</b>                            |                            |              |                           |                            |                      |                                |                        |
| - hire foreign workers                   | 88                         | 75           | 84                        | 74                         | 100                  | 44                             | 50                     |
| - hire part time/temporary workers       | 32                         | 27           | 27                        | 5                          | 40                   | 33                             | 38                     |
| - increase overtime work                 | 111                        | 95           | 100                       | 95                         | 100                  | 78                             | 100                    |
| - multi-tasking                          | 65                         | 50           | 69                        | 32                         | 80                   | 44                             | 38                     |
| - training programs                      | 77                         | 66           | 75                        | 47                         | 80                   | 56                             | 75                     |
| <b>Subcontracting</b>                    |                            |              |                           |                            |                      |                                |                        |
| - capacity subcontracting                | 82                         | 70           | 73                        | 68                         | 20                   | 56                             | 63                     |
| - specialisation subcontracting          | 94                         | 80           | 84                        | 79                         | 40                   | 78                             | 75                     |
| - increased subcontracting               | 31                         | 27           | 19                        | 32                         | 20                   | 56                             | 25                     |
| <b>Technology</b>                        |                            |              |                           |                            |                      |                                |                        |
| - introduced labour saving techn.        | 67                         | 57           | 67                        | 42                         | 40                   | 44                             | 38                     |
| - introduced new technologies            | 71                         | 60           | 80                        | 42                         | 20                   | 33                             | 38                     |
| <b>Capabilities/process upgrading</b>    |                            |              |                           |                            |                      |                                |                        |
| - gradual improvement                    | 57                         | 49           | 64                        | 26                         | 20                   | 44                             | 38                     |
| - improve mfg. capabilities <sup>5</sup> | 23                         | 20           | 17                        | 32                         | 20                   | 11                             | 13                     |
| - increased flexibility                  | 89                         | 76           | 84                        | 78                         | 60                   | 78                             | 63                     |
| <b>Location</b>                          |                            |              |                           |                            |                      |                                |                        |
| - (increase) overseas investments        | 21                         | 18           | 27                        | 11                         | 0                    | 11                             | 0 <sup>6</sup>         |
| <b>Marketing Strategies</b>              |                            |              |                           |                            |                      |                                |                        |
| - changed buyer base (upgrade)           | 66                         | 56           | 55                        | 53                         | 80                   | 33                             | 50                     |
| - changed responsibility towards buyers  | 56                         | 48           | 61                        | 32                         | 40                   | 33                             | 25                     |
| <b>Market Strategies</b>                 |                            |              |                           |                            |                      |                                |                        |
| - changed market focus                   | 59                         | 50           | 52                        | 37                         | 60                   | 56                             | 63                     |
| - expanded markets                       | 60                         | 51           | 53                        | 42                         | 40                   | 78                             | 50                     |
| <b>Product</b>                           |                            |              |                           |                            |                      |                                |                        |

|  |     |    |    |    |     |    |     |
|--|-----|----|----|----|-----|----|-----|
| - less labour intensive products                 | 21  | 18 | 20 | 5  | 40  | 22 | 25  |
| - higher value-added/more sophisticated products | 78  | 67 | 75 | 47 | 80  | 67 | 50  |
| - differentiated/extended range                  | 74  | 63 | 69 | 74 | 60  | 44 | 50  |
| - specialisation                                 | 47  | 40 | 47 | 37 | 40  | 56 | 38  |
| - improve product quality                        | 111 | 95 | 98 | 90 | 100 | 89 | 88  |
| <b>Design/branding</b>                           |     |    |    |    |     |    |     |
| - developed design capabilities                  | 36  | 31 | 16 | 47 | 0   | 56 | 50  |
| - introduced/developed own brand/label           | 34  | 27 | 17 | 42 | 0   | 78 | 100 |

<sup>1</sup> Includes categories 1, 2 and 6

<sup>2</sup> Includes categories 3 and 4

<sup>3</sup> 78 percent of companies still had in-house production

<sup>4</sup> Includes categories 6 and 7; 63 percent of companies still had in-house production

<sup>5</sup> I.e. taking on more responsibilities within the entire production process and organisation

<sup>6</sup> One of the companies in this category had, however, set-up retailing franchises overseas

### 7.3.1 *Defensive Strategies: Labour Intensification and Outsourcing*

#### *Labour strategies*

The use of foreign workers was even more common among Malaysian garment companies than among Singapore garment companies, with more than three quarters of the companies in the survey employing such workers. Moreover, even the domestically oriented OEM II companies and subcontractors frequently engaged in such labour strategies. The fact that levies were often diverted to the foreign workers, has probably meant this strategy was affordable for smaller companies as well (unlike was the case in Singapore). The average share of foreign workers in companies that employed them was approximately 37 percent (1998) and among subcontractors it even was 50 percent.

Having workers work overtime was a second very popular measure to deal with labour shortages and peaks in orders. Again, the use of this option was even more widely used in Malaysia than was the case in Singapore.

On the other hand a number of companies had also engaged in more pro-active labour strategies aimed at upgrading skills and productivity, such as multi-tasking and worker training. Multi-tasking has often been associated with labour flexibilisation and work-teams used in modular manufacturing systems (see e.g. Taplin, 1996). Training programs were implemented by almost two thirds of all companies, but it must be noted that the majority of this training took place on-the-job. In other words, workers were advised and corrected by their supervisors during their work. Only a few companies engaged in more formal and fundamental forms of worker training and sometimes even had separate departments for training and human resources development.

#### *Outsourcing strategies*

Both capacity subcontracting and specialisation subcontracting were popular among Malaysian garment companies, but only a small percentage of companies had increased the amount of subcontracting over the past 10 years, with the exception of the companies in the Local label and to a lesser extent OEM II categories. Most likely these companies were less restricted by their buyers in terms of further subcontracting of production. Moreover, for these companies setting up their own branch plants or subsidiaries was often not possible due to capital constraints.

### 7.3.2 *Offensive Strategies*

#### *Relocation strategies*

In stark contrast to what was observed in Singapore, only a small share (18 percent) of companies had invested in overseas establishments (in Singapore this share was 60 percent). The

cost increases and labour shortages experienced by most companies thus did not result in a substantial outward investment by the industry in lower cost countries in the region. Most companies still seemed to prefer solving labour problems 'at home', either through the employment of foreign workers or the setting up of branch factories in peripheral (e.g. along the Thai border) or rural areas, so as to tap into unused sources of labour *within* Malaysia. The investments that did take place were almost all accounted for by the OEM I group, which is not surprising considering their generally larger size and capital.

Several managers said there was still labour available locally, but the local population was often not willing to travel far to work, or to move closer to the factories. They preferred remaining in their rural communities and villages (Kampongs). In order to tap into these sources of labour, factories thus had to move closer to these people.

The continued possibility to make use of foreign workers to solve labour shortages has also discouraged relocation of production overseas. As far as relocation of production has been established or is considered, this is not necessarily seen as part of a more general internationalisation strategy, altering the functions and role of the Malaysian establishment.

As far as plans for the future go, relocation strategies will most likely become more important and indeed 53 companies indicated they had plans to invest in overseas subsidiaries, while 14 considered overseas subcontracting. Popular locations were Southeast Asia (43) and particularly Indochina<sup>15</sup> (31), Africa (11), HK/China (10) and South Asia, i.e. Bangladesh (7) and Sri Lanka (3). However, even for the future, only 5 companies envisioned relocation strategies to be part of a more general internationalisation strategy, where direct involvement in production of the Malaysian establishment was reduced and the focus shifted on production organisation and other non-manufacturing activities. This is also reflected in the fact that 79 companies (almost 68 percent of all companies) said they still wanted to increase the number of (production) workers in their establishment, while 33 said they wouldn't change the existing number. Clearly the focus of the companies in the survey was still predominantly on a production function, which was centred on production in-house or at least in Malaysia. A surprising result considering the continued problem of labour shortages and increases in labour cost. Obviously most of the companies in the survey are firmly rooted in their OEM roles. Although this was the case in Singapore as well, here this role was combined with a very deliberate internationalisation strategy and a shift away from direct involvement in production (i.e. towards OEM+ roles).

### *Technology*

Although 60 percent of all companies indicated they had invested in new technologies in the past 10 years, as was already observed in section 7.1, generally the level of technology is low and a great deal of these investments were not in the most advanced technologies and machines, while many also involved replacements. Also a large number of investments involved the kind of inspection machines often required by buyers or necessary due to their requirements, such as fabric inspection machines (to inspect fabrics when they are brought in and detect defects before the fabrics enters the production process) and needle detection machines (to check finished garments for broken or stray needles that may have accidentally been sewn into the garment).

Finally, in recent years a number of companies have introduced IT applications in the monitoring and planning of the production process, or so-called management information systems (MIS) and resource planning (ERP) systems. Such applications have been promoted by the industry associations as relatively cheap ways to increase efficiency and internal information flows. Particularly in the Southwest region these kind of technologies have been pioneered by a number of companies, as a local technology-based company located in the region had developed an ERP and MIS specifically for the garment industry (box 7.1). Although not widely adopted as of yet, the companies that had, listed positive results and a number of companies were considering or in the process of setting up these systems in the near future. The idea behind such

systems is to eventually integrate information across different units of a company, and link to buyers for online services and e-commerce applications.

**Box 7.1 IT Applications in Garment Manufacturing: Enterprise Resource Planning (ERP) and Management Information Systems (MIS)**

Two important IT applications in garment manufacturing are ERP and MIS. Enterprise resource planning involves the use of specific software packages, often tailored to the needs of a particular industry such as the garment industry, which automate the business process, e.g. sales order quotation and sales processing, fabric and accessories purchasing, inventory control, production control, work-in-progress tracking, material requirements planning and shipping including human resource information and payroll. Management information systems, involve software to capture and display real-time information for production management progress.

New Paradigm Technologies, a Malaysian technology based company, developed such systems for the textile and apparel industries specifically: *G•PRO* (MIS) and *GARMATE* (ERP). Although such tailored systems are also available from other (international) providers and their agents, the presence of this company in the Southwestern region has meant a relatively large number of garment companies in this region had in fact implemented at least one of these systems.

With *G•PRO* the conventional ticketing system is replaced by so-called SmartTags, which are read/write tags (information carriers) able to store information, which can be downloaded onto individual terminals, which capture vital production data at source in real-time and transmits the data through the computer network. Data can then be accessed through a specific software package, which presents live production data on demand in the form of graphics and reports. The system thus automates data collection and enables real-time production status feedback and online analysis. This may help in improving productivity, as problems and bottlenecks can immediately be detected and even anticipated, allowing for a quick response. All work in progress can be closely monitored, giving management real-time information of the productivity and production status at any given time. This in turn provides management with facilities and information for effective control, and may serve as a management decision support system and a quality control and audit system.

The *G•PRO* system may in turn be linked to other networks and systems, both within and outside the establishment. For instance it can be linked to CAD/CAM systems, to payroll administration systems, but also to ERP systems such as *GARMATE*. In addition, through computer networks and ISDN lines it can enable a head office to monitor branch operations. Finally, by integrating the technology into the web it may allow buyers to share production information in real time.

Although most of the companies that had implemented the *G•PRO* system were mostly still using it as an in-house MIS, several had the intention of extending it to a company wide IT business solution linking to both suppliers and buyers. Such systems may reduce lead-times and greatly increase flexibility, reliability and communication hence services to buyers.

*Source: [www.gprosystem.com](http://www.gprosystem.com) (2003); [www.binbingroup.com](http://www.binbingroup.com) (2003)*

The higher share of companies indicating to have engaged in technology strategies in Malaysia as compared to Singapore is likely to be a direct consequence of the stronger production and manufacturing focus (direct involvement in production) of companies in Malaysia in general.

*Capability development production process*

Almost 70 percent of the respondents indicated they had implemented strategies aimed at improving manufacturing capabilities. In most cases however, this involved the gradual improvement of manufacturing capabilities and it had taken place mostly in the OEM I companies. These companies had little choice but to do so if they wanted to retain their buyers. They were required to take on more responsibilities in the area of quality control, logistics and supply chain management, etc. Such strategies on the other hand played a minor role for subcontractors, who limited themselves mostly to assembly activities.

Only a small number of companies had made fundamental adjustments in their core competencies or capabilities, for instance by developing design capabilities, moving from CMT to OEM supply, etc.

In terms of production process and organisation, most producers indicated to have successfully increased productivity and flexibility in the past ten years and subsequently to have reduced lead times. Such gains were achieved mostly through upgrading of worker productivity, or as some producers put it: 'pushing workers harder', and less so through technological upgrading. In addition many companies also indicated to work more closely with suppliers to jointly try and reduce lead times.

At the time of the survey, 61 percent of respondents rated their productivity as medium to average, while 26 percent considered their productivity to be above average. These numbers are subjective though and most companies did not have ways to really measure their productivity, as they didn't have good benchmarks. Several of the large, foreign owned companies with establishments in several countries and regions did have such benchmarks and measurements. One of these indicated that their Malaysian operations ranked below Taiwan and Hong Kong, but above Thailand and China in terms of productivity (*-Interview manager Malaysian garment company, 2000*). This still doesn't say much about the general productivity level of Malaysian garment companies though, as it only applies to productivity levels within one specific group.

According to the National Productivity Corporation (NPC), productivity in the garment industry, as measured in sales value per employee, has declined 3.3 percent on average between 1997 and 2002. Added value productivity, i.e. the value added per employee, still showed an average increase of 0.9 percent in that same period, but the trend since 1999 was that of decline. The manufacturing sector as a whole, on the other hand, recorded an average annual growth of productivity (sales value per employee) and added value productivity of 7.3 percent and 7.5 percent respectively in that same period (Goh, 2003).

These comparisons give some indication of productivity levels in the industry, although more structured (international) benchmarking would be necessary to give a more accurate picture. It would appear the industry's national productivity performance is lagging behind, while regionally it takes a position somewhere in the middle league.

As most companies saw process, and particularly productivity, improvement, as an important way to face competition and retain buyers, they were asked how they intended to achieve these increases in productivity. The results are presented in table 7.14.

Most potential for improving productivity is clearly seen in the 'stream-lining' of the production process through the upgrading of skills, equipment and the workflow (industrial engineering). Surprisingly, however, the application of IT technologies did not score high, despite the fact that it has been heavily promoted by the main industry association and such technologies are locally available (see box 7.1) and specifically developed for garment.

**Table 7.14 Increasing Productivity**

| How increase will be achieved   | Frequency of answer | Percent |
|---|---------------------|---------|
| • Upgrade worker skills   | 65                  | 55.5    |
| • Upgrade equipment   | 48                  | 41.0    |
| • Process improvement/industrial engineering                              | 20                  | 17.1    |
| • Invest in IT applications   | 17                  | 14.5    |
| • Give more incentives/self-responsibility to workers or push them harder | 13                  | 11.1    |

This may be due to the fact that many of the older managers see IT technologies as too advanced for the garment industry. However, the new generation of managers, often educated

in at least basic IT technologies, may see this differently and have less 'fear' of these technologies.

### *Marketing and market strategies*

Approximately 56 percent of companies indicated they had changed their buyer base, upgrading or expanding the buyers they worked with. Generally speaking this involved the adding of new buyers to the existing base. For instance, as was observed in section 7.1, the client base of Malaysian OEM I producers is still very diverse. Although a move towards higher-end buyers can thus be observed, it does not appear to imply an abandonment of lower-end buyers (yet?). The high share of subcontractors having engaged in such marketing strategies is on the one hand due to the fact that they follow their main clients. In other words if the subcontractor works for a manufacturer that has added new higher-end buyers to its buyer base, he also considers 'its' buyer base to have changed. On the other hand, a number of companies in this category had added OEM supply to subcontracting, which meant they had added US/European buyers to their existing client base of local manufacturers. The changes in the buyer base are reflected in the changed market focus for OEM I producers and subcontractors. However, it was probably also a reflection of changes in market focus of buyers, which OEM suppliers have followed.

The changing market focus of OBM suppliers had more to do with strategies aimed at segmenting markets into different niches or focusing on different ones than before. In addition a number of these companies came from an OEM II background, thus their market focus had changed substantially.

For most OEM I companies extending their services to buyers was another important marketing strategy, aimed not so much at upgrading marketing linkages perse, but at strengthening these linkages and building on relationships with buyers.

Despite this general tendency of moving towards higher-end buyers and a general wish among garment manufacturers to move into export markets and work to the order of large Western buyers, some manufacturers mentioned the drawbacks of such a role or position and had deliberately opted for alternative strategies making them less dependent on buyers. One of the managers for instance, complained about its main buyer, GAP, saying it would in fact prefer to supply to less demanding buyers. Although GAP's orders are usually big, demands and requirements are very stringent and margins for producers in fact very small. The company was thus looking for ways to reduce its dependence on this one buyer and one of the routes chosen was the development of a local kid's wear brand, which was sold through own outlets in Malaysia. Although this still made up only a small part of total output and the sheer size of GAP's orders meant it could not easily be discarded, the company was consciously adopting a strategy that may eventually lead to a disconnection from chains.

Another example of a company deliberately choosing to operate outside GCCs is presented in box 7.2.

#### **Box 7.2 Case Study: Hing Yiap Knitting Bhd**

##### **Company background**

Hing Yiap Knitting was established in in Kepong, Selangor 1971 as a small knitting factory. Knitting activities were soon expanded with dyeing, cutting and marking activities, as well as the production of garments. The range of products at the time was still limited to plain singlets and T-shirts, which were produced on a contract basis and sold to local wholesalers and small retailers. From the mid 1970s onwards, the product range was extended with more and more sophisticated products, such as tracksuits, jackets, sweaters, polo's, shorts and pants. This was made possible because of growing demand for the company's products and the subsequent acquisition of new machines and technology, which allowed the company to manufacture such more complicated products.

In 1975, Hing Yiap was incorporated as a private limited establishment and business rapidly expanded to a broader market and customer base. The factory was upgraded and equipped with in-house knitting, dyeing, designing, tailoring, cutting, finishing and distribution facilities.

Subsequently, in the mid to late 1980s, Hing Yiap introduced two own brand labels for the local markets: Antioni (1986) and Bontton (1989). Thus emphasis was shifted away from contract manufacturing to own brand development, manufacturing and marketing. The success of their own brand labels also allowed them to eventually obtain licenses for the manufacturing and marketing of two American based brands for Malaysian and Southeast Asian markets: B.U.M. Equipment (1993) and Diesel (1998). In addition, in the late 1990s, the company obtained a marketing license for US intimate garment brand Vanity Fair. Further integration into marketing was established through the setting up of a large lifestyle chain-store targeting teenagers and young adults, with the intention of gradually increasing the number of such stores.

All in all the company managed to achieve impressive growth since its humble beginnings and by 1999 had evolved into a company group with six individual establishments and more than 600 employees. In terms of its organisation structure it had developed from a hierarchically organised family business into a flatter organisation, with increased responsibilities for individual employees. In addition family ownership was transferred in 1997, when Hing Yiap had its IPO and became a publicly listed company on the KLSE Second board.

### **Current structure and organisation of the company**

By 2002, Hing Yiap was a fully integrated company, handling almost all fabric knitting, dyeing, design, garment production, finishing and distribution/marketing in-house and producing exclusively for its own and its licensed brands. In addition it was venturing into marketing and retailing. The company employs approximately 1,500 employees in total both in manufacturing as well as marketing. The manufacturing plant produces about 750,000kg of fabric a year & approximately 3.5 million pieces of garment per year. The marketing company on the other hand sells about 7 million pieces of garment a year; in its own label as well as international labels in the territories of Malaysia, Singapore and Brunei.

Hing Yiap takes care of most of the design and product development for its licensed brands, and is merely dependent on the license holders for approval of designs. All brands are marketed and distributed through separate units, which also take care of design. Products are sold through department stores on a consignment basis.

The two own brands, Antioni and Bontton are a sportswear brand and a sports/casual wear brand respectively and positioned in the mid-segments of the local markets. The two licensed brands are 'fashion lifestyle' brands with a distinct image. For B.U.M. Equipment Hing Yiap holds a license for the entire Southeast Asian market, yet at this point the brand is only marketed and sold in Malaysia, Singapore and Brunei, although the company planned to penetrate more markets in the region in the near future. Products marketed under the B.U.M. brand name include not just garments, but also shoes and other fashion accessories such as bags and watches, which are all sourced through a separate trading company.

The license for Diesel has only recently been acquired and although it is for the entire Southeast Asian region as well, is only still marketed and sold in Malaysia. When sufficient market share and strength are reached in this market, the company has plans to expand this brand regionally as well though. The same is the case for the marketing and distribution of the Vanity Fair brand.

Production for all four brands is mostly taken care of by Hing Yiap's own manufacturing facilities, although the company does source out some of its production, most notably that of woven products (which make up only a small share of total output). Knitted fabrics are all produced in-house from imported yarns (India, Pakistan), although occasionally some capacity subcontracting takes place. All dyeing is performed in-house.

Woven fabrics on the other hand, are bought in, cut and subsequently sent out to subcontractors for assembly. In addition, some woven garments are sourced ready made from overseas on a contract manufacturing basis (in other words, Hing Yiap also functions as a garment buyer). Knitted garments are still almost all produced in-house and form the bulk of the company's output.

Approximately 90 percent of the company's output is sold in local markets, while exports go to Singapore and a small (and decreasing) share to Sweden.

### **Strategic focus and company development trajectory**

From the very start, downstream vertical integration has been one of the core strategies of the company. This extended not just to the integration of textile and garment production, but also beyond production into design, brand development, marketing and most recently retailing. According to the company, this

integrated structure allows better control over costs, quality and delivery schedules, as well as short lead times, quick response and flexibility.

The company's branding strategy has been at the core of its development since the late 1980s. Two own brands, with deliberately European/Italian sounding names, were positioned in the mid segments of the market, while the company's licensed brands were seen to push the company into the higher segments of the market. The bulk of the company's output has always been sold in local markets.

Both the development of own brands and sales in local markets have been part of two deliberate and interrelated strategies: first to eliminate dependence on buyers and second to remain outside the networks and chains of large international buyers, in other words not to opt for an export oriented OEM role. According to the management, they preferred producing and marketing for local and regional markets under their own or licensed brands as it allowed for much greater control over the company's own activities. Producing on an OEM basis, especially for large Western buyers, would mean giving up a great deal of freedom in decision-making and of control, while profit margins would be squeezed. An extra chain trajectory was seen as preferable and the development of the company demonstrates it can be profitable, and upgrading and development do take place in such trajectories as well. This was owed mostly to the dynamic and visionary management of the company, which had over the years become completely professionalised

For the future, however, it was argued that it would become increasingly difficult to maintain the vertically integrated basis of the company, specifically in the areas of textile and garment production, as competitive pressures and issues are most pressing in these areas. For instance stricter environmental standards cause problems for the dyeing process because of the cost of waste-water treatment. In addition, in garment production, labour shortages and obtaining foreign workers have become pressing issues, driving up cost. Finally, the company feels that regional integration and the phasing out of the MFA by 2005 will further decrease manufacturing competitiveness in Malaysia. The focus of the company is therefore shifting towards brand development and marketing, with a potential phasing out of production, for instance by contracting out garment production to producers in China. Finally, the company is looking to expand the marketing and distribution of its own and licensed brands into the Southeast Asian region.

*Sources: Interview (1999); Leusink & Veldhuisen (1999); [www.hingyiap.com.my](http://www.hingyiap.com.my) (2003)*

### *Product & branding*

Just as in Singapore, almost all companies had improved product quality and approximately 67 percent had moved into the production of higher value added and more sophisticated products. Such a move was most common among OEM I companies and subcontractors, which in the case of the former group is directly driven by changes in buyer strategies and demand and in the case of the second group indirectly, via their main customers. On the other hand OEM II suppliers were less inclined to make such shifts, as demands from their buyers in this respect were less and as they generally produced for low- to mid-end local market segments.

More surprising was the fact that product strategies, outside quality improvements, were not as prominent among OBM suppliers. Perhaps this says something about the level of sophistication of local brands, or perhaps the focus of companies in this group was more on branding and marketing than on product per se. This may also be the reason why only half of the OBM companies indicated to have developed their design capabilities. Most probably were not so much involved in the development of original, innovative designs, but more in basic designs, based on existing trends and products in (international) markets (see box 7.6). Design capabilities beyond the basic copying of existing designs were thus not necessary.

Generally speaking, development of design capabilities had not been a commonly applied strategy, particularly not among the OEM I companies and neither was brand development, even though these were the kind of strategies strongly promoted in IMP-2 as one of the keys to upgrading of the industry. The brands that have been developed by manufacturers make up a very small part of total output. Similar limitations to this shift from mass manufacturing to brand development and marketing as were observed in the case of Singapore apply: the difficulties of moving from large- to small-scale production or small batch sizes and short runs (high sunk

cost) and the substantial 'capability gap' between design, marketing and retailing on the one hand and production on the other, bringing with it substantial switching costs and risk.

Although 42 percent of the small OEM II suppliers claim to have introduced and developed their own brands, these are usually lower-end labels destined for domestic markets through for instance supermarket chains and factory outlets. Only a very small number of firms has actually committed itself to brand development, often leaving actual production to subcontractors, while focusing on sales and marketing of their product, through established distribution linkages and sometimes even through their own retail outlets.

The biggest difference between Singapore and Malaysia in terms of design and branding is the fact that in Singapore, among OEM I suppliers, the development of design capabilities was much more common (almost 40 percent of OEM I companies had implemented such strategies). The development of these design capabilities were not necessarily geared towards own brand development, but rather towards added and enhanced services for buyers and a general trend of assuming more responsibilities, thus shifting towards OEM+ type roles. Obviously this trend is hardly noticeable in the case of Malaysian OEM suppliers

The clear sequencing of strategies that was observed in the case of Singapore is less obvious in the case of Malaysia, as only a few companies have truly shifted away from process and production oriented strategies, although in recent years it has become clear that continuing to rely on the most defensive strategies such as the use of foreign workers is becoming increasingly difficult, perhaps signifying a shift towards more offensive strategies.

Overall strategies up till the late 1990s, however, appear to have been more conservative than was the case in Singapore.

### 7.3.3 Outcomes of Competitive Adjustment Strategies

Effects of strategies may be measured both quantitatively and qualitatively. An overview of quantitative changes is given in table 7.15 below.

The most notable difference with the Singapore case is the fact that in Malaysia almost all companies experienced moderate to substantial growth of *all* factors, with the exception of value added and the profit margin, which more often had remained more or less the same. Despite mounting labour shortages, in most companies even the number of employees had increased - in almost a third of the companies substantially.

**Table 7.15 Indication<sup>1</sup> of Quantitative Changes in Malaysian Establishment (1989-1999)**

| Change                 | All companies<br>(N=117) |    |    |    |   | OEM I & OBM Mfg.<br>(N=64) |    |    |    |   | OEM II/Local label<br>(N=28) |    |    |    |    | OBM & ODM/OBM<br>(N=8) |    |    |    |   |
|------------------------|--------------------------|----|----|----|---|----------------------------|----|----|----|---|------------------------------|----|----|----|----|------------------------|----|----|----|---|
|                        | 1                        | 2  | 3  | 4  | 5 | 1                          | 2  | 3  | 4  | 5 | 1                            | 2  | 3  | 4  | 5  | 1                      | 2  | 3  | 4  | 5 |
| <b>Annual turnover</b> | 48                       | 34 | 11 | 0  | 1 | 47                         | 36 | 9  | 0  | 0 | 50                           | 29 | 18 | 0  | 0  | 75                     | 25 | 0  | 0  | 0 |
| <b>Sales</b>           | 46                       | 33 | 10 | 2  | 1 | 50                         | 33 | 11 | 0  | 0 | 43                           | 39 | 7  | 7  | 0  | 75                     | 13 | 0  | 0  | 0 |
| <b>Value added</b>     | 9                        | 27 | 27 | 3  | 0 | 13                         | 28 | 27 | 5  | 0 | 4                            | 25 | 29 | 4  | 0  | 13                     | 13 | 50 | 0  | 0 |
| <b>Fixed assets</b>    | 31                       | 33 | 26 | 0  | 1 | 39                         | 34 | 20 | 0  | 0 | 21                           | 29 | 32 | 0  | 4  | 25                     | 50 | 25 | 0  | 0 |
| <b>Employees</b>       | 32                       | 32 | 20 | 6  | 4 | 36                         | 31 | 20 | 5  | 3 | 25                           | 29 | 14 | 14 | 11 | 50                     | 38 | 13 | 0  | 0 |
| <b>Profit margin</b>   | 5                        | 29 | 34 | 18 | 2 | 6                          | 38 | 31 | 14 | 2 | 0                            | 21 | 43 | 18 | 0  | 13                     | 13 | 25 | 50 | 0 |

<sup>1</sup> For an explanation on the interpretation of the table see table 6.11 in the previous chapter

This would suggest growth was achieved mainly through the mobilisation of more resources (both capital and labour) rather than through productivity increases and efficiency gains. It is hard to gauge from such numbers alone whether and how these changes were a consequence of specific strategies. Moreover, they say little about changing functions and roles of companies,

possibly leading to upgrading development trajectories. Therefore changes in production and the functions of companies need to be considered in more detail.

### *Changes in production*

Considering the main changes that had occurred in terms of production cost, quality and capacity, several patterns and trends can be noted that may have been the result of implemented strategies (see table J in the appendix).

First, despite labour intensification, outsourcing and other cost retention strategies, most companies' business costs increased (77 percent of companies reported an increase). Labour costs seem to have been the biggest contributor to these cost increases and for most companies (more than 70 percent) these costs have started weighing heavier on total business cost (i.e. the share of labour cost in total cost increased).

However, of the 89 companies, which saw an increase in production cost, 28 (or 31 percent) managed to maintain their profit margin and 32 (36 percent) even reported an increase in the profit margin. This could imply strategies aimed at increasing productivity or at shifting towards higher value-added products and buyers have been successful in offsetting cost increases<sup>16</sup>.

Of the 82 companies that reported an increase in productivity, 37 (45 percent) indicated a small, 34 (41 percent) a moderate, and 11 (13 percent) a substantial increase. However, as demonstrated in the previous section, productivity development is ambiguous due to a lack of good benchmarks. The increase recorded here is measured against the company's previous performance, but says little about developments compared to other companies, industries or countries.

Of the small number of companies that were not operating at full production capacity, for only three this was the result of a deliberate strategy. This included two companies that had relocated capacity overseas and one said to have shifted towards producing higher-end products in smaller quantities. For most other companies that were not operating at full capacity this was a temporary issue related to shortages of labour.

In contrast to what was observed in Singapore, only approximately 15 percent of respondents indicated to have reduced employment in the Malaysian establishment (compare to 54 percent in Singapore), and production restructuring to the extent as experienced in Singapore has clearly not taken place (yet).

However, approximately 65 percent of companies said their need for skilled labour had increased. This could imply complexity and skill intensity of products and production activities have increased and thus could be the result of strategy.

These indicators seem to point towards a general trend of upgrading within production towards higher value added products and buyers.

### *Shift in business emphasis and main functions*

The majority of companies in the survey indicated they had not substantially changed their business emphasis and functions in the past 10 years and were still either manufacturing garments for third parties (OEM I and OEM II) or manufacturing and/or marketing their own brand or label. Approximately 37 percent of all companies (43 in total) said they had changed their functions, yet of these companies, 28 (or 65 percent) reported this change to involve additional control over (more) subsidiaries and/or subcontractors (most of which were located in Malaysia). This did not, however, imply a substantial change in actual functions or the role of the company (which was still focused on production). Only 8 companies indicated they had shifted production to these new subsidiaries and/or subcontractors, while they now concentrated mainly on non-production activities. Another 4 mentioned to have added responsibilities in terms of marketing/retailing to existing functions.

A number of companies (16) had moved from production for local manufacturers (subcontracting) to (some) direct OEM supply and had thus changed their production role within networks and chains to full package suppliers.

Finally, although 34 companies said they had introduced or developed their own brand/label, only 6 (5 percent of total and 18 percent of companies that had introduced own brand/label) said this had entailed a shift in emphasis toward the production and marketing of this own brand/label.

Fundamental changes in the functions and role of the company were thus not common and implemented strategies had mostly achieved expansion and advancement within existing roles. It is not clear whether this will change in the near future either, despite the fact that many companies recognised the countless imminent threats to their competitiveness. For instance when asked about plans for the future in terms of the function of the Malaysian establishment and number of employees there, 47 companies said they indeed had plans to change the function of their Malaysian establishment, but in 33 of these cases (or 70 percent) this meant an increase in manufacturing capabilities and services to buyer, without substantially changing the role of the establishment. In addition, as was discussed above, the vast majority of companies (96 percent) were planning to retain or increase the number of production workers in their Malaysian establishment, suggesting a continued production role.

The sometimes rather contradictory plans for the future were probably a consequence of the fact that most managers appeared to have positive views on their own business, even if they had more negative expectations for the industry as a whole. They expected competitive pressures would not affect their own business as much as it would others (see table K in the appendix to this chapter). However, contradictory plans for, and views on, the future may also have had to do with management not always being well informed or having a clear vision on the company's future strategic direction.

#### 7.4 Firm Level Development Trajectories

Table 7.16 presents eight generic company development trajectories that could be identified in Malaysia while table 7.17 specifies these trajectories further by dividing them in 'sub-trajectories' and providing an insight into the starting point and current position of companies.

It appears the majority of companies (more than 70 percent) have followed steady trajectories, i.e. changes have taken place within the same role (see box 7.3).

**Table 7.16** *Generic Company Development Trajectories*

|                                 | Generic trajectory <sup>1</sup>                    | no. of companies | Share  | Sub-trajectory (see table 7.17) |
|---------------------------------|--|------------------|--------|---------------------------------|
| A.                              | OEM I → OEM I (steady)                             | 50               | 42.7 % | 1/2/3                           |
| B <sub>1</sub> & B <sub>2</sub> | Subcon/OEM II → Subcon/OEM II (steady)             | 17               | 14.5 % | 4/6/12/15                       |
| C <sub>1</sub> & C <sub>2</sub> | Subcon/OEM II → OEM I                              | 11 <sup>2</sup>  | 9.4 %  | 5/13/14                         |
| D.                              | OEM II → OEM I & OEM II                            | 5                | 4.3 %  | 7/8                             |
| E <sub>1</sub> & E <sub>2</sub> | OEM II → Local label/OBM                           | 6                | 5.1 %  | 9/10/11                         |
| F <sub>1</sub> & F <sub>2</sub> | Local label/OBM → Local label/OBM (steady)         | 11               | 9.4 %  | 18/19/20/21                     |
| G.                              | OBM Mfg. → OBM Mfg (steady)                        | 5                | 4.3 %  | 16/17                           |
| H.                              | Textile producer → integrated company (downstream) | 2                | 1.7 %  | 22                              |
| I.                              | Other  | 10               | 8.5 %  | -                               |
|                                 | <b>Total</b>                                       | 117              | 100. % | -                               |
|                                 |  |                  | 0      |                                 |

<sup>1</sup> For an explanation see table 6.15 in chapter 6

<sup>2</sup> Including two companies still involved in subcontracting

**Table 7.17** *Company Development Trajectories in the Malaysian Garment Industry*

| Starting point        | Trajectory   | Current role/ position | No. of comp. | Share (in %) |
|-----------------------|--|------------------------|--------------|--------------|
| <b>OEM I</b>          | 1. OEM I steady                                      | OEM I                  | 45           | 38.5         |
|                       | 2. OEM I → added own brand (≤ 20% of total output)   | OEM I                  | 4            | 3.4          |
|                       | 3. OEM I → diversified/integrated into textile       | OEM I                  | 1            | 1.0          |
| <b>OEM II</b>         | 4. OEM II steady                                     | OEM II                 | 10           | 8.5          |
|                       | 5. OEM II → shift to OEM I & added own label/brand   | OEM I                  | 1            | 1.0          |
|                       | 6. OEM II → added own label (≤ 20% of total output)  | OEM II                 | 3            | 2.6          |
|                       | 7. OEM II → added some OEM I                         | OEM II & OEM I         | 2            | 1.7          |
|                       | 8. OEM II → added some OEM I & own label/brand       | OEM II & OEM I         | 3            | 2.6          |
|                       | 9. OEM II → shift to local label                     | Local label            | 3            | 2.6          |
|                       | 10. OEM II → shift to OBM                            | OBM                    | 2            | 1.7          |
|                       | 11. OEM II → shift to OEM/ODM & OBM                  | OEM/ODM&OBM            | 1            | 1.0          |
| <b>Sub-contractor</b> | 12. Subcon. steady                                   | Subcontractor          | 3            | 2.6          |
|                       | 13. Subcon./CMT → shift to full package OEM I        | OEM I                  | 8            | 6.8          |
|                       | 14. Subcon. → shift to OEM I, but still some subcon. | OEM I & subcon.        | 2            | 1.7          |
|                       | 15. Subcon./CMT → shift to full package OEM II       | OEM II                 | 1            | 1.0          |
| <b>OBM Mfg</b>        | 16. OBM Mfg steady                                   | OBM Mfg                | 4            | 3.4          |
|                       | 17. CMT → full package                               | OBM Mfg                | 1            | 1.0          |
| <b>Local label</b>    | 18. Local label steady                               | Local label            | 5            | 4.3          |
|                       | 19. Local label → added some OEM I                   | Local label            | 1            | 1.0          |
|                       | 20. OBM/Local label → added OEM/ODM                  | OEM/ODM&OBM            | 1            | 1.0          |
| <b>OBM</b>            | 21. OBM steady                                       | OBM                    | 4            | 3.4          |
| <b>Textile prod.</b>  | 22. Textile → diversified/integrated into garments   | Textile based          | 2            | 1.7          |
| <b>Other</b>          |  | Other                  | 10           | 8.5          |
| <b>Total</b>          | -  | -                      | 117          | 100.0        |

Table 7.17 illustrates that a trajectory followed by an individual company may fit into a certain generic trajectory category (e.g. OEM I steady), but be slightly different from that followed by another company in that same generic trajectory (e.g. also added brand, but this makes up less than 20 percent of total output).

### **Box 7.3 Case Study: Tai Wah Bhd**

#### **Company background**

Tai Wah Garment Industries Sdn Bhd was incorporated in Johor Baru (JB) in 1969 and commenced operations in 1971 as a manufacturer of knitted polo-shirts and pullovers for export. It was a subsidiary joint venture of a Singapore garment manufacturer, but eventually all operations were shifted to JB and Tai Wah became the company headquarter. By the late 1990s there were no more operations in Singapore, although there was still a 20 percent Singaporean ownership in the company.

The company has operated on a full package basis from the start of operations in 1971, producing to the order of low- to mid-end non branded buyers. Exports were all to/through Singapore though.

In the early 1980 the company directly penetrated into international markets, exporting directly to European and US markets. The product range was extended to include pants and shorts, yet remained focused on knitwear. In the meantime the buyers base was expanded and upgraded, so by the late 1980s the company had shifted to producing mostly for international branded buyers and specialty retail chains.

From the mid 1980s, following its shift to direct exports, orders increased substantially and the company expanded its capacity accordingly, by setting up manufacturing branches in different locations within the State of Johor.

Finally, in an attempt to develop downstream activities, the company entered into an alliance with Ramatex, one of the country's biggest integrated textile companies, which, however had its origins (and up till date its main focus) in textiles production. The idea behind this alliance is that it would provide Tai Wah with access to (knowledge about) downstream activities, while it would help Ramatex improve its

textile product quality up to international standards, as Tai Wah was producing to the order of some of the most demanding international buyers. Although the agreement initially didn't work out as imagined, the two companies nonetheless prolonged their alliance and in 2001, Tai Wah set up a garment factory in Windhoek, Namibia (Tai Wah Garments & Manufacturing), in alliance with Ramatex and following the latter's set up of a large textile mill in Namibia a few months earlier. These subsidiaries were to take advantage of the AGOA (see chapter 1) for access to US markets.

#### **Current structure and organisation of the company**

By 1999, Tai Wah had developed into a large scale OEM Supplier, with 12 manufacturing establishments in Malaysia, producing on average 6 million pieces a year, employing more than 2700 people and generating an annual turnover of approximately US\$ 48 million (1997). In 2001 another 1500 employees were added in Namibia.

In 1999, Tai Wah was the largest supplier for Nike in Malaysia and the 6<sup>th</sup> largest supplier to Nike in Southeast Asia. Approximately 55 percent of Tai Wah's output was dedicated to Nike. Other important clients included Adidas, Gear for Sport, Eddy Bauer, Puma and GAP. Relationships with these buyers was often long standing, with some going back more than ten years.

The company specialises in knitted casual and sportswear, still mostly polo-shirts and pullovers (80 percent of output is knitted tops).

All production takes place within the company and only occasionally sewing activities are subcontracted (capacity subcontracting). However, Nike, the company's main buyer did not allow subcontracting. Before the set-up of the Namibian subsidiary, approximately 15 percent of all output was produced in the Tai Wah's main establishments, while the branches accounted for 85 percent of total output. There was a distinct division of labour between the headquarter in JB (the original factory), which performed all sales and marketing, purchasing, warehousing and distribution activities as well as some of the cutting; and the subsidiaries, two of which also performed cutting, while the rest was involved in assembly (Make-Trim).

#### **Strategic focus and company development trajectory**

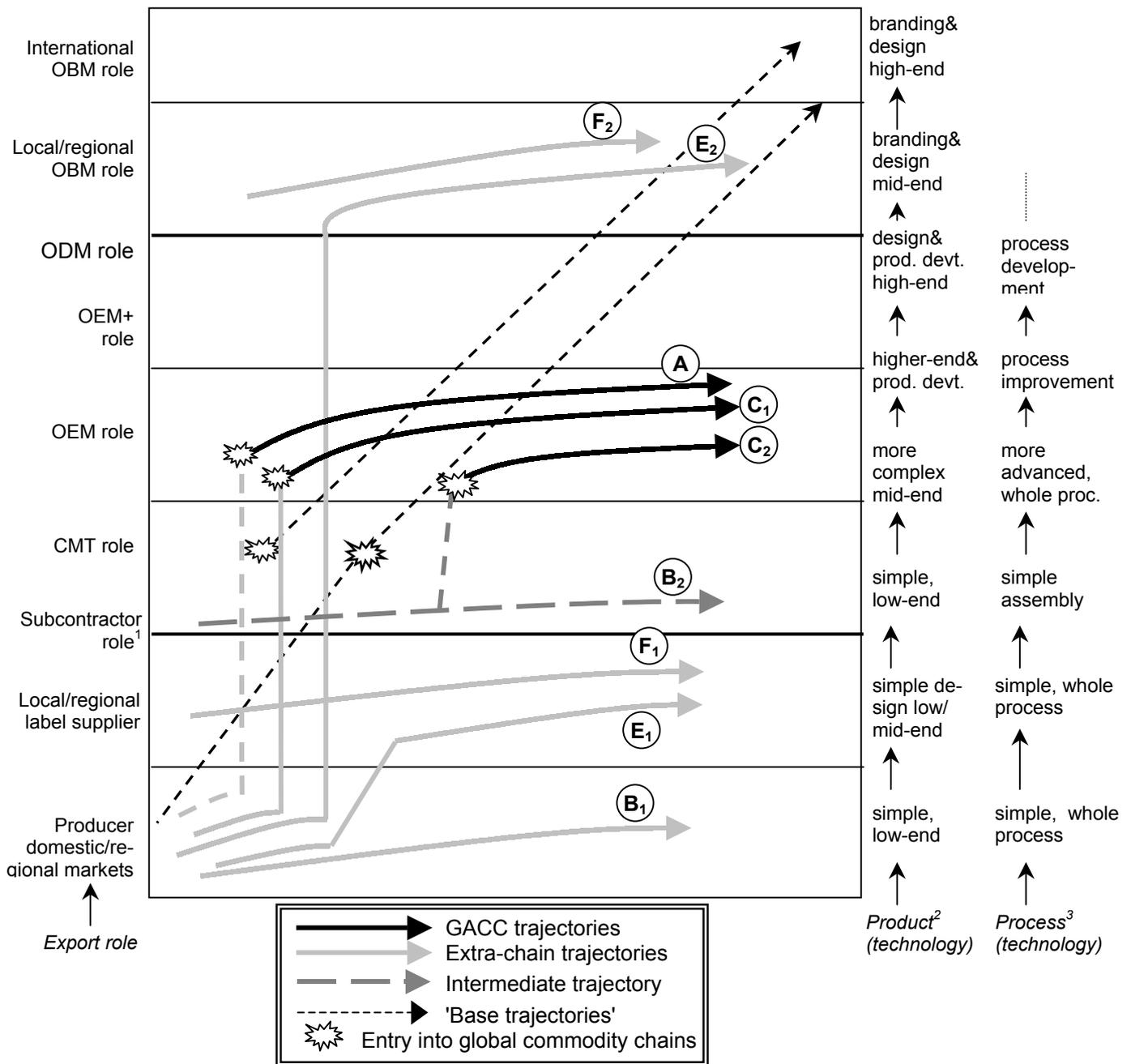
Tai Wah has followed a very outspoken steady OEM trajectory, in which the main strategy has been to develop and upgrade manufacturing capabilities to live up to the requirements of the most demanding buyers and build good relationships with these buyers by becoming a high-quality, reliable supplier. Advanced machinery such as CAD/CAM systems, computerised cutting machines and a hanger system were installed in several of the companies branches and there were plans to install hanger systems in all. In terms of products Tai Wah had deliberately focused on the production of less labour intensive high volume products such as polo-shirts and pullovers, while it was slowly phasing out more complicated (hence labour intensive) products such as jackets. These process and product strategies have enabled the kind of high volume, efficient, high quality production necessary for producing to the order of large scale international buyers like Nike and GAP. However, there have been no apparent moves beyond this OEM role.

The company's main buyer, Nike, is known as one of the buyers with the tightest control, in terms of product quality and labour standard requirements, but also with regards to the brand name. Thus it won't outsource responsibilities that touch directly on this brand name and its design, meaning the possibilities for advancing within the chain for its vendors are in fact limited almost exclusively to production roles. Tai Wah's strategies have all been strongly buyer driven and there appeared to be no intent to move upstream towards non-production roles. The company did recognise its dependence on just one buyer was a potential weakness, but saw the solution to this issue in acquiring more buyers and not necessarily functioning more independently from them.

It did however have ambitions to integrate into downstream activities. This ambition was perhaps in part realised when Tai Wah was bought by Ramatex, and became an integrated, yet independently functioning part of this Group.

*Sources: Interview (2000); [www.namibian.com.na/2001/December/marketplace](http://www.namibian.com.na/2001/December/marketplace) (2003); [www.emergingtextiles.com](http://www.emergingtextiles.com) (2003);*

**Figure 7.4 Company Development Trajectories in Malaysia**



<sup>1</sup> Subcontractors may be grouped in two categories as well, those supplying to domestically oriented garment manufacturers and those supplying to export oriented local producers (OEM I). The latter group is implied here. The fact that the subcontractor trajectory is placed above the OEM II and local label trajectories does not imply they have superior capabilities, but is just done to illustrate the subcontractors' intermediate positions in between chain and extra chain trajectories.

<sup>2</sup> See note 1, figure 5.5.

<sup>3</sup> See note 2, figure 5.5.

Figure 7.4 visualises the generic company development trajectories described in table 7.16, excluding D., G., H., and I. It illustrates similar trajectories as in Singapore were found, but on a whole trajectories are less dynamic and 'lower-end'.

As in Singapore, even most locally owned OEM suppliers having followed an OEM steady trajectory have probably started out as small producers for the domestic market, or for exports to

Singapore, but they have moved to OEM roles relatively quickly after their incorporation and have subsequently remained with in this role.

Thus, the OEM to OEM+ trajectory, found in a number of cases in Singapore, seems missing in Malaysia. Just two companies seemed to fit this trajectory, one locally owned (see box 7.4) and one of which was part of large foreign owned MNCs. In other words, its development trajectory had been determined mostly by the parent company and the Malaysian establishment had not out of its own initiative followed such a trajectory (see box 7.5).

#### **Box 7.4 Case Study: PCCS Group Berhad**

##### **Company background**

In 1973, Mr. Chan Choo Sing and Mr. Chan Kok Hiang started a small garment manufacturing business in Batu Pahat, with only three sewing machines in a small shop-house. Production was initially only for local markets. In fact many such small shop-house garment factories were set-up in Batu Pahat in the 1960's and 1970's and the Chan brothers factory was thus one of the many such establishments in and around Batu Pahat.

In the early 1980s, however, the company managed to secure some contracts for export and in 1981 it was incorporated as Perusahaan (Malay for 'enterprise') Chan Choo Sing Sdn Bhd, or PCCS in short. Exports grew substantially and quickly made up almost 100 percent of total output.

The company's buyer base was upgraded first from lower end, non-branded mostly European buyers in the early eighties to the company's current buyer base consisting mostly of branded buyers and retail chains such as Adidas, GAP, Warner Brothers, Nike, Puma. The main product focus was thus on branded sports- and casual wear.

Soon after its incorporation as a garment manufacturer in 1981, the company started diversifying into a whole range of garment related activities by setting up subsidiaries. These subsidiaries manufactured products and performed activities not just for the company, but also for third parties.

Thus in 1983 Beauty Electronic Embroidery Centre was established (which in turn set-up a subsidiary in 1996), followed in 1985 by KEZA, a manufacturer of cotton fabric and elastic band (50 percent of output for own company, 50 percent sold to industrial users and other garment companies), and Mega Labels & Stickers in 1989, engaged in the printing of labels and stickers for the garment, electronics, food and consumer products industry. In the early 1990s Tex Line Associates was set up, providing trading and buying house services to its customers. Tex Line has offices in Singapore, Bangladesh, Indonesia, Vietnam and Hong Kong.

In addition the company expanded its garment manufacturing operations through the setting up of manufacturing branches and subsidiaries locally, while in 1998 the company set-up its first overseas subsidiary in Cambodia: PCCS Garments Limited.

Throughout technology and machinery was constantly upgraded in all units of the company, to achieve international quality and delivery standards.

All in all, from the start of business in 1973, the company has achieved impressive growth and development, and in 1995 the separate entities of the companies were grouped under one holding company and listed on the KLSE Main Board under the Group name PCCS Group Berhad (PGB).

##### **Current structure and organisation of the company**

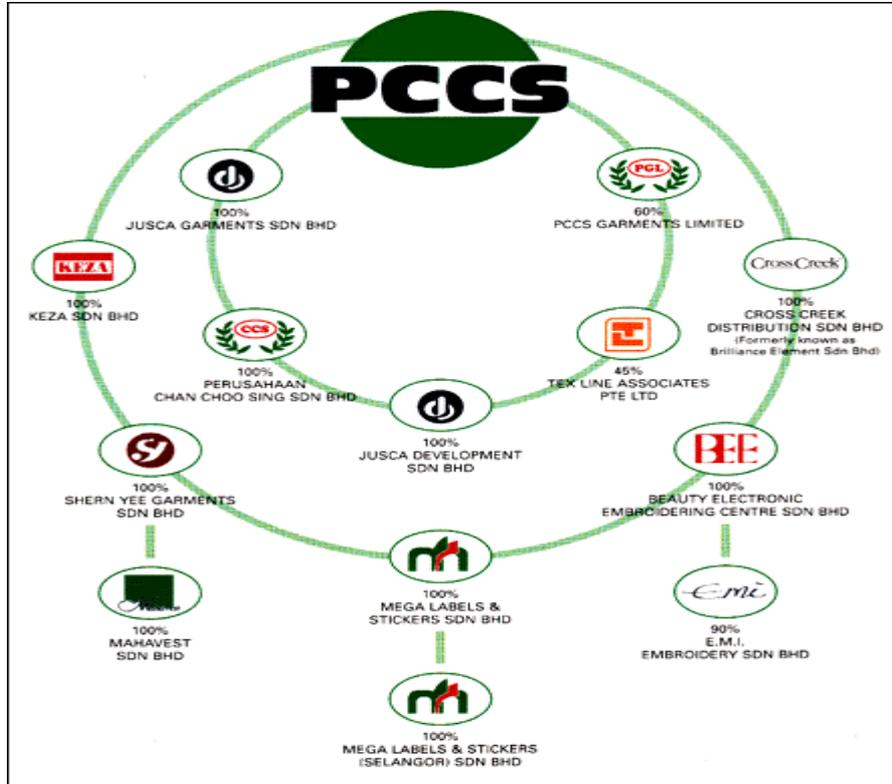
As of 1999, the company consisted of 12 establishments, 9 of which were actively engaged in garment manufacturing or ancillary services. PGB employed approximately 5200 people, of whom and estimated 3600 were engaged in garment production in Malaysia (including non-production staff). In addition, the Cambodian establishment employed roughly 2800 people (predominantly production workers) and accounted for about 57 percent of the garment division's total output. The garment division's annual turnover for 1999 was RM 167 million, up from RM 36.6 million in 1997. This 350 percent growth rate was mostly due to the set-up of the Cambodian establishment in 1998.

Because of its set-up the Group is capable of producing both higher value added garments that require stringent quality control in Malaysia and at the same time of servicing customers that require simple style, basic items at competitive prices through its overseas establishment and offices (Tex Line) in countries like Bangladesh, Indonesia, Vietnam and Cambodia.

Inputs can be sourced from within the group, although 60 percent of inputs still have to be imported, mostly due to buyer nomination of overseas suppliers for specific products.

Perusahaan Chan Choo Sing Sdn Bhd, the main Malaysian garment manufacturing facility is equipped with some of the most advanced technologies, both in terms of production machinery, and IT applications and information system (e.g. MIS and ERP systems).  
The figure below gives a schematic illustration of the company structure

### PCCS Group Berhad Organisation Structure



### Strategic focus and company development trajectory

Ever since its formal incorporation in 1981 the main strategies of the company have been

- Diversification in the apparel chain
- Development of an integrated set-up
- Investment in technology and continuous upgrading of machinery and technologies

These strategies were all set within an overall corporate strategy of advancing within an OEM role towards becoming a preferred supplier capable of providing the highest quality products and services to buyers, from a regional supply base.

Considering the company's development path, specifically the set-up of buying and trading offices regionally and the establishment of overseas production facilities, it is clearly set on an OEM→OEM+ development path, as was confirmed by the company's ambitions to further increase capabilities and services to buyers (hence continue performing and OEM role), increase overseas investments and shift of emphasis of the main Malaysian garment manufacturing establishment (CCS) towards management, control and pre-assembly functions.

Sources: Interview (2000); [www.pccs.net](http://www.pccs.net) (2003)

### Box 7.5 Case Study: Pen Apparel Sdn Bhd

#### Group background

Pen Apparel Sdn Bhd is a fully owned subsidiary of the Hong Kong based Tal Apparel (TAP) Group. The beginnings of this group date back to 1949/1950, when C.C. Lee established a spinning mill in Hong Kong, which later merged with the South China spinning company and the Hong Kong establishment of the Japanese Toray Group to form the Textile Alliance Group (Tal Apparel Group). The Toray Group later sold its interest in TAP. From spinning the company diversified into garment manufacturing and eventually spinning activities were abandoned altogether and the company focused on garment manufacturing.

The TAP group has developed into one of the leading global OEM+ suppliers for higher-end buyers ranging from US department stores such as JC Penney, to branded marketers and designer labels such as Tommy Hilfiger, DKNY, Liz Claiborne, Polo Ralph Lauren, Yves Saint Laurent, and retail chains such as Marks & Spencer and GAP. It is a market leader in the US market for dress shirts, with an estimated 1 out of every 8 dress shirt in the USA (excluding tailor-made shirts) having been manufactured by a member of the Group. It has invested significantly in R&D on fabrics and especially fabric treatments and holds a number of manufacturing patents, including US and EU patents for its pucker free technology. In addition it has introduced wrinkle free shirts, machine washable wool pants and other easy care garments, De-Odorant technology (treatment that offers protection against micro-organisms such as bacteria and fungi). Next this focus on product technology, the company has also focused on process technology, and particularly the improvement of efficiency of production and distribution organisation through information and communication technology. For instance, it has formed a strategic alliance with JC Penny, developing IT based QR and JIT systems in co-operation with this US retailer, cutting down on inventory, lead times and response time.

The Group employed a total of approximately 17,000 people in 1999.

The legal HQ was moved to, and incorporated in Jersey (UK) in 1996, prior to the hand-over of Hong Kong to China in 1997. The Group HQ, South China Jersey Ltd., is therefore legally British owned. Actual ownership is still by the Lee family (85%) and the Toray Group from Japan (15%) (also owners of Malaysian based Pen Group, involved in yarn spinning and textile weaving). The operational headquarters are still located in Hong Kong.

Manufacturing operations are all carried out in Asia and Pen Apparel is the holding firm and regional HQ for Malaysia. Other production locations include Hong Kong (2 establishments), Taiwan (1 establishment), Thailand (2 establishments) and China (1 establishment). In addition, the group has several sales offices worldwide: Tokyo, New York, Dallas, London and Singapore.

### **Company background**

Pen Apparel Sdn Bhd was set up in Malaysia in 1982 and initially only produced flannel shirts. It was located in and EPZ on the island of Penang in the North-West of Malaysia. Production was - and is - exclusively for export to US (75 percent in 1999), European (15 percent in 1999) and Asian markets (10 percent in 1999). The main problem the company faced at the time of establishment was obtaining quota, which due to the allocation system was hard for newcomers (see chapter 4). Therefore, in 1985 Pen Apparel bought a local establishment that had quota (mainly for T-shirts), but was in poor shape: Penang Textile Sdn Bhd. Subsequently, Imperial Garments was bought in 1987 for the same reason. The product range was expanded to dress shirts (woven), knitted shirts, denim shirts, skirts, pants and shorts. These were divided between the different establishments, so each could specialise and achieve higher productivity and efficiency. Pre-assembly activities were mostly taken care of by Pen Apparel though, which was the biggest establishment and the one with the most advanced machinery and technology (the company was the first in Malaysia to introduce a CAD/CAM system in 1984). The company introduced MIS, ERP and other IT applications that had been developed within the TAP Group.

Approximately 50 percent of all fabric inputs are sourced locally, but these are all sourced from Pen Fabric in Penang, which is owned by the Toray group and thus in fact an affiliated company. Pen fabric exports approximately 90 percent of its output and Pen Apparel is in fact one of the very few local garment producers it supplies to.

By the late 1990s Pen Apparel had grown into one of the largest players in the Malaysian garment industry, with an annual turnover of almost RM 160 million (1997) and 3500 employees in its three establishments.

### **Current structure and organisation of the company and its position within the group**

Within the group Malaysian is the second largest producer after Thailand, although it may be expected that China will become a more important production location in the near future. In terms of productivity, the Malaysian production establishments comes third, behind Taiwan and Hong Kong, but before Thailand and China. All establishments in the locations produce more or less the same type of products and the quality of products complies with the group standards and is thus roughly equal in each location. However, the establishment in Thailand is the only one that is also producing outerwear. Outerwear is more labour intensive than shirts and pants (outerwear takes over 100 operations) and therefore it is hard to do these items in Malaysia, where labour shortage is a major problem.

Most of the sales, marketing and buyer negotiations go through the office in Hong Kong, which allocates orders to the production establishments. After allocation, the buyer deals directly with the regional producers. About 95 percent of orders are handled this way. Only 5 percent is done directly with the regional establishments. Therefore it is important that quality levels are the same in all establishments.

Group auditors constantly visit the establishments in each location and compare them for quality control. Thus each establishment has its own quality control, there is group quality control and quality control by buyers through their auditors.

Within Malaysia, there is a distinct division of labour between the three establishments, according to both product and activities. Pen Apparel functioning as the headquarters and takes care of design, pattern making, marking and grading for all companies, as well as cutting for Penang Textiles. Most of the embroidery is also done by Pen Apparel, although in case of limited capacity production it is subcontracted. Imperial Garments is the more independent subsidiary and the only one producing skirts, pants and shorts, while performing all of its own fabric cutting.

#### **Strategic focus and company development trajectory**

When looking at the strategic focus and development of the company, it is important to distinguish between those initiated by the Group HQ and those initiated by Pen Apparel itself. Generally speaking all strategic decisions are made at the corporate level and strategies implemented by Pen Apparel all reflect these general company policies. Thus the kind of buyers produced for, products manufactured and systems operated. Once an order is allocated to Malaysia, Pen Apparel decides how it is allocated within Malaysia, sources for certain inputs that are not provided by the HQ itself and selects local suppliers and subcontractors. HR policies are also formulated independently to a certain extent and the company does its own industrial engineering research to increase productivity and reduce work in progress. The company indeed places great emphasis on HR development. It has a separate training department and works together with a well-known US textile and apparel consultant (Kurt Salmon Associates) to develop training programs and improve efficiency.

The general development path of OEM+ is reflected in part in the development of Pen Apparel, with product specialisation, advanced equipment and communication technology, increased responsibilities in terms of QC towards buyers, etc., yet within the Group Malaysia is still predominantly a production location. Accordingly, locally, Pen Apparel's development trajectory has very much remained within the OEM role.

The fact that the company is part of such a big group has, however, enabled it to implement certain strategies due to easy access to capital within the Group (e.g. buying other companies to obtain quota) and has enabled it to benchmark its performance internationally, giving it a competitive edge within Malaysia. Other advantages include for instance being able to implement tested technologies (new machines are often tested in one factory and if found useful there subsequently installed in other establishments of the Group).

Although Pen Apparel operates a rather 'detached' business with regards to the Malaysian production environment, the Group's commitment to its Malaysian production facilities seem quite strong and there are plans to increase Pen Apparel's independence, by letting it deal directly with buyer. This is a general tendency, as the Hong Kong office plans to focus its efforts more on the Group's China operations.

Pen Apparel on the other hand, and specifically its Managing Director, is aware of the importance of a strong local industry for its own operations and competitiveness as well and actively participates in local industry organisations, as well as providing a benchmark for other companies, sharing information and supporting (even financially) certain activities of the industry association.

*Sources: Interview (2000); Leusink & Veldhuisen (2000); [www.tapgroup.com](http://www.tapgroup.com) (2003)*

As to OBM trajectories go, it must be noted that only a few are truly design oriented companies or brand developers (see box 7.6.) with own retail outlets locally and overseas. The rest involved lower-end casual wear brands based on existing designs and styles. This is somewhat different from the situation in Singapore, where most OBM companies were centred around one or more local designers and their collections.

#### **Box 7.6 Case Study: Padini Holding Berhad**

##### **Company background**

The Padini group can trace its beginnings to the establishment of Hwayo Garments Manufacturers Company in Selangor, a sole proprietorship formed in 1971 to carry out manufacturing of ladies' garments and wholesaling of finished products to departmental stores. In addition a textile trading company established in 1973 established.

In 1975 the company opened a small retail outlet, for sale of its products under the Padini brand name and subsequently expanded its product range to include basic men's wear (mostly t-shirts) and slacks. Ladies wear and t-shirts were manufactured in the company's own production facilities (a second factory was set up for the manufacturing of t-shirts), but slacks were imported from China. Therefore a garment trading company was set-up.

As the retail business grew, a second shop was opened in 1981, selling products under a new brand name: Vincci. At the same time one of the factories was sold off, although Padini did keep sourcing from this factory.

The recession of the early to mid 1980s hit the company hard, especially due its reliance on just a small range of products and due to the credits in the textile trading business, where customers were sometimes given up to six months till payment. Many of these credits were defaulted upon during the recession. After the recession the company therefore changed its strategy, downscaling its textile trading company (and eventually closing it in 1985) focusing more on brand development and diversifying its brand and on marketing. Thus it introduced a Japanese children's wear brand (or rather it copied an established Japanese brand, which was not registered in Malaysia): Miki, which was sold in local department stores. In that same period after the recession, the policy of department stores changed to working with suppliers on a consignment basis, rather than outright sales. According to Padini this development had the advantage of enabling brand development strategies.

In the years since 1987, the company rapidly expanded its number of brands and labels, each positioned in different niches of the market and targeting a specific group of consumers (e.g. office wear, casual wear, teenage mix&match wear, etc.). All of these brands were sold in department stores, while some were also sold in own stores, such as SEED and Padini Authentics. As department stores started becoming more demanding (e.g. companies had to take part in store promotions whether they wanted or not, they had to finance renovations, etc.), the company started focusing more on these own stores. In addition it transformed it extended its brands to include not just garments, but a whole range of fashion products (brand stretching), thus transforming them into lifestyle brands

In 1994, the company decided to diversify into shoes. As one of its oldest boutiques, Vincci, was not very successful anymore, it was transferred into a ladies shoes retailer. Shoes were mostly sourced locally. This was a huge success, both in terms of growth and revenues and in terms of raising the company's profile. By 1999, there were 15 Vincci shoe shops and the number continued to grow. In addition two so-called mega stores were set-up, holding all the company's brands under one roof

In 1995 Padini was converted into a private limited company and subsequently registered on the KLSE Second board in 1998.

Finally, in 2000 the company set up three cafes, which were integrated with their SEED retail outlets and Padini Dot Com Sdn Bhd was set up to provide electronic business services and solutions for the group, such as online shopping.

#### **Current structure and organisation of the company**

By the end of the 1990s, Padini Holdings had developed into an integrated and diversified company focusing on the marketing and retailing of its own lifestyle brands. Annual turnover for 1999 was almost 93 million RM and the total product range consisted of garment, shoes and fashion accessories for men, ladies and children, covering more than 1,000 items.

The products of the Group were sold through 65 specialty shops and 121 consignment counters located in Peninsular Malaysia; nine outright counters in East Malaysia; and six outright counters in Singapore and Brunei. Even though the Group still carries out manufacturing, this is being done almost exclusively for internal consumption and not for re-sale to third parties. Although the company has an integrated structure, with design, manufacturing, marketing and retail all being performed in-house, own production is limited and most products are sourced from China, Thailand and Vietnam. Local sourcing is limited, as local producers are considered too slow and too expensive.

#### **Strategic focus and company development trajectory**

Relatively soon after the company's set-up it diversified into retail. After the recession of the early 1980s this strategy was extended to a more broad strategy of brand development and marketing. Although the company retained a foothold in production, this has become of minor importance to the overall business.

The brand development strategy is mostly focused on marketing (image development, setting up brands for specific niches, market positioning) and retailing (setting up of own shops and only selling in higher-end, more progressive department stores such as Japanese Takshimaya, Isetan and Sogo). Design perse is of lesser importance. Most designs are, as management itself admits, not exactly original designs. The company has a design and merchandising team that keeps itself up to date with trends in

USA, Hong Kong and Japan and copies these. In several cases the brand names were even copied from Japanese brands, which were doing well in the Japanese market, but not registered in Malaysia.

The introduction of online shopping and the scaling down of sales through department stores with the intention of eventually selling the bulk of its products in own, stand-alone stores (modelled after the highly successful concept of Hong Kong based Giordano, which has shops all over East and Southeast Asia) further illustrates this marketing and retailing oriented brand development strategy.

Padini's strategy has been strongly oriented towards the domestic market, as management believes it is essential to establish a strong foothold and brand name locally. It has therefore never really had any export ambitions and has limited itself to a number of outright counters in Singapore and Brunei.

For the future the company plans to continue down the brand development, marketing and retailing path, introducing new and expanding existing brands and setting up more shops. However, it is looking to franchise retailing, so as not to have to carry the responsibility and risk of operating the shops, yet retaining control over layout and brand image. Thus it can focus even more on marketing and brand development. In addition it is looking to establish a few of its brands in regional markets, although in the foreseeable future these are unlikely to overtake the local market.

*Sources: Interview (1999); [www.klse.com.my/website/listing/lc/padini.htm](http://www.klse.com.my/website/listing/lc/padini.htm) (2003); Padini Holdings Berhad, Annual Report (1999); [www.padini.com/eshop/default.asp](http://www.padini.com/eshop/default.asp) (2003)*

As in Singapore, most OBM companies started out as such, or had made a shift early on in their existence, coming from an OEM II position. The same is true for local label producers (see table 7.17)

Many companies also still seemed to be at the start or in the middle of a transition to another role, hence 'halfway' a certain trajectory. For instance, a number of companies in the OEM II category, i.e. producers for domestic and regional markets, have added some exports to Western markets under OEM arrangements. Perhaps this signifies an eventual complete shift towards OEM I supply<sup>17</sup>.

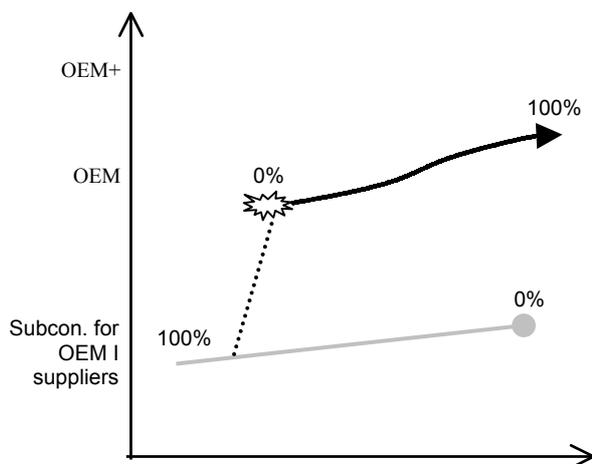
An interesting observation to be made is that a shift from production for local markets to production for export markets to the order of US and European markets appears slightly less common than a shift from subcontractor for OEM I supplier to becoming an OEM I supplier oneself. Although the numbers are too few to draw definite conclusions - one OEM II supplier had followed a development trajectory towards OEM I supply and 5 had added some OEM I supply, while a total of 8 subcontractors to local export oriented manufacturers had shifted completely to OEM I themselves, while 2 had added OEM I supply and were gradually phasing out their subcontracting activities. The responsibilities of these subcontractors within the whole production process are much more limited than for instance those of OEM II suppliers, but the fact that they are aware of international quality standards and capable of producing to the specifications of international buyers, in addition to the facts that they sometimes already have contacts, perhaps make the shift towards full-package supply to these buyers a little easier. The main constraint is usually the capital needed to invest in pre-assembly and finishing equipment, such as CAD systems, cutting machines, etc.

The trajectory followed by the two companies combining OEM/ODM and OBM are not included in figure 7.4, as they were rather unique cases. However, one was visualised in figure 7.6 and included as a case study in box 7.7

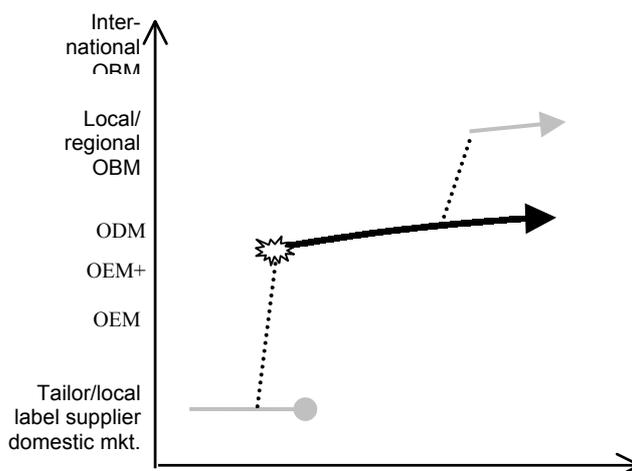
As was demonstrated in the case of Singapore, individual company trajectories even within the same generic trajectories may differ and be less smooth than these generic trajectories would suggest. Figures 7.5 and 7.6 illustrate two such individual company development trajectories.

Figure 7.5 illustrates the development trajectory from subcontracting to OEM I. Such a transition is of course never abrupt, but rather a gradual one.

**Figure 7.5 Individual Company Trajectory I:**  
*Subcon. → OEM I*



**Figure 7.6 Individual Company Trajectory II:**  
*Local label → OEM/ODM & OBM*



### Box 7.7 Case Study: Gordon Apparel Sdn Bhd

#### Company background

Gordon Apparel was incorporated in 1988, yet the history of the company goes much further back, to the time when Mrs. Looi started as a dressmaker, sewing clothes for the wives of diplomats (mostly evening gowns). As orders grew beyond mere dressmaking to include sales of ready made garments to local retailers, the family-run fashion wholesale business, was officially incorporated in 1988 and named Gordon Apparel.

A typical family business, the oldest daughter grew up helping her mother with dressmaking, attended a local design school and joined the business. Likewise, a younger daughter ended up designing clothes as well because of the family business. In fact, of 6 children, 5 now work in the family business in different management and design functions. The family also set-up a garment trading company in 1992, involved in retail, wholesale and import (mostly from China). This affiliated company functions independently, but falls under the same family management.

In 1997 the company managed to secure a small export quota for the US market and contracts with two large US retail chains: JC-Penny and Macy's. Gordon Apparel produced mostly dresses and women's evening wear for these buyers on an ODM basis, i.e. goods were sold under Gordon Apparel's own label. From this time onwards, sales in local markets were gradually being replaced by exports.

However, the two main designers, Beatrice and Melinda Looi, having established somewhat of a name for themselves in the local and even regional fashion scene, also occasionally design collections for showing in major fashion events and small ready-to-wear collections for sale under their label in local boutiques. They plan to eventually expand this business and open their own stores.

#### Current structure and organisation of the company

Gordon Apparel is still a small company, with an annual turnover in 1998 of just RM 600,000 and just 30 employees in 1999. The gross profit margin in 1998 was estimated to be around 30 percent though. All production takes place in-house and only embroidery is outsourced and the company is still very much a family-run business, with all key positions occupied by members of the Looi family. However, it appears the second generation is more business oriented and formally educated in design and management and has ambitions of expanding and growing the business substantially, both through the acquisition of more overseas buyers and the further development of own the own labels locally, with ambitions of venturing into direct retailing.

#### Strategic focus and company development trajectory

From the days before official incorporation till the present, Gordon Apparel has always been strongly design oriented and indeed design centred. With designers Beatrice and Melinda Looi the company is not just trying to market its own brand, but positioning itself as a designer label.

Design skills were passed on from mother to daughters and they contended that their mother was the best teacher and had given them invaluable advice on the finer points of designing. "Although she had no formal training, her cutting is the best I've seen, and as a child, I used to watch her make beautiful clothes for her customers".

However, both daughters also had formal educations in fashion design. Beatrice attended classes at a local design school after finishing her formal education. She then joined the family business and started off designing women's dresses and workwear for the local market. She now assists her mother in designing evening dresses for export to the United States, EU and Middle East, and occasionally squeezes in a collection of her own in major fashion events.

Melinda managed to get a dose of foreign exposure while still in design school when she won the Moda (Malaysian Official Designers Association) Young Designers competition in 1995, and was sponsored to complete her course in Montreal, Canada. She entered several fashion contests and in 1995 emerged second runner-up in the Asean Young Designers Contest in Singapore and received the Cotton Award at the Young Designers Contest in Japan. In 1997, she won first prize at the *Vo Lait* (White Creations) contest in Montreal.

Melinda returned to Malaysia last year and immediately went to work with her Mother and sister at Gordon Apparel. Meanwhile brother Louie Looi had started managing the family business and was behind the successful obtaining of the export quota for the USA in 1997. A firm believer in a pro-active business attitude, he argued the company should actively market itself as a company capable of handling ODM orders and try to secure new buyers in both the USA and Europe.

The case of Gordon Apparel illustrates that ODM trajectories may in fact more easily follow out of a local label or OBM function, as design capabilities are essential and perhaps not so easily picked up, but rather passed on. In addition it gives an example of a family-run business that is not necessarily closed and resistant to change. This probably has to do with the hand-over to a second generation, which through their higher education levels and ambitions have managed to professionalise the business to an extent

Sources: *Interview (1999)*; [www.asiapacific.com.my/ga](http://www.asiapacific.com.my/ga) (2003)

## 7.5 Malaysian Garment Industry Development Trajectories

At the industry level development trajectories have been less diverse as was the case in Singapore. This was on the one hand a consequence of the less dynamic development trajectories at the level of existing companies and on the other hand of the fact that entry of new segments has been limited to non-existent. In addition, several limitations to the development of linkages within the industry (both horizontal and vertical) have prevented the kind of clustering that could improve the industry's overall competitiveness, as is often suggested in the literature and is seen as an important strategic thrust in the IMP-2.

Existing producers appear to have remained firmly rooted in their contract manufacturing roles and although many have achieved impressive growth and have managed to upgrade processes and products, very few have managed to extend beyond simple contract manufacturing roles, while internationalisation has been limited. The continued presence of a number of foreign owned branches, using Malaysia mostly as a production base, while not substantially investing in technology or moving beyond production, has probably just added to more conservative trajectories among OEM producers.

However, one of the routes that couldn't so easily be distilled from the original survey (because of the way the questionnaire was set-up), but became clear from some additional research and background checks, were diversification strategies into retailing. In several cases, particularly in the cases of publicly listed companies, companies has diversified into the management of retailing for international brands wanting to enter the Malaysian markets. In the case of Singapore, such operations were usually run by specialised agents, but in Malaysia several manufacturers had diversified part of their company into essentially becoming an agent for distribution and marketing. This may in the future open possibilities for developing, marketing

and retailing own brands, as it provides companies with information and knowledge of markets and helps develop distribution networks and channels.

Up till now, at the industry level, Malaysia hasn't seen the kind of consolidation and decline of the production segment as had taken place in Singapore. The industry therefore remains more fragmented and diverse, with a large number of small companies, even among the export oriented OEM I category. It is this group of small companies, particularly the domestically oriented ones, which have been most conservative and appear somewhat resistant to change, as they take a rather distrustful view of other companies and Government alike. It is likely that these are the companies that will be hardest hit by ongoing trade liberalisation in the form of AFTA and China's entry into WTO, as both will most likely increase the influx of imports. Moreover, this group is not linked to the export oriented segments of the industry, while locally they seem locked in to lower quality supply and distribution networks.

Generally, the production segment of the industry seems to have reached the limits of competitive adjustment based on defensive strategies and adjustment upgrading strategies. Unless some of the more pro-active trends noted among some companies (development of design capabilities, brand development, diversification, internationalisation, etc.) will take on industry wide proportions, industry decline in terms of production segment seems inevitable, particularly because no new segments seem to really present themselves in Malaysia.

Hardly any international buyers had a local office in Malaysia, even though Government has tried to promote the establishment of such offices. Most buyers and agents cover Malaysia from Singapore or Hong Kong and see no need for locating separate offices in Malaysia, as essentially there is just not enough product sourced from Malaysia to justify such a set-up<sup>18</sup>. Particularly not with the general trend among buyers of network consolidation. Moreover, other countries in the region are often more easily covered from Singapore.

Some buyers, such as FILA and Adidas, did have offices in Malaysia, but decided to close these down in the late 1990s or reduce their presence to that of a QC branch reporting to the Singapore office. Also, in the mid 1990s a few Malaysian garment companies set-up their own sourcing arms, to provide services to buyers. One of these, in Penang, was unsuccessful and had to close down again, while another was set-up in Singapore, not Malaysia. Finally, although there are some local agents, particularly in the Southwest, these are hardly the kind of regional/global offices that could change the profile of the industry.

As to the development of a local fashion industry, evidence is not convincing either. Although there is in fact an impressive number of small boutiques and retail outlets to be found in just about every shopping mall in Malaysia, many sell imported goods from China or other countries in the region. Next to these smallest boutiques and shops, there are a few, admittedly reasonably successful, local retailers with own brands and outlets. These are, however, even more disconnected from other segments of the industry than was the case in Singapore. None are members of industry association, nor do the industry associations see themselves as representing this group of companies

Branding and marketing development by existing producers was negligible. In addition, in Malaysia, the size of the OBM segment (i.e. local design based fashion oriented companies with own brands and original designs) was much more limited.

Within the context of the IMP-2 both brand development by existing producers and the development of a local fashion industry and encouragement of local designers and brands through fashion weeks and designer awards, was seen as an important way to upgrade the industry. However, the fashion industry and scene present can hardly be said to be of great substance, or international allure for that matter.

Finally, at the industry level, the development and strengthening of local linkages at all levels, such a prominent element of IMP-2 policy and recommendations, and seen as crucial for improving the (international) competitiveness of the industry, has been limited. Considering the increased demands for shorter lead-times and added services, such linkages may indeed enhance the industry's competitiveness. Moreover, it has been argued that in a quota free world, the production and sourcing of garments will gravitate towards those countries and regions that have both labour and material inputs readily available. However, in Malaysia an industry development trajectory towards a more integrated industry has not been achieved and does not seem likely given a number of limitations and bottlenecks.

Although the Government has tried to an extent to protect local inputs suppliers and has identified further development and upgrading of this segment as an important thrust for its cluster policy, because of the incentives in place, the local textile industry is basically locked-in in supply relationships with the domestically oriented garment industry, which supplies to local, less demanding and lower end markets. If they do supply to export oriented companies, this usually involves only the lower-end or secondary inputs, for which nomination by buyers is not needed or more lenient. In other words, local input suppliers receive relatively little pressures or incentives (through information linkages) in terms of stringent requirements, for upgrading. The actual incentives put into place (in the IMP-2) seem unable to really address the gap between the export oriented and domestic segments and in fact may even widen them.

For the local supplying industry to be linked to the export oriented garment production segment, first upgrading to internationally competitive quality standards is required, after which it would make sense to try and approach buyers in an attempt to acquire nomination. In other words, textile and accessories suppliers too need to engage in the initial upgrading necessary to 'appear on the radar-screen' of buyers. As of yet this has not been the case, despite the recommendations and incentives under the IMP-2.

These findings were confirmed by a related study undertaken in 2000/2001 by two graduate studies at the section International Economics and Economic Geography at Utrecht University in The Netherlands: "Clustering for International Competitiveness in the Malaysian Textile and Apparel Industry; a case study of Batu Pahat" (Akveld & Liebrechts, 2001). The aim of this study was to establish whether cluster development in the textile and apparel industry in both functional and geographical terms was occurring in the way envisaged by Government's Cluster Strategy as part of the IMP-2. The study was based on an extensive survey among companies in the textile industries group<sup>19</sup> in the State of Johor and especially in and around Batu Pahat, with its high concentration of both textile and garment companies. Results of this survey demonstrated that although there were many supplier-customer linkages between local textile and garment companies, these were in fact still of minor importance to the export oriented segment of the garment industry and although sales to export oriented garment producers had increased according to the textile companies surveyed, this is probably just due to overall increased sales of these garment exporters and not so much to a shift from foreign to local input sourcing.

In addition linkages and co-operation among textile companies and between textile companies and garment producers remains superficial, in the sense that it mostly involves for instance informal exchange of information, order sharing and simple supply of specified orders, rather than product development, the formation of alliances (with a few exceptions among the larger textile and garment producers, as is demonstrated by the case in box 7.3), etc. The IMP-2 and related incentives and programs put in place have thus not been able to establish the kind of cluster depth and breadth that was envisioned in the Plan's original Cluster Strategy (Akveld & Liebrechts, 2001). This is in large part (though not entirely, as policy alone cannot achieve industrial development) a consequence of the (continued) lack of strong linkages in terms of co-operation and co-ordination, among policy makers, implementers and private institutions, and

between these institutions and the industry, which has severely limited the effectiveness of policy implementation<sup>20</sup>.

## Conclusion

In this chapter, the structure and characteristics of the Malaysian garment industry, competitive adjustment strategies and firm and industry development trajectories were outlined based on the results of a survey conducted between the end of 1999 and the beginning of 2001. This was done comparatively to the Singapore case presented in the previous chapter

As to the *structure and characteristics of the Malaysian garment industry*, what stands out most are:

- the generally small-scale of companies, with only a few very large players.
- the higher level of foreign involvement in the industry when compared to Singapore
- the fragmented nature of specifically the smallest segment of companies, with a large number of companies engaged in a variety of activities and products, yet with very little 'mass' in terms of their shares in total turnover, employment, exports, etc.
- the dichotomy within the industry between export oriented OEM segment, and domestically oriented small scale cottage industry, with very few cross linkages and distrust among especially the latter group towards large export oriented companies, Government, the industry association and other small companies alike.
- the dominance of OEM suppliers and reliance on especially US buyers and export markets and the wide range of buyers these work with
- due to specific histories and Government incentives (e.g. EPZs), a marked difference in company and industry characteristics per region, which has resulted in distinctly different (yet not isolated) clusters or rather agglomerations of companies.
- the fact that the industry is still firmly 'locally rooted' as far as production networks go, with exception of only a few of the largest OEM suppliers and foreign owned companies.
- a relatively larger share (in comparison to Singapore) of vertically integrated companies, both among the very largest and the smaller companies. In the case of large conglomerates or groups, such set-ups implied a number of separately run business units specialising in certain activities and performing these not just for other members of the group, but also for third parties.
- Finally, at the industry level (i.e. not within companies) integration and linkages are in fact weak, with limited and weakly developed local backward linkages, superficial horizontal linkages as well as weakly developed policy networks.

A closer look at *firm competitive adjustment strategies and development trajectories* revealed that generally speaking competitive adjustment strategies have been rather defensive and conservative, although in the area of the production process, particularly the OEM I segment has implemented a number of more pro-active strategies (e.g. new technologies, industrial engineering and worker training) not just to increase efficiency and productivity, but also to overcome labour shortages. Product strategies beyond the kind of quality improvements generally required by markets and buyers were less common though.

Overall most companies in the industry appear to be followers rather than forerunners. Internationalisation has also not been a commonly opted for strategy. Development trajectories have predominantly been of a steady nature, as few companies have substantially changed their roles within chains, with the exception of a number of producers having shifted from subcontractor to OEM roles.

Despite labour shortages and rising cost of production, the industry has experienced quite consistent growth, particularly in terms of exports, over the past two decades. Moreover, the use of foreign workers (facilitated by lenient Government policies) and setting up manufacturing

branches in peripheral locations within Malaysia, seems to have been sufficient to offset labour shortages, while advances in process technology and organisation have enabled companies to deal with cost increases. In addition process and product strategies have enabled companies to keep up with increasing buyer requirements and establish themselves as reliable suppliers of (higher-end) quality basic wear.

Finally, the (artificial) 'protection' offered by the quota system (see also Dooren, 2003; Loo, 2002), has ensured continued sourcing by international buyers, even though cost in Malaysia were not lowest and efficiency not highest. The reasonable performance of the industry and the fact that sustaining connections was not extremely hard, seems to have masked the fact that the industry and companies within it may have grown and upgraded processes and products, but have achieved OE rather than real upgrading. It remains to be seen if defensive and follower strategies will be sufficient for even sustaining connections to GCCs in the near future, as cracks seem to be showing in the relatively favourable local and international circumstances.

In the longer run, the 'followers-attitude' may thus present a real danger of getting 'stuck in the middle' (eventually leading to disconnection from chains) between more capable apparel companies in the NIEs and lower cost producers both within and outside the region.

This threat becomes even more real considering the fact that at the industry level, development trajectories have been mostly tied to the role of contract manufacturing and new sources of growth and diversification for the industry have not presented themselves.

The majority of companies operating outside chains appear to have remained mostly in low-end segments and markets, while engaging mostly in defensive strategies. Resultant trajectories have been steady and exploitative, with only a few making substantial shifts.

Moreover, it appears that for existing OEM companies, alternative trajectories (e.g. extra-chain trajectories or OBM trajectories) are difficult to embark on once an intra-chain, OEM trajectory has been chosen. Thus disconnection from chains will most likely imply exit from the industry altogether for most companies (with the exception of the smallest one, which may be able to go back to subcontracting). Given the fact that the limits of the observed followers strategies and steady trajectories appear to be reached, a substantial shake-out and consolidation in the industry may be expected in Malaysia, similar to what that took place in Singapore in the early 1990s, with only the companies able to move to more pro-active strategies and advancing in chains, towards OEM+ roles, surviving<sup>21</sup>.

In the next chapter the analysis will be extended to the dynamics behind the strategies and trajectories observed in this and the previous chapter.

## Notes

<sup>1</sup> All data presented in this chapter were derived from the producer survey conducted by the main researcher in Malaysia between October 1999 and January 2001, unless otherwise noted.

<sup>2</sup> The main producer survey was completed in January 2001, and results presented in this chapter thus pertain to the period up until 1999/2000. 'Current' implies as of 1999/2000, and in the past ten years implies the period from roughly 1989 till 1999/2000, unless otherwise noted.

<sup>3</sup> Numbers for Singapore and Malaysia are comparable, as both were asked to give numbers for the same base year: 1997. Only in cases, where a respondent couldn't give numbers for this year, a different base year was used.

<sup>4</sup> Numbers are lower than total (117 and 57 for Malaysia and Singapore respectively) due to non-response

<sup>5</sup> It is likely this group of buyers is in fact more important than is suggested by table 6.7, as a number of companies indicating to produce for branded buyers were in fact producing for licensees

<sup>6</sup> This company was the exclusive distributor for Lectra Systems, France, for Singapore, Malaysia and Brunei.

<sup>7</sup> The relationship between sales orientation (export or domestic) and share of inputs sourced locally proved to be statistically significant, with chi-square being 23,599,  $df = 8$  and  $\alpha = 0.003$

<sup>8</sup> Of all 117 companies in the survey, 9 sourced 100 percent of inputs locally, 3 did not source inputs themselves and 11 could not respond to this question. The percentages are thus based on an N of 103

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<sup>9</sup> In some cases the quota allocation system presented a dilemma, as some producers argued that their buyers wanted a guarantee that they had enough quota to fulfil an order, while the quota allocation system required proof of confirmed orders by buyers.

<sup>10</sup> E.g. devaluation of currencies of other (Southeast) Asian countries makes imports from these countries cheaper, hence may cause an influx of cheap imports into local markets. The currency peg, halted the devaluation of the Malaysian Ringgit, which made it relatively more expensive than currencies of other countries in the region that didn't implement capital controls and whose currencies devaluated much more

<sup>11</sup> Based on MIDA's estimation of approximately 1000 apparel companies in Malaysia (MIDA, 1999).

<sup>12</sup> According to our original findings and database a number of the interviewed companies were MGMA members, however, asked if they were a member of an industry association, none confirmed their MGMA membership.

<sup>13</sup> A chi-square test demonstrated statistically significant relationship between size and cooperation at the 90% probability level (chi-square = 13,437; df = 7;  $\alpha = 0,062$ ) and between sales orientation and cooperation at the 99% probability level (chi-square = 17,411; df = 2;  $\alpha = 0,000$ )

<sup>14</sup> Due to the small number of companies per category, it was not always possible to test whether observed differences were statistically significant. However, the differences were double checked and confirmed through qualitative data, such as the observations made by the main researcher in the different companies, conversations and interviews with important industry members and representatives (e.g. those with years of experience and active participation in the industry), institutional representatives, etc.

<sup>15</sup> Including Myanmar, Cambodia, Vietnam and Laos

<sup>16</sup> Many companies indicated profit margins actually fluctuated per year, dependent on changes and developments in markets and trade (e.g. currency fluctuations)

<sup>17</sup> In many cases producers had the ambition to shift entirely to OEM I, but were limited by quota allocations.

<sup>18</sup> For instance, the value of products GAP sources from Malaysia is approximately 140 million US dollars on an annual basis. This is an estimated 1.5 percent of the value of all products sourced by GAP worldwide. Hardly enough to justify the setting up of a separate office.

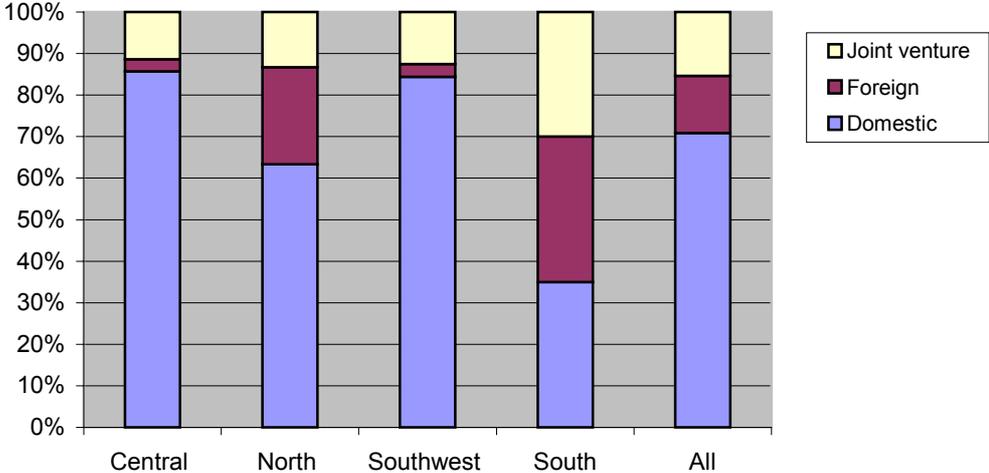
<sup>19</sup> This group included companies involved in: Natural fibre spinning and weaving mills, dyeing, printing and finishing of yarns and fabrics; manufacturing of synthetic/natural textiles; manufacturing of made-up textile goods except wearing apparel; knitting; manufacturing of accessories (e.g. buttons, zips, elastic banding, padding), supply of machinery and/or spare parts and provision of specific services (e.g. packaging)

<sup>20</sup> Ironically, lack of co-operation and co-ordination at the institutional level was explicitly noted in the MIER report, as an issue to be addressed; yet it appears not to have been dealt with at all, which of course does not exactly provide the good example Government should be setting for the industry.

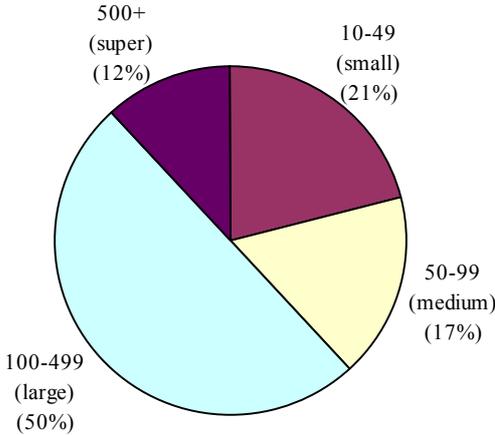
<sup>21</sup> In fact, since the completion of the survey in 2001, several of these trends indeed seem to be taking shape, with a number of companies merging and an apparent increase in overseas investments.

**Appendix II: Additional Tables and Figures Malaysia Survey**

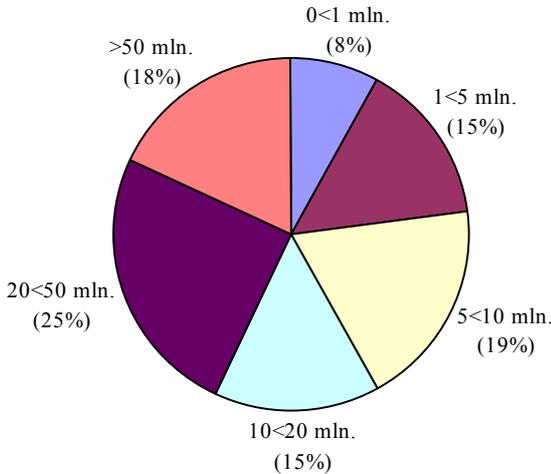
**Figure A Company Ownership by Region**



**Figure B Company Size by Employment**



**Figure C Company Size by Annual Turnover (RM)**



**Notes:**

- There were no companies with less than 10 employees and five with more than 1000 employees
- turnover includes dependent branches and subsidiaries, as these are usually just manufacturing branches and not profit centres, hence they are included in a consolidated company account.
- six of these companies had an annual turnover of more than 100 million RM
- non-response was 1 for employment and 11 for annual turnover

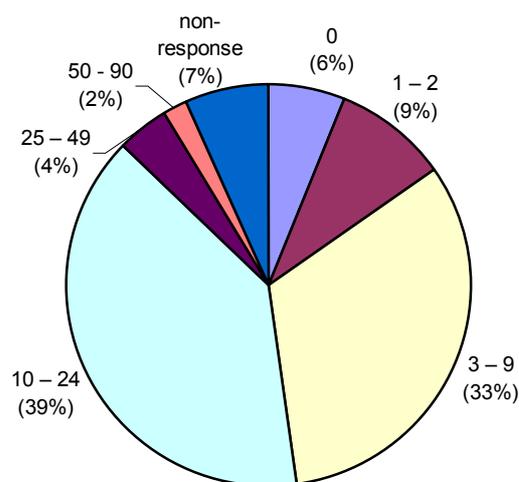
**Table A Average Employment Numbers and Ratios (1998)**

| <b>Employees</b>  | <b>Average all multi-establishment companies (90)</b> |  | <b>Average Ratio</b> |
|---|---|--|----------------------|
| Number of employees this establishment                        | 279   | N = 89<br>N.R. <sup>1</sup> = 1                                | 1 : 4.8              |
| Number of employees entire company                            | 1,336   | N = 60<br>N.R. = 30  |                      |
| Number of employees Malaysia                                  | 629   | N <sub>relevant</sub> <sup>2</sup> = 51<br>N = 35<br>N.R. = 16 | 1 : 2.5              |
| Number of employees overseas                                  | 1,592   | N <sub>relevant</sub> = 51<br>N = 24<br>N.R. = 27              |                      |
| Number of employees in Malaysia of locally owned ME-companies | 899   | N <sub>relevant</sub> = 20<br>N = 10<br>N.R. = 10              | 1 : 1.6              |
| Number of employees overseas of locally owned ME-companies    | 1,423   | N <sub>relevant</sub> = 20<br>N = 10<br>N.R. = 10              |                      |
|   | <b>Average interviewed establishment (117)</b>        |  | <b>Average Ratio</b> |
| Number of non-production employees                            | 34  | N = 104<br>N.R. = 13   | 1 : 5.6              |
| Number of production employees                                | 191   | N = 105<br>N.R. = 12   |                      |

<sup>1</sup> Non-response<sup>2</sup> Refers only to companies with overseas presence**Table B Export Destinations and Average Shares per Destination (1998)**

| <b>Export destinations</b>    | <b>No. of comp.</b> | <b>Valid percentage (N = 109)</b> | <b>Average share exports to Asia</b> | <b>Average share exports to Europe</b> | <b>Average share exports to North America</b> |
|-------------------------------|---------------------|-----------------------------------|--------------------------------------|--|---|
| Asia                          | 22                  | 20.2%                             | 100.0 %                              | -                                      | -   |
| Europe                        | 9                   | 8.3%                              | -                                    | 100.0 %                                | -   |
| North America                 | 6                   | 5.5%                              | -                                    | -                                      | 100.0 %                                       |
| Asia & Europe                 | 4                   | 3.7%                              | 34.3 %                               | 65.7 %                                 | -   |
| Asia & North America          | 4                   | 3.7%                              | 56.7 %                               | -                                      | 43.3 %  |
| Asia & Europe & North America | 18                  | 16.5%                             | 6.2 %                                | 24.4 %                                 | 69.4 %  |
| Europe & North America        | 43                  | 39.4%                             | -                                    | 32.0 %                                 | 68.0 %  |
| Other <sup>1</sup>            | 3                   | 2.8%                              | -                                    | -                                      | -   |
| not applicable <sup>2</sup>   | 8                   | -                                 | -                                    | -                                      | -   |
| Total                         | 117                 | -                                 | -                                    | -                                      | -   |

<sup>1</sup> Including 'Asia & Middle East' and 'Europe & Australia'    <sup>2</sup> Companies not involved in exports

**Figure D** Number of Buyers Malaysian Garment Manufacturers Worked With**Table C** Main Products Manufactured by Malaysian Garment Producers (1999)

| Product(s) manufactured in this establishment | No. of comp. | Valid percentage <sup>1</sup> | Product(s) manufactured in this establishment | No. of comp. | Valid percentage <sup>1</sup> |
|---|--------------|-------------------------------|---|--------------|-------------------------------|
| Knitwear                                      | 93           | 86.1 %                        | Outerwear                                     | 25           | 23.1 %                        |
| - men's                                       | 42           | 38.9 %                        | Women's dresses                               | 17           | 15.7 %                        |
| - women's                                     | 36           | 33.3 %                        | Undergarments                                 | 17           | 15.7 %                        |
| - men's & women's                             | 15           | 13.9 %                        | - men's                                       | 8            | 7.4 %                         |
| Children's/baby wear                          | 49           | 45.4 %                        | - women's (lingerie)                          | 9            | 8.3 %                         |
| Woven garments                                | 40           | 37.0 %                        | Socks/gloves                                  | 3            | 2.8 %                         |
| - men's                                       | 15           | 13.9 %                        | Jeans-wear                                    | 2            | 1.9 %                         |
| - women's                                     | 18           | 16.5 %                        | Other   | 6            | 5.6 %                         |
| - men's & women's                             | 7            | 6.5 %                         |   |              |                               |
| Sportswear                                    | 31           | 28.7 %                        |   |              |                               |

<sup>1</sup> Based on N = 108, as 9 companies indicated they were not involved directly in production

**Table D** Level of Technology in Malaysian Garment Manufacturing Establishments (1999)

| Technology                  | Companies using technology |                    | Age Technology |           |
|-----------------------------|----------------------------|--------------------|----------------|-----------|
|                             | number                     | share <sup>1</sup> | ≤ 5 years      | > 5 years |
| CAD                         | 53                         | 48.2 %             | 22             | 31        |
| CAD/CAM                     | 30                         | 27.3 %             | 15             | 15        |
| Computerised cutting        | 11                         | 10.2 %             | 9              | 2         |
| Hanger/conveyor belt system | 18                         | 16.7 %             | 12             | 6         |
| ERP/MRP system <sup>2</sup> | 53                         | 48.6 %             | 21             | 32        |
| QR system                   | 12                         | 10.8 %             | 4              | 8         |
| Computers                   | 11                         | 98.2 %             | -              | -         |
| E-mail                      | 93                         | 83.8 %             | -              | -         |

<sup>1</sup> Valid percentage based on N excluding non-response

<sup>2</sup> Efficient Resource Planning or Material Resource Planning systems

**Table E Production Locations Malaysian Garment Manufacturers (1998-1999)**

| Production location  | No. of companies | Share (N=37) | Type of establishment |                |                 |
|--|------------------|--------------|-----------------------|----------------|-----------------|
|  |                  |              | Other establishments  | Subsidiaries   | Sub-contractors |
| Cambodia   | 7                | 18.9 %       | 5                     | 2              | -               |
| Indonesia  | 6                | 16.2 %       | 4                     | 1              | 1               |
| Bangladesh   | 5                | 13.5 %       | 5                     | -              | -               |
| China  | 5                | 13.5 %       | 3                     | -              | 2               |
| Sri Lanka  | 5                | 13.5 %       | 2                     | 2              | 1               |
| Vietnam  | 3                | 8.1 %        | -                     | 2              | 1               |
| Myanmar  | 3                | 8.1 %        | -                     | 2              | 1               |
| US/Canada  | 3                | 8.1 %        | 2                     | 1 <sup>1</sup> | -               |
| Brunei   | 2                | 5.4 %        | 1                     | 1              | -               |
| Hong Kong/Singapore/Taiwan   | 1 (each)         | 2.7 %        | 2                     | -              | 1               |
| Thailand/Philippines/Fiji  | 1 (each)         | 2.7 %        | 2                     | 1              | -               |
| Italy/Morocco  | 1 (each)         | 2.7 %        | 2                     | -              | -               |
| South Africa   | 1                | 2.7 %        | -                     | 1              | -               |
| <b>Total number of companies with overseas production: 37 (32% of total)</b> |                  |              |                       |                |                 |

<sup>1</sup> This involved an investment set up to supply a number of basic items to US customers, which were not labour intensive, but did require short time to market and frequent, small batch delivery and were quota items. The establishment was set-up not so much to increase turnover or profit, but as an extra service to customers.

**Table F Non-production Units of Companies in the Survey: Functions and Location**

| Other units of company not involved in production            | Total <sup>1</sup>      |                    | Local      |           | Overseas   |          | Total |
|--|-------------------------|--------------------|------------|-----------|------------|----------|-------|
|  | other est. <sup>2</sup> | subs. <sup>2</sup> | other est. | subs.     | other est. | subs.    |       |
| Headquarters   | 12                      | -                  | -          | -         | 12         | -        | 12    |
| Sourcing/buying agency                                       | 2                       | -                  | -          | -         | 2          | -        | 2     |
| Sales & marketing office                                     | 21                      | 6                  | 4          | 3         | 17         | 3        | 27    |
| Marketing/distribution/warehousing facilities                | 6                       | 3                  | 3          | 2         | 3          | 1        | 9     |
| Trading company  | 11                      | 5                  | 10         | 5         | 1          | -        | 16    |
| Retail services/outlets                                      | 3                       | 5                  | 2          | 4         | 1          | 1        | 8     |
| Upstream activities (e.g. yarn spinning, textile production) | 10                      | 1                  | 9          | 1         | 1          | -        | 11    |
| Complementary activities (e.g. dyeing, embroidery, washing)  | 3                       | 3                  | 3          | 3         | -          | -        | 6     |
| Accessories production                                       | 3                       | -                  | 3          | -         | -          | -        | 3     |
| <b>Total</b>   | <b>73</b>               | <b>25</b>          | <b>34</b>  | <b>20</b> | <b>39</b>  | <b>5</b> |       |

<sup>1</sup> Total refers to number of companies that have such other establishments/subsidiaries; there is some overlap in these numbers, as some companies may have several different non-garment producing units within the company. If a company had more than one of the same facilities (e.g. 4 retail outlets) it was only counted once.

<sup>2</sup> other est. = other establishment; subs. = subsidiary

**Table G Input Sourcing Locations (1998)**

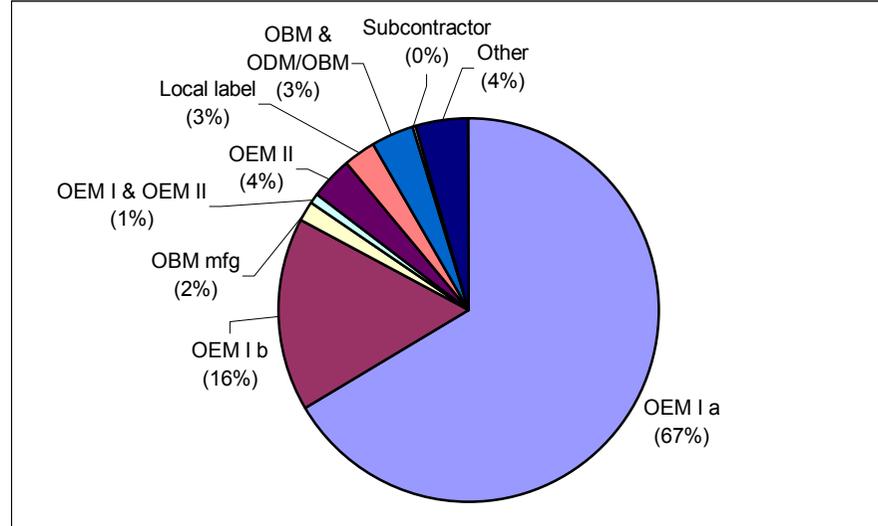
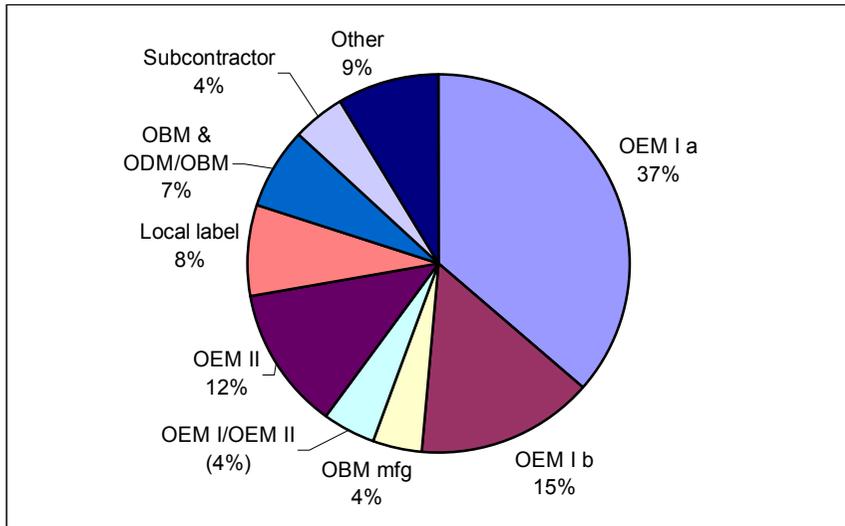
| <b>Sourcing locations fabric</b> | <b>No. of comp.</b> | <b>Share</b> | <b>Sourcing locations accessories</b> | <b>No. of comp.</b> | <b>Share</b> |
|----------------------------------|---------------------|--------------|---------------------------------------|---------------------|--------------|
| Taiwan                           | 71                  | 61 %         | Malaysia                              | 76                  | 65 %         |
| Malaysia                         | 64                  | 55 %         | Hong Kong                             | 44                  | 38 %         |
| Hong Kong                        | 36                  | 31 %         | Taiwan                                | 34                  | 29 %         |
| China                            | 20                  | 17 %         | Singapore                             | 8                   | 7 %          |
| Korea                            | 16                  | 14 %         | Europe                                | 5                   | 4 %          |
| Japan                            | 12                  | 10 %         | USA                                   | 5                   | 4 %          |
| Europe                           | 12 <sup>1</sup>     | 10 %         | Japan/China                           | 4 <sup>(each)</sup> | 3 %          |
| India                            | 11                  | 9 %          | Other Asia <sup>3</sup>               | 8                   | 7 %          |
| Indonesia                        | 10                  | 9 %          | <b>Sourcing locations threads</b>     | <b>No. of comp.</b> | <b>Share</b> |
| Singapore                        | 9                   | 8 %          | Malaysia                              | 87                  | 74 %         |
| Thailand                         | 7                   | 6 %          | Hong Kong                             | 4                   | 3 %          |
| Canada/USA                       | 5                   | 4 %          | Taiwan                                | 4                   | 3 %          |
| Other <sup>2</sup>               | 6                   | 5 %          |                                       |                     |              |

<sup>1</sup> Of these 12 companies, 4 sourced from Italy

<sup>2</sup> Including Pakistan and Australia

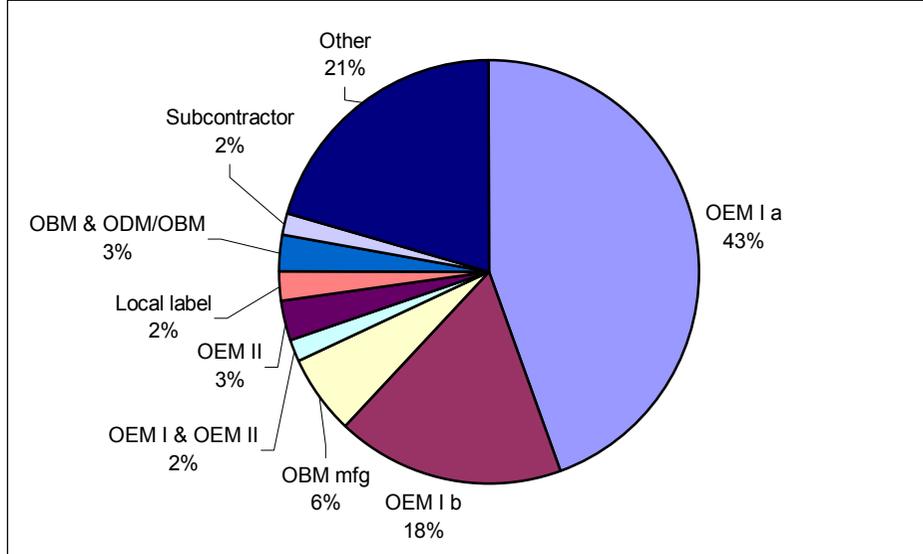
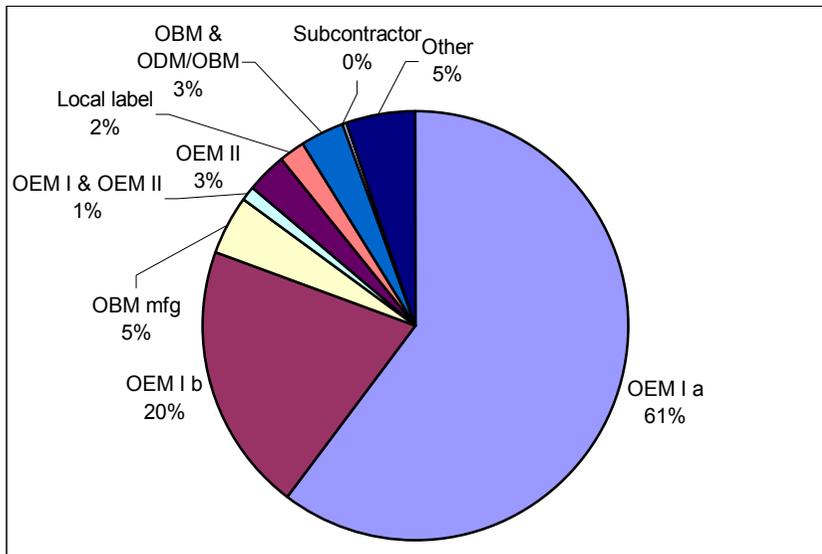
<sup>3</sup> Including Thailand, Korea, Indonesia

**Figure E Share Category in Total Number of Companies<sup>1</sup> ('99)** **Figure F Share of Category in Total Turnover ('97)**



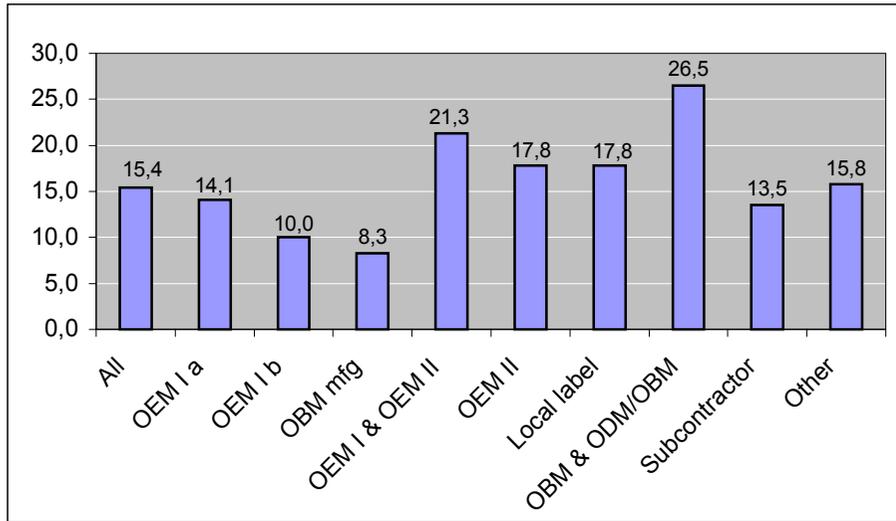
**Figure G Share Category in Total Value Fixed Assets ('97)**

**Figure H Share Category in Total Employment ('99)**

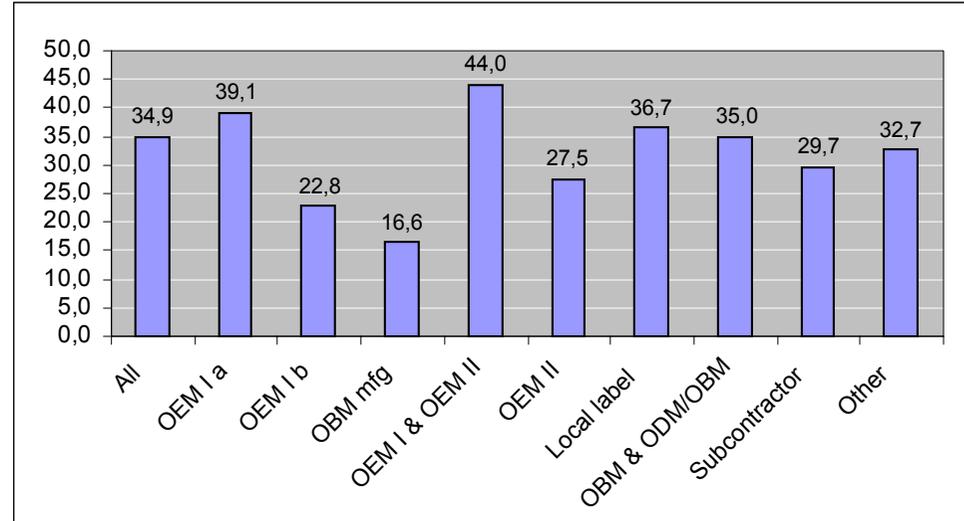


Source: UU Survey, 99/01

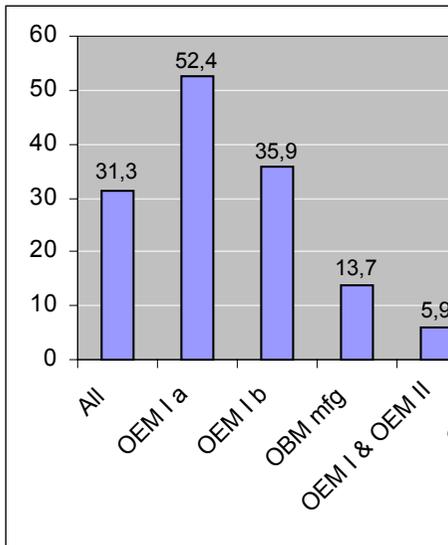
**Figure I Average Profit Margin per Category ('97)**



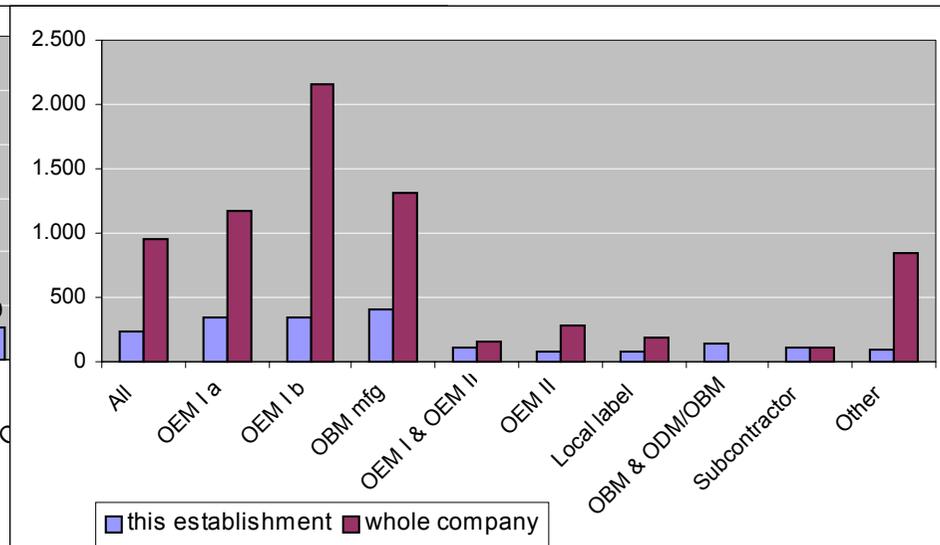
**Figure J Average Share Value added per Category ('97)**



**Figure K Average Turnover per Category ('97)**



**Figure L Average Number of Employees per Category ('99)**



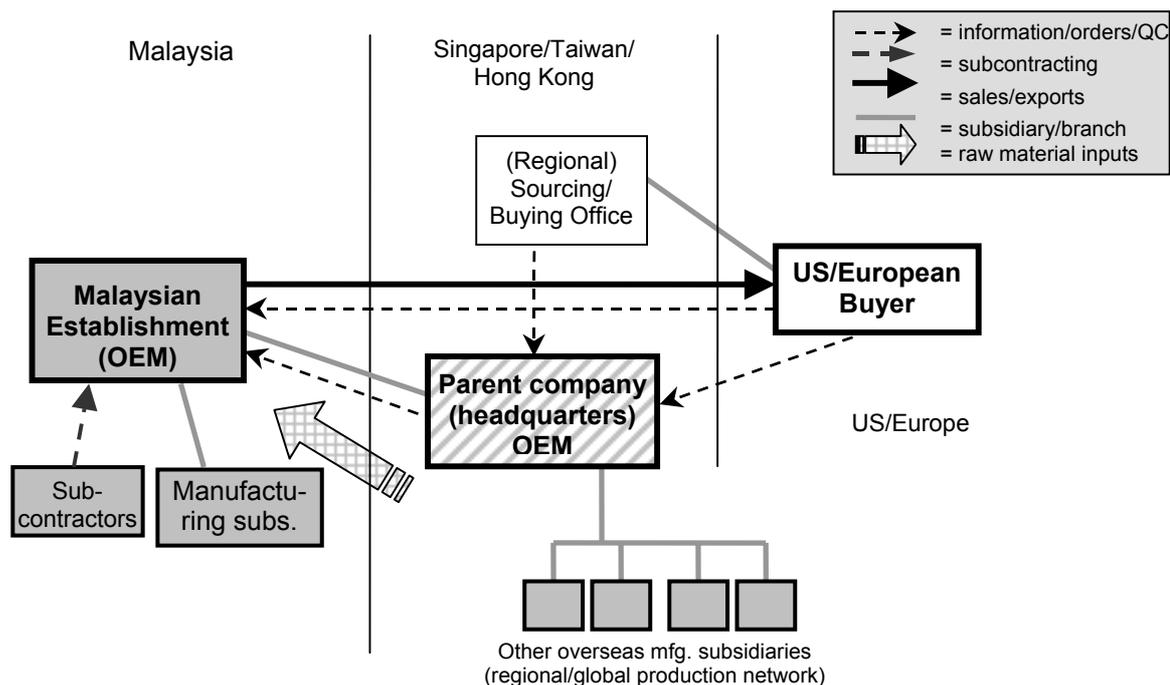
<sup>1</sup> The above figures do not include the two companies in the 'Textile based' category, as their garment output only represented a small part of their total output and value added. Thus turnover, employment and profits were only generated to a small extent by actual garment production, making it hard to compare them to the other companies in the survey.

**Table H Main Company Categories by Region (1999)**

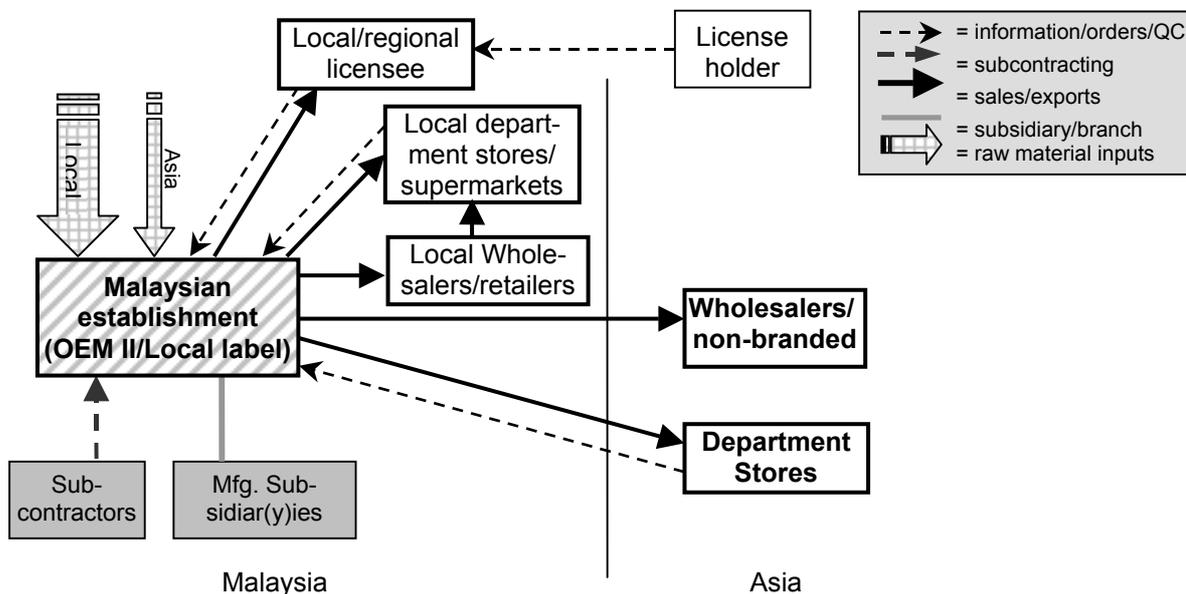
| Main company category   | Region    |              |           |             |           |             |           |             |            |
|---|-----------|--------------|-----------|-------------|-----------|-------------|-----------|-------------|------------|
|   | Central   |              | Northeast |             | South     |             | Southwest |             | Total      |
| <b>1. OEM I</b>   | <b>8</b>  | <b>13.6</b>  | <b>16</b> | <b>27.1</b> | <b>15</b> | <b>25.4</b> | <b>20</b> | <b>33.9</b> | <b>59</b>  |
|   | 22.9      |              | 53.3      |             | 71.4      |             | 64.5      |             | 50.4       |
| <i>a) OEM for export, locally owned</i>                             | <b>7</b>  | <b>16.7</b>  | <b>11</b> | <b>26.2</b> | <b>7</b>  | <b>16.7</b> | <b>17</b> | <b>40.5</b> | <b>42</b>  |
|   | 20.0      |              | 36.7      |             | 35.0      |             | 53.1      |             | 35.9       |
| <i>b) OEM for export, foreign owned subsidiary or joint venture</i> | <b>1</b>  | <b>5.9</b>   | <b>5</b>  | <b>29.4</b> | <b>8</b>  | <b>47.1</b> | <b>3</b>  | <b>17.6</b> | <b>17</b>  |
|   | 2.9       |              | 16.7      |             | 40.0      |             | 9.4       |             | 14.5       |
| <b>2. OBM Mfg</b>   | <b>2</b>  | <b>40.0</b>  | <b>2</b>  | <b>40.0</b> | <b>1</b>  | <b>20.0</b> | -         | -           | <b>5</b>   |
|   | 5.7       |              | 6.7       |             | 5.0       |             | -         |             | 4.3        |
| <b>3. OEM I &amp; OEM II</b>  | <b>1</b>  | <b>20.0</b>  | <b>2</b>  | <b>40.0</b> | -         | -           | <b>2</b>  | <b>40.0</b> | <b>5</b>   |
|   | 2.9       |              | 6.7       |             | -         |             | 6.5       |             | 4.3        |
| <b>4. OEM II</b>  | <b>8</b>  | <b>57.1</b>  | <b>4</b>  | <b>28.6</b> | <b>1</b>  | <b>7.1</b>  | <b>1</b>  | <b>7.1</b>  | <b>14</b>  |
|   | 22.9      |              | 13.3      |             | 4.8       |             | 3.2       |             | 12.0       |
| <b>5. Local label</b>   | <b>3</b>  | <b>33.3</b>  | <b>1</b>  | <b>11.1</b> | <b>2</b>  | <b>22.2</b> | <b>3</b>  | <b>33.3</b> | <b>9</b>   |
|   | 8.6       |              | 3.3       |             | 9.5       |             | 9.8       |             | 7.8        |
| <b>6. OBM</b>   | <b>5</b>  | <b>83.3</b>  | -         | -           | -         | -           | <b>1</b>  | <b>16.7</b> | <b>6</b>   |
|   | 14.3      |              | -         |             | -         |             | 3.2       |             | 5.1        |
| <b>7. OEM/ODM &amp; OBM</b>   | <b>2</b>  | <b>100.0</b> | -         | -           | -         | -           | -         | -           | <b>2</b>   |
|   | 5.7       |              | -         |             | -         |             | -         |             | 1.7        |
| <b>8. Textile based</b>   | <b>1</b>  | <b>50.0</b>  | -         | -           | <b>1</b>  | <b>50.0</b> | -         | -           | <b>2</b>   |
|   | 2.9       |              | -         |             | 5.0       |             | -         |             | 1.7        |
| <b>9. Subcontractor</b>   | -         | -            | <b>3</b>  | <b>60.0</b> | <b>1</b>  | <b>20.0</b> | <b>1</b>  | <b>20.0</b> | <b>5</b>   |
|   | -         |              | 10.0      |             | 4.8       |             | 3.2       |             | 4.3        |
| <b>10. Other</b>  | <b>5</b>  | <b>50.0</b>  | <b>2</b>  | <b>20.0</b> | -         | -           | <b>3</b>  | <b>30.0</b> | <b>10</b>  |
|   | 14.3      |              | 6.7       |             | -         |             | 9.4       |             | 8.5        |
| <b>Total</b>  | <b>35</b> | <b>30.0</b>  | <b>30</b> | <b>25.6</b> | <b>21</b> | <b>17.9</b> | <b>31</b> | <b>26.5</b> | <b>117</b> |

Note: Black numbers in the cells refer to the number of firms in category per region, grey number to the right of black number refers to share (in %) of the region in a specific category, while grey number at bottom of cell refers to share (in %) of each category in a specific region.

**Figure M Production and Distribution Networks of Foreign owned OEM Suppliers**



**Figure N Production and Distribution Networks of Malaysian Domestically/Regionally Oriented Suppliers (OEM II & Local label)**



**Table I Government Incentives Programs Made Use of (1988-1999)**

| Incentives Programs                         | No. of comp. | Percent (N=117) | Incentives Programs             | No. of comp.   | Percent (N=117)   |
|---|--------------|-----------------|---------------------------------|----------------|-------------------|
| Exemptions on duties and taxes              | 91           | 77.8            | R&D funding                     | 5              | 4.3               |
| Human Resource Development Fund (HRDF)      | 64           | 54.7            | Pioneer Status                  | 4              | 3.4               |
| Investment Tax Allowance                    | 18           | 15.4            | Industrial Adjustment Fund      | 3              | 2.6               |
| Re-investment Tax Allowance                 | 17           | 14.5            | Technical Acquisition Fund      | 3              | 2.6               |
| SMI funding                                 | 15           | 12.8            | Promotion Malaysian Brand Names | 3              | 2.6               |
| Export Market Devt. Scheme                  | 7            | 6.0             | Other                           | 7 <sup>1</sup> | 6.0               |
| Industrial Technical Assistance Fund (ITAF) | 5            | 4.3             | None                            | 13             | 11.0              |
| Just 1 program                              | 28           | 23.9            | - Exemptions                    | 19             | 67.9 <sup>2</sup> |
|   |              |                 | - HRDF                          | 4              | 14.3              |
|   |              |                 | - SMI                           | 4              | 14.3              |
|   |              |                 | - Other                         | 1              | 3.6               |

<sup>1</sup> Including for instance export tax incentives (1), tariff protection (1) and industrial linkage program (1)

<sup>2</sup> Share of companies making use of just one program

**Table J Changes in Production (1988-1998)**

|  | Increased                                    | No change | Decreased |
|--|--|-----------|-----------|
|  | Share of relevant companies in %             |           |           |
| Production cost (N=115)                | 77.4   | 13.0      | 9.6       |
| Labour cost as % of total cost (N=113) | 71.7   | 17.7      | 10.6      |
| Product quality (N=116)                | 91.4   | 7.8       | 0.08      |
| Productivity (N=112)                   | 73.2   | 24.1      | 2.7       |
| Profit margin <sup>1</sup> (N=103)     | 38.9   | 38.9      | 22.3      |
| Production capacity (N=111)            | 82.0<br>(still use full production capacity) |           | 18.0      |
| Number of employees (N=113)            | 63.7   | 20.4      | 15.9      |
| Need for skilled workers (N=108)       | 64.8   | 32.4      | 2.8       |

<sup>1</sup> Percentages in this table may differ slightly from table 7.15 as numbers in this table are based on an N excluding non-response, while figures in table 7.21 are based on total N (117)

**Table K Expectations for the Future**

| Expected                                 | Yes   | No    | Just maintain |
|--|-------|-------|---------------|
| • Growth of garment industry in Malaysia | 56.1% | 40.4% | 1.8%          |
| • Growth of business for company         | 87.0% | 8.7%  | 4.3%          |
| • Growth of company                      | 83.0% | 13.2% | 3.8%          |
| • Growth of establishment                | 54.6% | 38.9% | 6.5%          |

## **8 Interpreting Development Trajectories of Garment Firms and the Garment Industry in Singapore and Malaysia**

### **Introduction**

Having analysed the characteristics, strategies and development trajectories in the Singapore and Malaysian garment sector at the firm and industry levels, we now turn to the task of understanding the patterns identified. This requires a closer look at the dynamics or causalities behind strategies and development trajectories.

The exercise will give a better insight into whether and how incorporation into global production networks and chains may lead to local industry development or why it doesn't. As such the current chapter forms a crucial last part of this study. The analysis will deal with Singapore and Malaysia in comparative perspective, so as to highlight similarities and differences.

In the conceptual framework outlined in chapter 3, two types of main determinants or sources behind strategies and trajectories were identified: external and internal or firm-specific ones. The former include the international and national business environments as well as the industry specific local context, while the latter include aspects such as size, history, organisation structure and the less tangible management style and business attitudes within the firm, which are in turn often shaped by the national business system and industry specific context.

Most of these aspects have been considered implicitly in the previous chapters. In the current chapter they will be more explicitly linked to the strategies and development trajectories identified and the differences found between the cases of Singapore and Malaysia in the previous two chapters, allowing for an assessment of their validity as explanatory factors.

As the factors behind the strategies and trajectories of individual firms and industries as a whole, often operate simultaneously and interrelate with one another, the most important determinants and their differential effects, but also their interactions will be analysed.

Section 8.1 starts with a consideration of the relationship between strategies, development trajectories and outcomes in terms of roles/positioning at the firm level. Subsequently we try to give an insight into the forces behind the – differences in the – most common adjustment strategies and development trajectories found in Malaysia and Singapore.

Section 8.2 considers industry level development trajectories and particularly the limited (Singapore) to negligible (Malaysia) impact and potential of new sources of growth and diversification at this level.

Finally, in section 8.3 these findings and their interactions are summarised to arrive at a more general assertion about the main determinants or forces behind firm and industry level dynamics in relation to incorporation into global production networks and chains in Singapore and Malaysia.

### **8.1 Forces Behind Firm Strategies, Development Trajectories and Competitive Positioning in the Malaysian and Singapore Garment Industry**

The relationship between firm adjustment strategies, development trajectories and competitive positioning appears quite straightforward and indeed has been presented as such in a great deal of the literature. Suggested is that pro-active strategies will enable taking advantage of the opportunities offered by linkages to buyers to embark on upgrading trajectories of the CMT-OEM-ODM-OBM kind, ultimately resulting in an OBM position.

However, based on additional literature, already in our review of theoretical notions and conceptual framework (chapters two and three), question marks were placed behind this rather simplistic imagery of the suggested relationships. These doubts were confirmed by the

empirical findings, which reveal a variety of strategies and successful and less successful (in terms of final outcome or positioning) trajectories, not all of which were necessarily straightforward or 'moving up', nor necessarily set *within* global networks and chains.

Although the Malaysian garment industry became incorporated into global networks and chains in a slightly different mode and at a later time than the Singapore garment industry, roughly similar competitive pressures have impinged on the competitiveness of garment companies in both countries (elaborated in chapters 4 and 5). These have necessitated, and evoked, a range of competitive adjustment strategies among them, and resulted in a variety of different development trajectories.

The question then arises how these strategies, trajectories and outcomes, and the extent to which they differ in the two cases analysed, may be explained and interpreted.

### 8.1.1 *Explaining Processes and Outcomes in Singapore*

Generally, in Singapore, a shift in strategy focus (from more defensive relocation strategies to the more offensive internationalisation strategies) can be observed since the mid 1980s, which in turn was a result of a shift in business approach and aim of strategic choices. The result of this is reflected in the development trajectories, which, although still rooted in contract manufacturing roles, have been moving towards more rewarding roles, such as OEM+, as opposed to merely maintaining roles. While OEM producers have not (been able to) embark(ed) on trajectories leading to OBM roles, despite more pro-active strategies and a shift in business approach, a number of companies operating *outside* chains have been quite successful in this respect.

Let us briefly consider what motivated or inspired these strategic choices, preferences and shift in business attitudes, and resultant development trajectories

Upgrading of products, processes and services to buyers was mostly buyer-driven and was necessary in order to retain buyers, but also increasingly to secure higher-end buyers and to demonstrate and provide the kind of 'extras' in terms of quality and reliability required when low prices are no longer a source of competitiveness. Upgrading of products and processes was not only driven by existing buyers but also by the necessity of, and opportunities seen in, working with new buyers.

A shift to higher-end buyers was thus in part necessitated by the fact that cost increases and currency appreciation made Singapore products too expensive for lower end-buyers causing them to steer away from Singapore altogether. Hardly any of the lowest-end buyers still sourced from Singapore, although some worked with Singapore agents to source from other countries in the region. To retain contract manufacturing roles manufacturers were forced to secure higher-end buyers that were willing to pay higher prices (even for relatively basic knitwear), under the condition that Singapore producers upgraded quality to an extent that they could produce 'special' products, e.g. with a special feel, or cut (see chapter 6). On the other hand, shifting to higher-end buyers was not just an ad-hoc response to changing buyer strategies (i.e. changing selection of buyers). Many companies had started relocating production overseas as early as beginning of the 1980s. They could have retained lower-end buyers by producing for them in their lowest cost locations, yet didn't. This kind of attitude is in part the result of the more general Singapore business philosophy of shifting to competing on quality rather than continuing to focus on price competitiveness and the idea of creative destruction (see chapter 4). In the context of the garment industry this meant low-end buyers, products and processes, had to make way for higher-end ones.

One of the most remarkable features of the Singapore garment industry is its geographical reach, achieved through extensive relocation and internationalisation that appears to have

been part and parcel of virtually every development trajectory observed. Thus even the smaller domestically oriented companies had expanded production overseas, either through ownership or subcontracting networks. OEM suppliers in particular have used internationalisation strategies as a way to avoid Singapore's high cost environment and quota limitations, but increasingly also as an expansion and competitiveness strategy.

Initial drivers behind relocation and internationalisation were rising wages and quota limitations, exacerbated by Government policies, particularly the high wage/high cost policy and the quota bidding system and the more general policy of pushing out labour intensive activities. Increasingly, limited (re)resources for expansion locally (labour shortages compounded by strict foreign worker policies, land shortages, etc.) further motivated the shift overseas, as this became the only way to expand.

In addition, after the crisis in the industry in the late 1980s, garment companies appear to have changed their business approach, hence strategic intent, with a deliberate aim to advance their positions towards co-ordinators of regional and international production networks, while providing added logistical and quality control services to their buyers. Within this general strategic direction, the nature of internationalisation strategies changed towards enhancing competitiveness through services provision, as opposed to retaining cost. Several Singapore producers started setting up factories and other establishments in different strategic locations overseas, carefully chosen so as to be able to take advantage of different local strengths and advantages. This enabled companies to offer specific services to buyers, such as supply chain management, close proximity to markets for specific products, preferential access to markets under favourable trade agreements, etc. (see e.g. box 6.3). The Singapore establishment became a one-stop centre for buyers, providing instant access to an array of different production locations and value chain services. As such, internationalisation was at the base, and formed an intrinsic part, of development trajectories towards OEM+ roles. As one of the producers argued: "I learnt that if you want to thrive, not just survive, in this industry, you have to go global" (Interview in *The Straits Times*, March 13, 2003).

This shift in strategy focus (from more defensive relocation to more offensive internationalisation) was driven by - the interaction between - a number of forces. First the initiative or strategic intent of management in companies; second the competitiveness crisis of the late 1980s/early 1990s and resultant shake-out in the industry; third the more general changing function of Singapore into a (manufacturing) services and trading centre, so deliberately propagated and encouraged by the Singapore State; and fourth the related changing position of Singapore in the sourcing networks of buyers. To start with the latter, following Singapore's general shift towards becoming a centre or hub from the mid 1980s onwards (see chapter 4), the City-State also started to assume a node or hub function within the networks of several buyers, some of which have set up a sourcing office in the City-State, while others at least have representation there. This seemed to have implications for the way Singapore producers have been viewed by buyers, or perhaps what is expected from them, and in turn how Singapore producers have positioned themselves vis-à-vis buyers. In addition, the close proximity of a substantial number of buying offices and agents, and more or less informal contacts with their representatives, appear to have had demonstration effects on producers. They were not just informed about international standards through the specifications and requirements of their own buyers, but appeared generally more aware of overall sourcing strategies, networks and requirements of buyers, to which they have to an extent adjusted their own strategies (providing their buyers with added services, international reach, etc.). Thus buyers too have indirectly - and sometimes even more directly - encouraged the kind of internationalisation that has taken place in Singapore.

When trying to explain the driving forces behind strategic choices in Singapore, and particularly behind the shift to more offensive strategies in the last decade, the

competitiveness crisis and shake-out experienced in the late 1980s/early 1990s cannot be discarded.

The crisis left an imprint not just in terms of the large number of firms that went bust, but also on surviving firms. These had experienced and seen first hand the dangers of defensive, cost-down strategies and this caused a shift in attitudes. Remaining firms had survived by changing their business approach (advancing rather than keeping up) and increasingly implemented more offensive strategies. This resulted in the internationalisation as discussed above, yet also in increased emphasis on diversification and the spreading of risks, so as not to become too dependent on (only a few) buyers and markets. Branding - or rather local label development - among OEM suppliers must also be understood in this diversification perspective, as they were driven not so much by the ambition (strategic intent) to shift completely to OBM (many companies had introduced own labels in the early 1990s, yet for most this still constituted less than 10 percent of total output), but rather by the perceived need to spread risk and become less dependent on buyers.

The development of own labels was also stimulated by the institutional context, as both the State – in a more general way<sup>1</sup> – and the industry association emphasised this avenue. The industry association changed its name into Textile and *Fashion* Federation and started promoting more explicitly local brands and design capabilities. However, it must be noted that in only a small number of the cases observed was own label development based on original designs and did it entail substantial involvement in marketing and retailing. The labels introduced by OEM companies made up small shares of total output, required minimal design capabilities (they were mostly copies) and were distributed through local department stores. Not exactly the kind of brand development perhaps envisioned by institutions, as overall, most contract manufacturers remained entrenched in OEM positions, although the emphasis within this role has shifted

A number of (small) domestically and regionally oriented companies operating outside chains, had however achieved OBM roles, or started out in such positions. A strategic orientation of operating outside chains and taking on local OBM roles was driven mostly by the initial choices and general business approach adopted by these companies. Several had never had any ambitions of mass production, but started out in, or aspiring, an OBM or ODM role. They were design or at least brand-driven, often set up and led by a designer/group of designers who were educated in fashion design and marketing (as opposed to OEM firms, led by business managers) and accordingly, their business outlook was profoundly different to those of large scale manufacturers. Their small size and relatively limited investments (i.e. low sunk cost) made them more flexible and willing to take some risks, following a trajectory leading to a fundamentally different role, increasingly away from production. Such examples were found in Malaysia as well.

The fact that OEM suppliers were unable, or unwilling to assume such roles and positions can be attributed to a competencies gap and sunk cost (see chapter 6), and – related to these – high switching cost of following such trajectories. Switching costs include for instance the cost of learning new skills, developing a brand name and setting up a distribution network, but also loss of business due to smaller scale (exit barriers).

Incorporation into global networks and chains thus often creates path dependency, making it increasingly hard to opt for a fundamentally different role.

More generally evidence from the surveys demonstrated that initial choices with regards to role and position determined, limited or at least influenced strategic choices further down the road. For instance, the companies operating outside global networks and chains that had successfully shifted from one role to the other had usually made this shift early on in their development or even at the start. This was particularly true for the shift towards OBM.

As already becomes clear from the above discussion, business attitudes, the local business environment and their interaction, are important drivers behind strategies and development trajectories. Before further elaborating on these, however, we will first consider the most commonly observed firm strategies and development trajectories in Malaysia.

### *8.1.2 Explaining Processes and Outcomes in Malaysia*

In Malaysia the most common strategies identified among garment producers included labour intensification (especially the use of foreign labour), the upgrading of product quality and production processes and the adding of higher-end buyers to the buyer base. Generally speaking there was a tendency of seeking solutions for competitiveness issues locally (reflected for instance in the locally rooted organisation structures of the majority of companies), while the aim of strategic choices for most companies, as expressed in their business focus, was one of sustaining connections, keeping up and following trends. Most OEM producers as a result followed steady OEM trajectories, achieving operational effectiveness and growth, sustaining connections, yet without advancing roles.

Among firms operating outside chains, the majority displayed even more conservative business attitudes with mostly steady development trajectories as a result, although a few examples of companies having followed successful extra chain trajectories demonstrated that they can be rewarding as well.

Labour intensification, making workers work overtime and the extensive use of foreign labour, is perhaps the most natural first reactions to competitive pressures – particularly increasing cost – in the context of the garment industry, given the limited possibilities for automation and the dilemmas linked to shifting to higher value added, more complex products. However, while in Singapore they were soon complemented by more proactive strategies, which eventually became more important, in Malaysia defensive strategies are still very common, despite pressing labour shortages and rising wages. The prolonged dependence on defensive labour strategies was made possible by relatively lenient foreign labour policies and the possibilities for evasion, as Government turned a blind eye to diversion of levies onto foreign workers and general exploitation of this rather vulnerable group (most overtime work was in fact carried out by foreign workers) (see chapter 5). On the contrary, in Singapore, many of these routes were quickly cut off by the Government.

The upgrading of product quality and improvement of production processes (introducing new technologies, reducing lead-times and improving productivity/efficiency) was almost entirely driven by (the requirements of) buyers. Although these 'upgrading' strategies are generally considered offensive, they are so in a non-deliberate way, in other words, they involve the kind of 'routinised upgrading' referred to by Fleury & Fleury (2001) (see chapter 2). In some cases, however, upgrading of products and processes was also done to be able to secure new buyers, signifying a shift to more deliberate offensive strategies, where the initiative lay with the producer.

In fact, most OEM producers had expanded their buyer base with higher value added (branded) buyers, although this did not imply a complete shift towards such buyers as a great number of producers still worked with lower-end buyers as well. This expansion of the buyer base was driven on the one hand by the fact that the lowest value added buyers reduced their total orders in Malaysia, or in any case did not increase them. As cost levels in Malaysia rose and new, lower cost locations, such as Bangladesh, 'opened up', there was a tendency for these lower-end buyers to shift their sourcing base. On the other hand, with cost increasing for Malaysian producers, they found it increasingly hard to produce at the low price points offered by low-end buyers and still maintain profit margins. In addition many producers

shifted from (lower-end) European to (higher-end) US buyers, as the latter usually also placed bigger orders. Finally, informal exchange of information among industry members, particularly locally concentrated ones, played a role in the 'spread' of this strategy. Evidence was found of producers recommending other producers in the same area to their buyers, either when they asked for permission to outsource part of an order to these companies or if they could not handle the order themselves at that moment.

All in all the shift towards higher-end buyers was driven by a combination of competitive pressures, changing buyer strategies and the opportunities seen by producers in higher price-points and bigger orders. Claims have been made that higher-end branded buyers present added opportunities for producers not just in terms of higher price-points, but also in the learning potential offered due to their increased inclination to outsource responsibilities (see chapter 1). Evidence in Malaysia seems to refute this claim, at least in part, as particularly branded buyers often reduced producer responsibility in terms of sourcing inputs (most nominated suppliers), or further outsourcing of production, while the transfer of responsibilities was in fact rather limited (see box 7.3). Connections to these buyers has thus encouraged further upgrading of products and processes, yet has contributed little to role advancement

The more general trends of seeking solutions to competitive problems locally (a tendency that so sharply contrasted with what was found in Singapore) and keeping up with buyer requirements inspired by a wish to sustain connections – at which most companies have indeed been successful – may be explained in terms of business attitudes, the industry specific characteristics as well as the institutional context, and the interaction between them.

The fact that most firms remained strongly rooted within Malaysia in terms of their organisational structures was made possible by pockets of labour still available in rural/peripheral areas (hence the high propensity for firms to set up numerous branches, even within the same region). Such local (re)resources were practically non-existent in Singapore due purely to the small size of the country. All in all relocation and internationalisation were not seen as necessary for expansion, nor specifically encouraged by the State (up till more recently) and therefore less popular.

But explanations should also be sought in the rather risk averse, closed nature of many companies in the industry. Business networks, on which many companies – even the smallest ones – often did rely, rarely extended beyond Malaysia, or even the immediate region in which companies operate. This is in contrast to what has been suggested in some of the literature on Chinese business networks in Asia (see chapters 4 and 5).

Generally the business approach of many of the smaller companies in the domestically oriented sector, but even among some of the export-oriented companies was rather non-committal. Among smaller, family owned businesses especially, there was somewhat of a wait and see attitude. As long as income was greater than cost, companies considered business to be good and did not see the necessity of making any changes. Due to low investments in these companies (they often use old machines that have been written off) and ease of laying off workers, exit barriers are low and often these companies will exit or move into other lines of business, rather than adjust, if business 'goes bad'. The survivalist attitude of these family businesses is not necessarily tied to surviving within the garment industry.

Such attitudes, predominant among the domestically oriented segment of the industry, have in part contributed to the dichotomy that has developed between the domestic and export oriented segments.

However, in Malaysia too, highly successful cases were found in this domestic segment, in which a visionary management set out development trajectories towards more advanced roles

such as local label and OBM supply. The observed dichotomy should therefore not be interpreted as a division between successful and unsuccessful firms *per se*.

Among the larger export oriented OEM suppliers such a complete lack of strategic intent was not found, as it would surely imply disconnection. Yet strategic intent among these producers was mostly limited to sustaining connections and maintaining roles. This meant that actual competitive adjustments were mostly determined by what was required (by buyers) to achieve this sustaining, whether to networks and chains driven by existing, or new buyers. This was often a conscious choice on the part of producers and has indeed ensured growth and the achievement of international quality standards. However, as buyers appeared little inclined to teach producers completely new capabilities and competencies beyond the products and roles in which producers have demonstrated skills, this buyer driven upgrading has not encouraged any role advancement at all. Moreover, such completely buyer driven upgrading could be detrimental to the industry, as these linkages may prove to be rather volatile in the long run. This is particularly true if a company also chooses to 'stick with' specific buyers only, as demonstrated by one of the interviewed OEM suppliers in Malaysia. The company operated in price-driven chains to the order of mass merchandisers and discounters. Asked whether it was looking to upgrade its buyer base the manager replied he intended to stick with these buyers and do what they had always done and were best at: mass production of basic products in Malaysia. They would try to keep doing this for as long as possible and if it was no longer profitable, the company would just shut its doors in Malaysia (*-Interview manager Malaysian garment company, 2000*). Obviously the company's strategy of hanging on to these buyers, meant it had tied its fate completely to their demands and requirements. The resulting development trajectory was one that even the company itself admitted may eventually lead to exit of the industry. Although definitely not typical for all Malaysian companies, this (rather fatalistic) sentiment was not unique either.

Steady trajectories may prove especially volatile come 2005. The Malaysian garment industry has competitive disadvantages *vis-à-vis* other Southeast Asian competitors (lagging behind Thailand and Singapore in terms of productivity and being more expensive than all other countries except for Singapore); *vis-à-vis* the Asian NIEs (in terms of competencies, flexibility and buyer connections); and *vis-à-vis* China in terms of price, labour availability, flexibility and increasingly even lead-times and competencies. In addition Malaysia has a more general disadvantage in terms of lack of local inputs. It is therefore likely that the sustaining of connections has not merely been a result of successful competitive adjustment strategies, but that the relative protection of the quota system has provided an even bigger (artificial) competitive advantage than has already been assumed.

The dominant strategic intent among OEM suppliers to merely sustain connections has amounted to path dependent development along adjustment upgrading trajectories particularly of the steady OEM kind. Such general business attitudes and approaches (the aim to keep up rather than advance roles) in turn were influenced by the institutional context and characteristics of firms and the industry as a whole.

Both Government and private institutions seem to stress mostly process improvements, benchmarking and learning from foreign capital as opposed to local entrepreneurship. On the other hand, policies that did stress more proactive strategies and dynamic trajectories, appear ill-suited to the existing needs and issues in the industry; stressing the need to develop and market own brands, when the industry has barely succeeded in developing design capabilities or even becoming less dependent on buyers, is perhaps somewhat ambitious and unrealistic. More importantly implementation failed almost completely due to deep rifts between policy-makers the economic bureaucracy and the industry, as was elaborated in detail in chapter 5.

Many companies were not even aware of the existence of certain policies, and the use of Government incentives programs by garment companies rarely extended beyond the cost reducing programs (see chapter 7).

Some of these tendencies were reflected in private institutions as well, as is illustrated by the two largest business associations. Their main programs are still aimed at improvement of manufacturing capabilities, through skills training, information and promotion of new technologies, as well as benchmarking. Although more recently they have also become more involved in information about investment opportunities overseas (a move driven to a large extent by the 'threat' of 2005) general focus is still on (contract) manufacturing rather than the development of non-production capabilities and competencies.

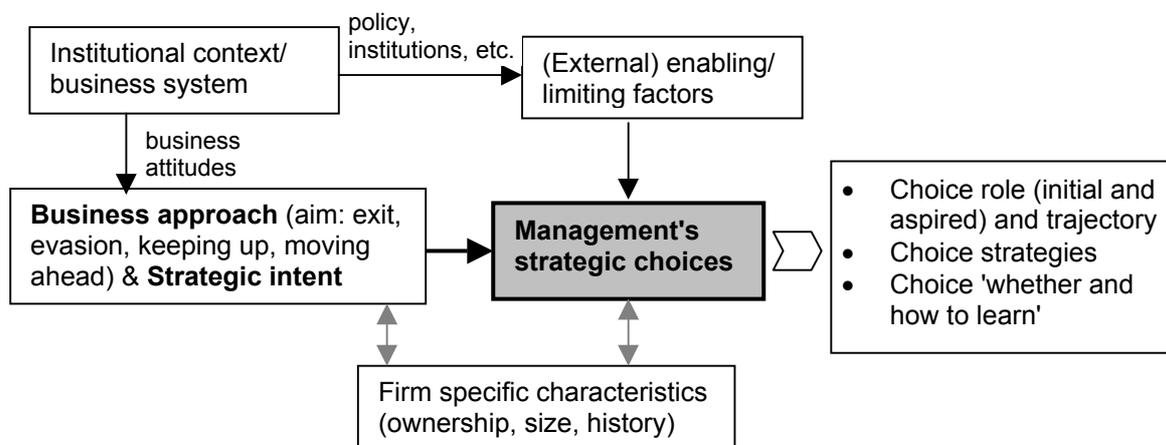
Finally, it was found that companies with foreign involvement were in fact even less likely to engage in strategies and follow trajectories that led to an advancement of roles. Their very set-up, as dependent *manufacturing* branches, makes such trajectories unlikely. The still relatively big (as compared to Singapore) involvement of foreign capital in the industry has thus also contributed to the mostly steady trajectories observed.

### 8.1.3 Malaysia and Singapore: Explaining the Differences

Turning to the different strategic choices and development trajectories found in Malaysia and Singapore, and how these may be explained, the different timing of entry undeniably plays an important role. The shake-out experienced in Singapore, which was instrumental in causing an attitude change that was behind the shift towards more pro-active strategies and OEM+ development trajectories, has not occurred in Malaysia. There are, however, signs that such a shake-out is imminent in Malaysia (see chapters 5 and 7).

But even if the garment companies in Singapore and Malaysia had entered global networks and chains at the same time, it is likely that differences in strategic directions and development paths would still abound. Given the fact that roughly similar types of buyers were found in both countries, explanations must be found in the (differing) interactions between the local business environment business approaches and strategic intent and choices local business environment. Figure 8.1 attempts to illustrate these relations schematically.

**Figure 8.1** *Interrelations Between Business Environment, Firm Business Approach, Strategic Intent and Strategic Choices*



At the base of the observed differences lie the more dynamic general business attitudes expressed in business approaches and strategic intent of Singapore garment producers as opposed to Malaysian garment producers. These have resulted in more dynamic strategic

choices and trajectories, while the generally more conservative business approach in Malaysia has contributed to more risk-averse choices, resulting in less dynamic trajectories. More generally put, Singapore garment companies appear to have more actively and deliberately leveraged the opportunities offered by linkages to buyers. Although these differences in attitude must in part be taken as such, the above discussions already illustrated that the local business environment may have an impact as well.

In Singapore, Governments continuous and relentless push for adjustment and restructuring and constant redefinition of the City-State's role within the regional and global economy has resulted in economic and industrial structures characterised by high dynamism and flexibility, patterns of creative destruction, the pushing out of labour intensive activities, internationalisation, and generally a continuous redefinition of roles. The 'hostile' high cost environment that Singapore producers have had to operate in and in which competitive pressures were exacerbated, rather than alleviated by the State, have necessitated early adjustment. These in fact followed more general economic and industrial restructuring trends through product upgrading, shifting out of low value added activities, internationalisation and redefinition of roles. These elements were also picked up by the industry association, which has performed somewhat of a bridge function between Government and the industry and managed to more or less forge a new 'identity' for the industry (stressing fashion content and internationalisation), which fit the development ambitions of the State.

In Malaysia on the other hand, economic and industrial structures have displayed less dynamism, as specific groups were favoured and there was a tendency for protection of certain industries, groups and interests through political patronage. In addition, up till the early 1990s, there has been strong emphasis on manufacturing capabilities and process upgrading, which were to be leveraged off foreign capital. Finally policy inconsistency (continued possibilities for evasion of measures intended to encourage upgrading) and weak policy implementation, have added to more conservative business approaches and strategic choices.

Comparing business attitudes in Singapore and Malaysia, one of the most obvious differences lay in trust levels, to an extent the result of forces in the local business environment, while in turn affecting firm business approaches and strategic choices.

Both the Singapore and Malaysian garment industry operated in a business environment that – sometimes quite explicitly – favoured foreign capital and large (government linked) companies and conglomerates, causing the industry to occupy a somewhat 'peripheral position' vis-à-vis the dominant forms of economic organisation. Official neglect was further enhanced, particularly in Singapore, by a general preference for high-tech industries and firms.

The surveys confirmed that in both countries industry members indeed felt a sense of neglect. However, effects of this position or perception have been more profound in Malaysia, as general 'favouratism' had an added dimension in the context of the garment industry due to the ethnically based re-distribution policies, the bigger involvement of foreign capital in the industry (as compared to Singapore) and the dichotomy between large export oriented and domestically oriented segments, which was more pronounced in Malaysia simply due to the fact that the latter group was much larger. These elements have contributed to high levels of distrust at virtually all levels. The extent of this became obvious during the empirical and secondary data gathering for our research, with accusations flying back and forth between all actors. More than one respondent made remarks about the 'Government only supporting bumis' (bumiputera entrepreneurs), 'Government and institutions neglecting the industry because it was Chinese', 'the industry association (MTMA) favouring export oriented

companies', etc., etc. On the other hand interviewed representatives of several institutions accused the industry of being 'closed and secretive', small companies of 'not participating or co-operating', while this complaint was voiced by some of the larger companies as well. Whether these accusations are true or not matters little, yet it is obvious that such attitudes, not only impede more structural cooperative arrangements that could encourage competitiveness (see also Dooren, 2003; Fukuyama, 1995), but also hardly foster the kind of openness and willingness to take risk that is needed for firms to opt for more proactive strategies and dynamic trajectories.

In Singapore on the other hand, Government is not necessarily distrusted, rather is seen as factor companies don't need to expect anything from. However, most garment companies in Singapore have remained open to the general attitudes within the national business system and dynamics of Singapore economic development (see chapter 4).

Paradoxically, industry specific policies in Malaysia since the late 1980s, have in fact been far more positive towards the industry than was the case in Singapore, where explicit policies for the industry were virtually absent. Perhaps it is a case of 'too little, too late'. But it also points to the fact that the fundamentals underlying the business environment (encouragement of profound adjustment, policy consistency, trust and openness) are perhaps more important than specific policy, or in any case need to be in place for such policies to be successful.

Finally, the often ascribed characteristics to CFBs regarding survivalist attitudes, distinct business preferences and strategies (see chapters 4 and 5), were found in both countries, but were most prominent in the case of Malaysia, with non-committal business approaches, distrust and 'vagueness of networks' quite common among particularly the small businesses (mostly CFB). In Singapore CFBs have increasingly professionalised, although the family usually retained control and key management positions.

This in part explains the more conservative business attitudes and approaches found in Malaysia. Yet evidence was not entirely conclusive<sup>2</sup>. Several individual cases in both Singapore and Malaysia (see e.g. box 6.3 and box 7.7) demonstrated that CFB are not by definition more closed or conservative. In addition, within Malaysia, such typical CFB characteristics were mostly found among the non-export oriented companies, particularly in the Central region. Many of the larger, reasonably successful OEM companies only displayed such attitudes to a limited extent, while most were still formally family-owned.

Finally, the typical 'closedness' of CFBs may become more of a thing of the past, as generation hand-over seems to be taking place. Many of the companies interviewed in Malaysia had recently been, or were in the process of being, handed over to the second generation. Often this 'new' generation had higher education levels than their parents, while some were educated overseas. Generally speaking they were thus more 'exposed' to external influences. As a consequence many had different ideas about how the business should be run (less hierarchical) and where the company should be headed. Several indicated they wanted to develop design capabilities or own brands, or wanted to apply their specific skills in for instance IT in further business development. It seemed business approaches among this group of newcomers were more pro-active, with a clearer view or vision as to strategic directions. Moreover, awareness of the drawbacks of (over)dependence on buyers appeared higher among this group. Although still operating as family businesses and often in closely-knit communities, the more 'outward' look of the second generation is likely to bring about some changes in attitude, if it hasn't already.

Let us now once more turn to industry level developments.

## 8.2 Forces Behind Industry Development Trajectories: Local Linkages and New Sources of Growth and Diversification

In both Singapore and Malaysia industry development trajectories are still strongly tied to the positions of existing producers, which are strongly rooted in OEM roles. In Singapore, however, this role has been increasingly detached from direct involvement in production (in the Singapore establishment), which has resulted in a sharp decline of the production segment of the industry. In Malaysia on the other hand the actual production segment, which is still firmly locally rooted continues to play an important role, within the industry and even within the national economy.

Recent policies and Government visions in Malaysia have stressed the development of local linkages, and in both countries have tried to encourage establishment of buying and trading houses and development of a local brands and a fashion industry, as ways to enhance competitiveness. However, actual developments cast doubts as to the potential of such new sources of growth and diversification to be successful and change the profile of the industry locally.

The industry development trajectory in Singapore included the entry of two new segments: buying offices and local brands / a local fashion industry. In Malaysia these segments were lacking (buying offices) or had a very limited impact, functioning largely detached from the rest of the industry (fashion industry), and were thus not explicitly considered. However, the impact and potential of the two new segments in Singapore should also not be overestimated, as we explain in more detail below.

In both countries industry dynamics in terms of the development (spreading and deepening) of local linkages - between existing and new segments in Singapore, and between OEM producers and local inputs suppliers in Malaysia - were limited.

In Malaysia the competencies gap that has developed between export oriented garment producers and local input suppliers, means that establishing local linkages between the two has become extremely difficult. Bridging this gap would require a concerted effort by garment producers, Government and local input suppliers, who would need to change their attitudes and business approach and engage in pro-active strategies, such as the upgrading of quality and lobbying for nomination with buyers. The likeliness of such a concerted effort is however limited, as export oriented garment producers are often tied to nominated suppliers outside Malaysia by their buyers and Government faces a competencies and implementation problem, not to mention a policy dilemma between cost down for exporters (duty free imports) and protection of local suppliers (tariff protection). Local input suppliers, moreover often lack capital and connections to engage in the sort of upgrading and lobbying required. The future for a more integrated garment industry in Malaysia thus seems bleak.

As to the development of the two new industry segments identified in Singapore, several factors seem to limit their potential as new sources of growth and diversification for the industry, able to contribute to a fundamental change in its profile. These factors include: (i) geographical location and sourcing base; (ii) size of the domestic market and growth potential of new segments; and (iii) the institutional context and how well it manages to develop new and appropriate policy or adjust existing policy according to the needs of these new segments.

### 8.2.1 *Buying offices*

In the last sections of chapter 6, when considering buyers as local actors in the industry in Singapore, remarks were already made about the importance of the geographic location of,

and the sourcing base covered from, Singapore and particularly how the latter evolves, as a factor behind the location and subsequent development of this new segment. Thus Singapore's central location and high quality infrastructure facilities had made it an attractive location for buyers to set up regional offices here (although they often also had offices in Hong Kong, so Singapore should perhaps be seen more as a sub-regional office).

It was, however, also argued that the sourcing base covered from Singapore was limited and had showed little to no growth over the past decade in terms of share of world trade. Malaysia was not altogether seen as a sourcing centre for other countries as it did not have the geographic location advantage Singapore had and the (relatively) limited amount of products sourced from the country did not justify the set-up of separate offices in the country. For Malaysia this segment thus did not feature as a real, or even possible, element in developments at the industry level. In Singapore it has, yet it has proven to be a rather volatile segment, as recent closures of a number of these offices demonstrated. Due to the impending abolishment of quota by 2005 and the fact that there are limited local inputs within the main sourcing countries covered from Singapore, it is likely that the attractiveness of the sourcing base and thus the attractiveness of Singapore as a location for regional sourcing offices will decrease in the near future. Moreover, trends of network consolidation among buyers may further reduce the likeliness of setting up or retaining a presence in Singapore (see chapter 6).

In addition the City-State's function as a sourcing and trading hub is somewhat one-sided. Although a few regional producers that have set up sales and marketing offices, the number pales in comparison to Hong Kong, which also has a large share of representatives and offices of inputs suppliers and services providers, making it a true one-stop sourcing and trading centre. Even producers in other Southeast Asian countries often prefer to set-up sales and marketing offices in Hong Kong, also as Government seems to have more actively promoted this. In Singapore incentives still appear to be aimed mostly at large multinationals (e.g. buying offices of US brands), rather than smaller set-ups of regional companies.

### *8.2.2 Development of Local Brands and Fashion Industry*

"Brand development" and a "local fashion industry" seem to have become the most important buzzwords in the policies and plans regarding the garment industry in virtually all of Asia and all countries in the region seem to organise elaborate fashion weeks, with young designer awards, fashion shows of local labels as well as international fashion brands.

As became clear in chapter 7, in Malaysia branding and the development of a local fashion and design industry is still in its infancy, due on the one hand to the limited number of producers engaging in brand development and the dominance of small boutiques selling imported goods in the retailing sector. Only a handful of local designer labels and brands have been successful so far (see box 7.6).

In Singapore, however, this new segment and more generally the development of Singapore into an international fashion hub<sup>3</sup>, of which local designers and brands/labels make up an important element, seems to have taken on dimensions of some importance to the overall industry structure, if judged by sheer numbers and Government and media attention alone. However, to which extent this new segment presents viable and longer-term growth and diversification options for the industry remains to be seen, as the case study in box 8.1 highlights.

#### **Box 8.1 Development of Local Brands and a Fashion Industry in Singapore**

Already in the early 1980s mention was made of the development of Singapore designer labels and fashion. However, not until the early 1990s did such a development really manifest itself and did

Government and institutional attention focus explicitly on the development of Singapore into a centre for fashion and design.

In 1985 the Society of Designing Arts (SODA) was set-up by private initiative. At the time there were only a few established designers around. SODA provided a platform for local designers and helped them establish a foothold in the local market through their own retailing space (set within a large store where each had its own corner). Several of these designers/brands have by now become well-known names in both local and sometimes even regional markets.

With increased attention for the development of a fashion segment, the local garment manufacturers association (Textile and Garment Manufacturers Association of Singapore TGMAS) became more and more involved in fashion oriented activities as well, most notably through the organisation of an annual fashion week and the participation in several initiatives to raise the profile of local fashion designers and brands both locally and overseas. In 1996 SODA merged with TGMAS to become the Singapore Textile and Fashion Federation, a name that clearly signifies the increasing importance of branding and fashion for the (image of) the industry.

The annual Fashion Week has grown into an event with local and regional designers, fashion shows and awards, while since 2001 a second fashion event, the Singapore Fashion Festival, is staged every year, organised by the Singapore Tourism Board in cooperation with a number of other organisations. In addition the four fashion and design schools have their annual graduation fashion shows, where fresh graduates present their collections.

An inventory of the local fashion industry (garments only) made in 2003, revealed approximately 70 companies, involved in the design, retailing and sometimes even manufacturing of their own brands and labels. These ranged from the OBM producers discussed in chapter 5 to local designers with just one boutique or selling their products through local fashion retailers and department stores. In addition, more than half of the producers in the survey had introduced their own brand, which were mostly sold in local retail and department stores and in some cases even in own outlets.

Although these are impressive numbers for a country as small as Singapore, several issues and limitations make it questionable that branding and the development of a local fashion industry present viable new sources of growth and diversification for the industry, to the extent of fundamentally changing its profile and role.

#### **Limited Growth Potential New Entrants and Lack of Linkages to Existing Segments**

Although many producers had introduced their own labels, these were in most cases non-strategic and made up only a small percentage of total business. Moreover few seemed to have intentions of fully committing themselves to brand development and shifting completely towards OBM supply, as such a shift was considered by most to be too difficult, risky and expensive (see chapter 7). The competencies gap between production on the one hand, and design, marketing and retailing on the other, is in fact much bigger and harder to overcome than has been assumed by Government and academics alike. The dynamics of the development of successful local brands and a local fashion industry are thus left to new entrants, of which there indeed appeared to be quite a few. However, these companies/businesses have faced a number of difficulties in gaining a foothold and take on a significant scale, which would enable them to actually contribute to changes in the local industry profile. Small domestic markets and limited growth potential have formed major obstacles and it is not clear whether these are so easily removed. This would not have to be a problem if they would be able to link to the existing producer segment so that the two segments could benefit from each other, the fashion/designer segment providing design and branding skills, the production segment providing mass and production capabilities.

The limited size of the Singapore domestic market presents a major obstacle to growth of local brands and designer labels, as evidence suggests a strong home base is needed to establish the kind of critical mass for further expansion overseas (see e.g. the case of Song+Kelly 21 in box 5.5). In addition competition in local markets is stiff, due to the presence and dominance of foreign and especially western retailers<sup>4</sup>. Government has invited these retailers to set-up flagship stores in Singapore (e.g. Top Shop from London, Mango and Zara from Spain, Versace and Louis Vuitton from Italy DKNY from the USA, etc.). They compete directly with local brands and retailers. Fitting the Singapore's general policy perspective of encouraging competition in local markets and FDI, the presence of so many foreign high-end brands is viewed as positive. They are seen to provide learning incentives and demonstration effects for local brands and designers (Interview SRA, 2003). More generally it should be seen primarily as a way to position Singapore regionally and internationally as a high-end shopping center and can thus also be considered a form of city-marketing.

However, in combination with the fact that local consumers preferences tend to be for Western brands, it is extremely difficult for local brands to compete in the mid to high-end segments. On the other hand, consumers, but even local designers tend to be followers rather than 'avant-garde', reducing the possibilities for the development of truly innovative, local designer brands and labels and a specific style that would stand out internationally (as for instance the Japanese fashion industry has managed to do). Local consumers were described as:

*"(...) quite fashion savvy, tuned into the newest trends and willing to spend. Yet they don't have the most innovative and outrageous kind of tastes and preferences, as for instance consumers in Japan have" (Interview, 2003).*

Local brands and designs thus compete mainly in the middle-end of the local market (the lowest-end is mostly taken up by cheap imported labels from e.g. China). Although they are reasonably successful in this segment, it of course represents only a small part of an already small market.

Other factors seem to limit the local brand and fashion segment's growth potential as well. Lack of capital and the fact that many designers are not necessarily businessmen or entrepreneurs, seems to prevent many of these design-oriented companies to grow beyond their small size and really make a difference in the industry. Only a few seem successful at expanding their businesses outside Singapore.

The lack of linkages between local designers and the existing producer segment, finally, makes it hard for both segments to establish strong, potentially internationally competitive brands. Evidence shows that internationally successful brands/designer labels are in fact often based on designs for mass production and consumption and not necessarily exclusive, as the examples of designer labels such as Donna Karan, Calvin Klein, Louis Vuitton, Ralph Lauren, etc. demonstrate.

*"One of the big problems at this moment from a production point of view is the lack of competent local designers to help them develop design and branding capabilities. This is not so much due to a lack of local design graduates, but rather due to a 'mismatch'. Local design graduates tend to perhaps shoot a bit too high. Not everyone can be the next Issey Miyaki or Versace, yet they all seem bent on having entire own collection in own store. That is OK, but then you must accept the consequences of that choice. (...) On the other hand many local producers have a hard time finding designers, as the kind of design work they offer - mass production oriented, often just one type of garment as opposed to entire collection and usually not truly original designs - is not what local design graduates want to, or perhaps even can do. These kind of design requires actual knowledge of production, which is lacking (among local design graduates). In addition it is not as 'romantic' as having your own boutique and collection. Although this is understandable to an extent, it means we are in fact stuck with a supply and demand mismatch." (Interview, 2003)*

#### **Lack of Coordination and Common Goals at the Institutional Level**

The number of institutions and organisations that are currently explicitly involved in the promotion and development of a local fashion industry are numerous, but their goals and reasons for wanting to promote the development of such an industry are often different.

Table 7.1 gives an overview of the main organisations involved, their goals and specific initiatives with regards to the fashion industry.

In addition, co-operation between the organisations is somewhat limited. This has resulted in a number of different and somewhat uncoordinated initiatives. For instance, the four local fashion schools seem unable to co-ordinate their yearly graduation weeks, which would enable them (through the pooling resources) to put on one big show, or to combine such a show with existing initiatives.

From this list of goals and initiatives in the table it becomes clear that even the definitions of what a local fashion industry is and why and how it should be encouraged differ.

The lack of coordination and common goals has meant some of the more fundamental issues impeding growth and development of competitive local brands and designer labels, such as most notably the competencies gap between production and design and the mis-match between the design and production segments, have hardly been addressed and promotion of a local fashion industry seems to be stuck at the level of show-casing and city-marketing.

*"Government needs to really invest in this. What it does/provides at this moment is mostly lip-service, especially when compared to other industries. If you want to get serious about it then perhaps select one or two recognised talents (winners) and finance trip to London to set-up solo-show there. This should then be backed up by manufacturers (who can provide the goods on a larger scale)." (Interview, 2003)*

However, private initiative has not been very successful so far either. For instance plans to launch a fashion incubator platform have still not materialised, although plans for such an organisation have

been around for several years. The opinion on how to support a local fashion industry also differs strongly among companies.

**Table 8.1 Organisations Involved in Development of a Local Fashion-Garment Industry (2003)**

| Organisations  | Goal with respect to fashion industry/centre  | Specific initiatives regarding fashion  |
|--|---|---|
| Textile and Fashion Federation Singapore (TaFF)          | Promote general industry interests (including, but not limited to fashion segment) with Government, co-ordinate, facilitate and encourage co-operation, information flows and technological development, as well as investment opportunities among industry mem | * Fashion Connections (annual fashion week in co-operation with IE) show-casing local designs and labels to potential foreign buyers<br><br>* Information and assistance for local designer members   |
| International Enterprise Singapore (IE) <sup>1</sup>     | Promote trade and internationalisation of industry  | * Fashion Connections/Fashion Week Singapore (annual fashion week in co-operation with TaFF) showcasing local designs and labels to potential foreign buyers, as well as local and regional design talent through designer award shows  |
| Singapore Tourism Board (STB) <sup>1</sup>               | Promote <b>tourism</b> and tourist spending through fashion industry. Raising profile of Singapore as fashion shopping centre   | <u>Locally:</u><br>* Organise Great Singapore Sale (with SRA) *<br>Involved in Fashion Week<br>* Support Fashion Festival (aimed at show-casing what retailers in Singapore have to offer) and<br><br><u>Internationally</u><br>* Promote/market Singapore as a tourist destination and shopping centre. Regionally this may include participation of local designers in 'road-shows'. In more distant locations not as specific. |
| Ministry of Information and the Arts (MITA) <sup>1</sup> | Promote the <b>development of design and the arts</b> as part of Singapore's drive towards a creative, knowledge based economy with emphasis on lifestyle industries  | Non-specific as of yet  |
| SPRING <sup>1</sup>                                      | Develop <b>local entrepreneurship</b>   | Firm specific programs and incentives, upon application by individual companies.  |
| Singapore Retailers Association (SRA)                    | Promote <b>retailers' interests</b> and raise profile local retail sector. Approximately 15 percent of members are garment retailers, both local and foreign owned  | * Research into global trends, supply chain management, IT developments, etc. relevant to retailing and identify key retail trends. *<br>Organisation of Great Singapore Sale (separate committee for apparel) and support of fashion festivals (both in co-<br><br>* Information & education (seminars, invited speakers, case studies)  |
| Fashion Schools  | Develop and showcase <b>young local design talent</b>   | Fashion shows of graduates during graduation weeks  |

Finally, representatives of institutional organisations have also complained about a general lack of initiative and entrepreneurship amongst local design-oriented companies.

*"(...) if they (local designers and labels) are to succeed they shouldn't look at Government to hold their hand. We provide opportunity and certain support, but in the end they have to show initiative as well. Take for instance the Singapore Fashion Festival, which just saw its third run. This year however, despite having notified them again in time and having done briefings through TaFF, very few participated. Afterwards we were criticized for that, but we*

*did not deliberately exclude them or make it harder for them. If they don't send in applications, after we have informed and briefed them, what are we supposed to do? This is an attitude problem" (Interview STB, 2003)*

This limited initiative is even recognized by private parties, as the remark below made by a businessmen who was active in the local industry association representing the fashion segment illustrates:

*"(I) get a little frustrated with the complaints from within the industry that there is lack of support by the Government and institutions. Designers need to take the responsibility, or bear the burden if you will, of their choice of profession. It is a very competitive business and it is not something you get into for a quick buck. It takes passion and determination and although Government can provide support in terms of providing affordable good education, access to information and infrastructure, etc., it cannot hold you by the hand and shield you from all risks. Entrepreneurship is about risk taking. We should get rid of this idea of paternalism, where the State will take care of you and protect you" (Interview, 2003).*

Ironically, although explicit policy and support, so clearly absent in the case of the garment production segment, is in place, it is not very effective due to lack of coordination and common goals. Moreover the fashion segment in fact seems less entrepreneurial.

However, the limited success of policy so far may also be due to the fact that the nature of a lifestyle business such as fashion requires a generally different kind of business environment.

### **Mindset Change**

The development of a local fashion industry fits in with a general policy shift from the mid to late 1990s onwards towards a knowledge based economy and the encouragement of lifestyle industries. However, in contrast to the earlier restructuring efforts and policies and the consequent shifts within and between industries, this shift towards lifestyle industries appears to require a change in attitude as opposed to the more or less technical and organisational adjustments required for production restructuring.

Thus, one of the main issues hampering the segment's development may in fact lie outside the scope of specific policy initiatives and in fact touch on two enduring characteristics of the local business system, making a fundamental shift difficult: lack of entrepreneurship and the strong role of State. The latter may have worked for encouraging the more technical adjustments needed for moving from labour intensive to capital intensive and knowledge based industrialisation, but may not be able to establish the kind of adjustments needed to develop into a creativity and lifestyle centred development model. Thus, as one of the interviewees argued:

*"Singapore's future as a fashion hub and the development of a centre of design and creativity, depends not so much on all the support programs and infrastructure we put in place. That bit is in fact easy. The key is a change in the socio-political fabric of this country. It requires a social environment in which people can truly express themselves and in which being different and 'out there' is considered a good thing, something to be encouraged. It requires a risk taking and entrepreneurial attitude. As long as people don't dare to be different, stand out and express themselves fully, Singapore becoming a centre for creativity is just not possible. Such a change in the mindset of the people and Government of this country is hard and will no doubt take time".*

In summary, moving from OEM to OBM at both the firm and industry levels is thus difficult, due to a competencies gap and mis-match between design and production, limited growth potential of new entrants, uncoordinated and somewhat 'superficial' policies and the fact that it may not be so easily encouraged through industrial policy in the first place, as it requires a mindset change of Government (allowing more freedom of expression), designers and consumers alike (becoming innovators instead of followers). This is most likely a much longer and harder process than the shifts made in the last three decades.

*Sources: Tan (1998); Interview SRA (2003); Interview STB (2003); Interview manager Singapore garment company (2003); Interview TaFF (2003)*

## **8.3 In Conclusion: Main Forces Behind Firm & Industry Development Trajectories**

From the above analysis and discussion a few important observations can be made with regards to the main forces or determinants of the strategies and development trajectories in the garment industry in Singapore and Malaysia. These include most importantly:

1. Although the GCC literature often stresses the importance of external linkages, hence the role of buyers as the main drivers behind the development of dependent producer

companies and industries in LDCs, developments in the Singapore and Malaysian garment industry demonstrated that the role of buyers through linkages at the firm level should not be overestimated. Although they are important drivers of product and process upgrading within OEM companies, their more general role in company and industry development was rather circumscribed (confirming observations made by Schmitz & Knorringer (1999) with regards to the footwear industry)<sup>5</sup>.

There is no denying that connections to buyers have led to substantial upgrading of products and processes for local OEM suppliers, as the quality and manufacturing competencies gap between them and the domestically oriented segments of the industry in both countries, but particularly in Malaysia, so clearly demonstrated. There was, however, little encouragement of strategies aimed at moving beyond production<sup>6</sup>, as was experienced by several Singapore producers trying to develop ODM capabilities, which was met with little enthusiasm by their buyers (see box 6.1), and by the fact that even working for high-end buyers, did not automatically lead to an advancement in roles, yet seemed to actually increase dependence due to stricter compliance and requirements (see e.g. box 7.3).

Although the type and origin of the buyer worked with, appeared to make some difference in the extent to which more dynamic trajectories were encouraged, this effect should also not be overestimated as a driving force, rather should be seen as an enabling factor. Thus the fact that cases such as those presented in box 6.5 and 7.7, demonstrated department stores are in fact more willing to enter into ODM arrangements, the choice to do so, is still driven more by the initiative of the producer than of the buyer.

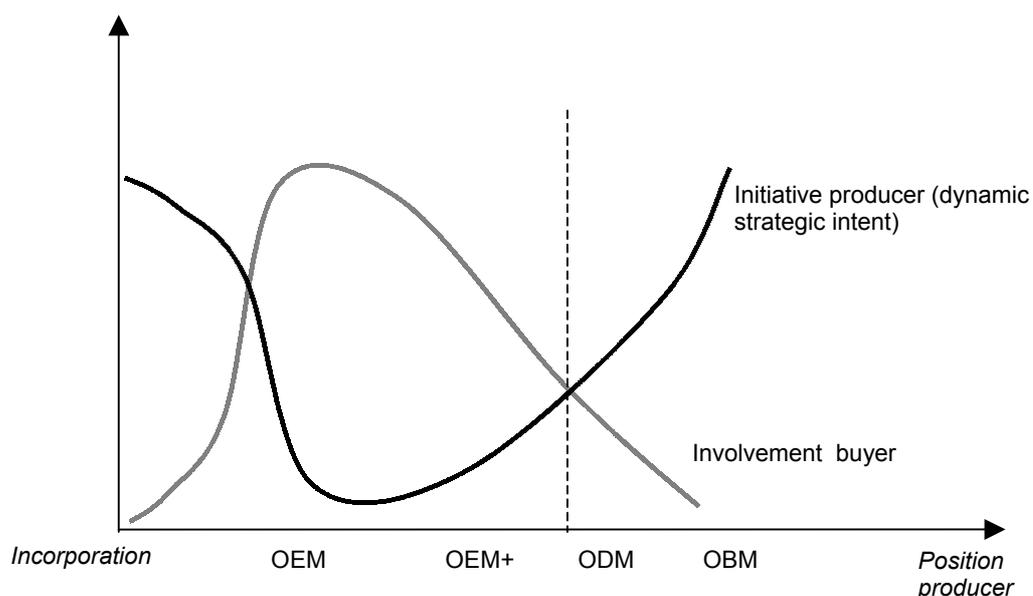
Generally speaking, buyers do not seem inclined to teach producers completely new capabilities and competencies, rather they go by existing and demonstrated skills and strengths and further develop these<sup>7</sup>. In the case of the Singapore and Malaysian garment industry this meant the main products sourced are basic high quality knitwear, as this is considered the strength of the region. In addition buyers source the two countries for higher value added and so-called strategic products, i.e. products for which the buyer can take little risk in terms of delivery and defects (thus requiring high standard QC and levels of reliability of the producers)<sup>8</sup>. Malaysia is still mostly seen as a production base, while Singapore was increasingly considered an intermediate 'node' in the networks of buyers, where production co-ordination of more extensive networks takes. The responsibilities transferred to, and services expected from, producers in the two countries are closely tied to these 'designated' roles.

2. Breaking out of 'buyer-designated' roles required initiative (dynamic strategic intent) on the part of producers to develop advanced capabilities, as buyers will not engage in such more fundamental teaching (why should they if these roles or specific strengths are already fulfilled elsewhere). In other words, moving beyond certain roles was mainly found to be the responsibility of producers and dependent on their business attitudes and approaches.

The number of companies successfully following extra-chain trajectories in, or leading to more advanced roles - positions were companies are (more) firmly in control of their own destiny (see the cases of Hing Yiap in box 7.2 and the Clothing Company in box 6.2) - further illustrated the importance of strategic intent and vision for successful development, rather than just being able to keep up with requirements of buyers.

What thus became clear is that role advancement requires a different approach to business on the part of the producer and more initiative (strategic intent), while it implies decreasing involvement of the buyer. The interface between producer initiative and buyer involvement are visualised in figure 8.2.

**Figure 8.2 Buyer Involvement and Producer Initiative After Incorporation**



The figure illustrates that own initiative at the time of incorporation of producers into the networks and chains of global buyers is high, yet decreases once a company has managed to position itself firmly in an OEM role. Although this doesn't mean no initiative of the producers is required - the producer must still demonstrate a willingness and ability to learn from buyers - it is the buyer that determines most of the actual strategies. Subsequently, trajectories towards role advancement (less dependent, more rewarding positions) necessarily imply a decreasing role of buyers and an increasing role of dynamic strategic intent and own initiative.

The dotted vertical line indicates the point at which a substantial shift in core competencies takes place, which brings with it substantial switching cost for firms that have specialised in mass production for export. These are often so substantial and do not just involve financial investments, but also a shift in attitudes and the learning of very different skills, that it is hard and risky for OEM producers to make this shift. Indeed both the Singapore and Malaysian cases illustrate that it is often easier for companies operating outside chains, with lower sunk-cost and different 'business outlooks' to begin with, move to, or enter in, such positions.

3. Business attitudes, approaches and strategic intent are in turn influenced by the national business environment, while strategic choices are enabled, limited or encouraged by a number of forces or factors in the national and international business environment of the firms in the survey (see figure 8.1).

As was elaborated in some detail in section 8.1.3, the local business environment has a considerable influence on firm business attitudes and approaches. Particularly the characteristics of underlying fundamentals of the business environment, such as the dynamism of general economic and industrial structures and institutions, policy consistency and implementation, trust levels and openness, were identified as playing an important part, while industry specific policies aimed at upgrading were in fact found to be only secondary to these fundamentals. In addition rapid or dramatic changes in the business environment, such as the competitiveness crisis and resultant shake-out in Singapore, as well as the Government policies encouraging these, may cause shifts in attitude, in turn leading to shifts in business approaches and strategic choices.

General characteristics of the industry may also affect attitudes among garment producers. As one respondent remarked:

"It is also the nature of the industry, with its constant changes and high level of uncertainty, which may induce short term thinking" (*-Interview manager Singapore garment company, 2003*)

External factors enabling, limiting or encouraging specific strategic choices included for instance: (i) resource availability, particularly labour; (ii) quota and trade agreements; (iii) the nature of the industry with its limited automation possibilities and the large gap between competencies in production and design/marketing - competencies not easily mastered through 'learning by doing' or through small, incremental technological innovations, as has been described in much of the research on for instance the electronics industry (see e.g. Hobday, 1995a, 1995b; Wong, 1999; Ernst, Ganiatsos & Mytelka, 1998); and (iv) specific policies, e.g. foreign worker policies, wage policies, etc.

4. At the industry level, the success of new segments in other parts of the values chain, such as buying offices and a local fashion industry, and their potential as new sources of growth and diversification is to an extent determined by forces seemingly outside the influence sphere of individual firms or policy makers, i.e. the sourcing base covered and size of the local market. However, at the industry level too the national business environment and particularly the lack of local linkages, played an important role in the observed dynamics, and it could even be argued that at this level external linkages may in fact limit local developments, or at least play a secondary role. Thus it has been observed in several other countries as well, that connection to global networks and chains, i.e. external linkages, may lead to the development of separate segments within an industry: a usually small scale, domestically oriented segment and a large scale, often more automated, export-oriented segment (e.g. See Dooren, 2003 for the case of the Mexican garment industry; Vargas, 2001 and Gibbon, 2000a). This results in rather dualistic development patterns

In the next and final chapter the observations made in this and the previous chapters will be linked back to the theoretical and conceptual notions presented in chapters 2 and 3 and to the research questions at the beginning of the book. This will allow us to put the findings of the study in a broader perspective and come to some conclusions with regards to the main question posed at the onset of the study, i.e. what globalisation through incorporation in global networks and chains means for local industry development.

## Notes

<sup>1</sup> At the TDB, the garment industry is currently part of the portfolio of the 'Lifestyle Businesses' section

<sup>2</sup> In general, several authors have warned for ascribing too many characteristics of small CFB in Asia to the fact that they are Chinese owned (see e.g. Yeung, 2002). Research in Germany for instance, has demonstrated similar characteristics pertain to small family owned businesses here as well (Schamp, 2003).

<sup>3</sup> A fashion hub can be defined as a centre of fashion design, comprising apparel, but also accessories, footwear, related activities (e.g. modelling agencies, hairstylists, etc.) and support infrastructure (fashions schools, design centres, public and private institutions, etc.); it is the central and most important part of an area or and it a forerunner and innovator; there is international recognition of the centre's competitiveness in the area of fashion and design, while it is also seen as a place where fashion sellers and buyers come together (Tan, 1998).

<sup>4</sup> This dominance pertains not so much to actual numbers, but rather to the fact that these foreign retailers have better access to capital and are thus generally larger, occupy the prime retail spaces in the central shopping areas and are actively courted by Government and provided incentives to set up shop in the City State.

<sup>5</sup> It must be noted that the important role of buyers in developments in the global industry are not contested here, as they are by far the most important innovators or drivers of innovations within the GACC. Implied here is their role in local development in specific locations.

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<sup>6</sup> Moreover, it must be noted that although some buyers may transfer responsibilities (thus offering producers upgrading opportunities) this also entails a transfer of cost and risk to the producers, requiring producers to bear more risk, investments and costs, while at the same time having less to say about the whole process and flow of production, due to ever more stringent requirements, in terms of production, sourcing of inputs and distribution.

<sup>7</sup> Although hard to make explicit in the context of our research, it is also likely that buyers are less inclined to develop producer competencies when they feel the latter operate under 'artificial competitive advantages', such as trade agreements and quota 'protection', particularly if these advantages are likely to disappear soon.

<sup>8</sup> For instance, one of the interviewed buyers noted that it would not allocate orders that absolutely had to be delivered on time as they were sold to a third party (in the particular case the buyer an international sportswear brand sold part of its output to specialty sportswear chains) to less reliable countries such as Indonesia and Vietnam, but rather to countries like Singapore or Malaysia.

## 9 Discussion and Conclusions

With ongoing economic globalisation and particularly the realisation that the gains from this globalisation are spread unevenly among and within countries and regions, there is an increasing need to understand the forces behind success or failure and thus behind winners and losers in the global economy. The question is thus how developing countries may gain from economic globalisation. This interrelationship between economic globalisation and local development formed the theme of this study, which has been framed in terms of local *industry* development, the incorporation of *local firms in LDCs* in *global production networks* and *chains*, and the *longer term perspectives* for development after incorporation.

It was postulated that not just the sustaining of connections and maintaining of roles, but increasingly the leveraging of opportunities offered by linkages to lead-firms for *advancing* to more rewarding roles, presents the real challenge for firms and industries in LDCs, as it is such advancement that offers the best prospects for longer-term development. Advancing to more rewarding roles was defined using the concept of governance and implies - inter alia - a shift towards positions in, or possibly outside, networks and chains, with less competition, higher returns and less dependency.

The study moves beyond the issue of incorporation, and away from the exclusive focus on upgrading - so common in the literature -, while explicitly including local dynamics, in its analysis of the effects of economic globalisation on local industry development.

The focus was on firm competitive adjustment strategies, firm and industry development trajectories and the forces or determinants behind these strategies, adjustments and trajectories. These elements were considered in the context of the highly dynamic global apparel industry (chapter 1), specifically the cases of the Singapore and Malaysian garment industry.

Incorporated into global networks and chains in the late 1960s and early 1980s respectively, by now, garment companies in both countries are facing the challenges of increasing internal and external competitive pressures and threats (chapters 4 and 5). The analysis of our empirical data gave an in-depth insight into competitive adjustment strategies as a response to these pressures, into firm and industry development trajectories in Singapore and Malaysia (chapters 6 and 7), and into the main forces behind them (chapters 4, 5 and 8).

In this final chapter the analysis will be concluded, by addressing the research questions, followed in the second part by a reflection on, and interpretation of, the main findings.

*Research question 1: What are the structure and characteristics of the garment manufacturing industry in Singapore and Malaysia?*

An elaborate consideration of the structure and characteristics of the Singapore and Malaysian garment industries was presented in chapters 6 and 7. The industry in both countries displays obvious similarities in terms of the predominance of local ownership, export orientation and position in chains as OEM suppliers to (roughly) the same types of US and - to a lesser extent - European buyers.

The differences are perhaps more subtle, but also more important, in light of the question of positioning in chains.

First of all, companies in Malaysia are on average smaller and have simpler, more locally rooted organisation structures. Second, foreign involvement in the industry in Malaysia is more substantial than in Singapore. Third, in Singapore there is a more pronounced OBM segment that

has started to expand regionally as well. Fourth, a number of OEM suppliers in Singapore have managed to position themselves in OEM+ roles within production networks and chains, commanding extensive regional/international production networks. They functioned as co-ordinators and orchestrators of extensive networks for their buyers and not merely as local suppliers, as Malaysian OEM suppliers still mostly did. The geographical spread of the Singapore garment industry is indeed one of its most remarkable features.

In Malaysia, one of the remarkable features of the industry was the operation of distinctly different segments next to one another, with hardly any linkages between them. On the one hand the export-oriented segment was linked to both overseas suppliers and clients, while local linkages were limited to subcontractors, locally based foreign owned input suppliers and input suppliers of non-strategic inputs. The domestically oriented segment on the other hand relied on local inputs and local, or sometimes regional markets. An intermediate group was formed by local licensees, although most of these companies had a set-up and behaviour quite similar to the other companies in the domestically oriented segment.

Although in Singapore these two distinct segments were identified as well, the divides between them don't appear to be as sharp as is the case in Malaysia, probably as a result of the much smaller scale of the industry as a whole (i.e. smaller number of companies).

*Research question 2: How have apparel firms and the local apparel industry community in Singapore and Malaysia responded to changing competitive conditions?*

Initially strategies in both countries were mostly defensive, labour intensification being the most popular strategy. As competitive pressures increased, such strategies alone no longer sufficed to survive and a shift towards more pro-active strategies has taken place, although defensive strategies are still applied. Moreover, the shift towards a high road to competitiveness was much more pronounced in Singapore than in Malaysia, due to the different timing and development phase, and - related to this - a difference in general business approach and strategic intent of producers. In Malaysia strategic intent is more conservative, aimed at maintaining roles and 'keeping up' with buyer requirements, resulting in strategies that were only moderately offensive and very strongly buyer driven.

Business approaches and strategic intent of many Singapore producers, particularly since the early 1990s, were more dynamic, as they started aspiring more advanced roles in networks and chains, resulting in more proactive strategies. Thus defensive strategies no longer formed core strategies by the late 1980s. Relocation, first implemented by Singapore producers as early as the beginning of 1980s, took on the form of (more offensive) internationalisation from the late 1980s onwards, substantially changing the role of the Singapore establishment into regional HQ, coordination and services centres that functioned as a one-stop centre to buyers, as they could 'provide' the advantages of several locations, even close to US markets, within one company. OEM suppliers in particular increasingly derive their competitiveness from their international linkages and networks.

In summary, the most common competitive adjustment strategies were on the one hand upgrading within production; moving into higher end, higher quality products and to higher-end buyers; and - often simultaneously - moving into co-ordinating and intermediary export roles through relocation and outsourcing of production. In addition, many firms seem to have opted for branding - or rather local label development - as a strategy to spread risk and become less dependent on buyers.

In Malaysia the picture is somewhat different and the shift towards truly pro-active strategies not (yet?) visible to the same extent as in Singapore. The most common competitive adjustment strategies were on the one hand still labour intensification and on the other hand upgrading within production and moving to higher-end buyers. Generally, Malaysian producers are much more inclined to 'solve' their competitiveness problems within the national context, i.e. new sources of competitiveness were sought locally.

*Research question 3: Is it possible to identify new sources of growth and diversification at the industry level; what has been their impact so far and to which extent will they be able to fundamentally change the profile of the industry locally?*

Two new sources of growth and diversification were identified: first the location of buying offices and a general development into a regional sourcing/trading hub and second the development of local brands and a local fashion industry. Both are non-production based activities and offer opportunities for higher value added activities and jobs.

Such segments were encountered in Singapore, where they had taken on some dimensions of importance, although impact has up to date been limited due to the small size of most of the companies in the fashion industry segment, and the fact that in recent years a number of buying offices has in fact closed again.

In Malaysia, buying offices were lacking altogether, while a local fashion industry has up to date not really emerged to the extent of having any real impact on the profile of the industry. Assertions as to its future potential were also hard to make, and for this reason it was not explicitly considered.

In Singapore, the potential of these two segments as new sources of growth and diversification for the industry are limited by several factors. These include (i) for buying offices and the general development of a sourcing/trading hub: geographical location, limited sourcing base and the lack of regional offices of 'sellers'; (ii) for the fashion industry: the size and sophistication of the domestic market, lack of business acumen among design based companies and lack of linkages to the existing production segment; and (iii) for both segments the institutional context and how well it manages to develop new and appropriate policy or adjust existing policy according to the needs of these new segment.

Moreover, in the case of the development of a local fashion industry, future potential doesn't just seem to lie in the ability to develop certain (technical) skills and competencies and acquiring enough capital to expand, but also involves more fundamental shifts in mind-set and general attitudes of all actors involved.

*Research question 4: Which are the firm and industry development trajectories that can be identified as outcomes of firm competitive adjustment strategies and industry level dynamics?*

In chapter 3 a typology of firm and industry development trajectories is presented, based in large part on the experiences in the East Asian NIEs. The latter have embarked on dynamic development trajectories, leading to more advanced roles in global networks and chains. At the firm level, the generic trajectories identified in this typology include 'exit and partial exit trajectories', 'reactionary adjustment' and 'adjustment upgrading trajectories' and finally 'upgrading trajectories'. At the industry level the typology includes 'sunset', 'upstream', 'steady' and 'reconstitution trajectories'.

In both Singapore and Malaysia, the majority of companies have followed trajectories falling into the 'adjustment upgrading' category. Such trajectories appear to have been adequate for

sustaining connections to chains, and producers in both countries have managed to establish themselves as reliable suppliers of high quality basics.

In Malaysia, the nature of these steady trajectories has implied that the majority of companies have maintained OEM positions, achieving operational effectiveness, by adding higher-end buyers to their client base and learning about international quality and standards through them. Yet few producers embarked on development trajectories that led to more advanced roles and less dependence on buyers.

While the majority of OEM suppliers in Singapore have also followed adjustment upgrading development trajectories, these were on average more dynamic in the sense that quite a few companies are in the process of shifting to, or have already shifted to OEM+ positions, mostly through extensive internationalisation of their production organisation and activities. This may signify a shift to development trajectories of the upgrading kind, leading to a position as a specialised agents or global logistics managers (as defined in the typology in chapter 3).

As with the observed difference in strategic choices between companies in the two countries, these differences in development trajectories are related to business attitudes and strategic intent. In both countries, firm development trajectories leading to a shift from OEM to OBM or even ODM roles are rare. Although particularly in Singapore quite a few OEM suppliers have introduced own labels, for local markets, these are usually introduced as a means to diversify and spread risk, and usually do not signify (aspired) development trajectories towards OBM. These observations illustrate the difficulties of embarking on OEM-ODM-OBM trajectories, due to the high cost of switching between these roles.

In this respect, trajectories leading to OBM roles are often successfully followed by companies in extra chain positions that have never engaged in large-scale export manufacturing on a contract basis. Although only a few such cases were identified, moving to ODM is more likely to be successfully achieved by companies focusing on design and operating outside networks and chains as well.

Finally, exit and partial exit trajectories have taken place, as the industry inventories made in both Singapore and Malaysia illustrated. In Singapore such trajectories were adopted particularly in the late 1980s and early 1990s, resulting in a substantial industry shake-out.

In Malaysia, the non-committal attitudes of particularly small domestic producers and the fact that so many companies in the initial company database had closed or could not be traced, implies these trajectories are especially found among this group of firms. On the other hand, pending changes in Malaysia's international business environment may also cause a greater number of OEM producers to (be forced to) embark on (partial) exit trajectories in the near future.

At the industry level Malaysia has clearly followed a steady trajectory, remaining firmly rooted in an OEM production role. In Singapore, at the industry level some reconstitution of the industry towards a regional co-ordination & control/trading and sourcing centre is taking place, as an increasing number of existing companies are becoming one-stop centres for buyers, providing regional and increasingly global reach and logistics services, while buyers have set-up offices in the country to oversee regional sourcing operations. However, this reconstitution is less profound than what has taken place in Hong Kong, as regional and international production networks controlled and co-ordinated by Singapore garment companies are still mostly ownership based and not the kind of loose organisational networks commanded by true 'global logistics managers'. More importantly, the segment of local buying offices has proven to be

somewhat volatile, while other important elements of a regional co-ordination & control/trading and sourcing centre, such as the establishment of marketing/sales offices of regional producers (sellers), the regional sourcing base, and establishment of input suppliers or their representative offices, are weakly developed or absent

*Research question 5: How does the local industry environment support or impede the capacity of local firms and industry communities to adjust to a changing competitive environment and advance their positions relative to global networks and chains?*

In chapters 4 and 5 the local industry environments in Singapore and Malaysia respectively were considered in detail, while in chapter 8 their effect on actual strategies was brought to the fore more explicitly. The findings illustrated that its impact on strategies and development trajectories both directly and indirectly, and both in a positive and a negative sense, is substantial. However, it is not always easy to pinpoint or rank this impact precisely, as it is multifaceted, with strong interrelations and interactions with firm-specific factors.

Elements in the local business environment influence business attitudes in the industry, which in turn influence strategic intent and choices, while they also enable, encourage or limit more directly the strategic choices and options of companies.

Particularly the characteristics of underlying fundamentals of the business environment, such as the dynamism of general economic and institutional structures, the dominant economic ideology, policy consistency and implementation, trust levels and openness, play an important part. All these elements appear to be stronger in Singapore than in Malaysia. This has resulted in (generally) more dynamic business approaches and strategic intent, and greater commitment to strategic choices that put companies on development trajectories towards more rewarding roles, in Singapore than in Malaysia. The fact that industry specific policies in Malaysia since the late 1980s have been more positive towards the industry than was the case in Singapore, further seems to illustrate the importance of these underlying fundamentals; as they are rather weak in Malaysia, industry specific policies have remained rather ineffective as well.

Other elements and events in the local business environment found to have supported or impeded adjustment strategies and development trajectories include most notably corporatism, the role of the industry associations, sudden increases in competitive pressures and threats, resource availability and certain specific policies. Illustrating the role of the dominant form of economic organisation, the corporatist nature of industrial relations have encouraged, or rather enabled specific adjustment strategies in both countries. Thus in Singapore, it enabled easy restructuring and relocation of operations, while in Malaysia it appears to have mostly encouraged labour intensification - and exploitation. The differential effect of this factor in the two countries is a result of its interplay with other factors, such as availability of labour locally in Malaysia, and the more acute competitive (cost) pressures in Singapore. In both countries the industry associations have more or less echoed general tendencies in the local industry environment (dominant economic ideology and political economy of industrial development). In the case of the two main industry associations in Malaysia, the emphasis is on process improvement and benchmarking, hence keeping up, while distrust and limited reach (efficiency of implementation) are issues for them as well. In Singapore the industry association increasingly focused on non-production activities and 'fashion content', while membership expanded to include producers, as well as local brand and fashion companies and local offices of buyers and agents. In both countries the associations perform a bridge function to the Government, and are considered by the latter as their main negotiation partners. In addition they form important platforms for the exchange of

information and ideas among industry members. Due to the broad reach of the Singapore association as opposed to the more dispersed interests within, and particularly between the different industry associations, the former appears more successful in performing a bridge function and providing a platform.

Rapid or dramatic changes in the business environment, such as the competitiveness crisis and resultant shake-out in Singapore, as well as specific Government policies encouraging these, caused a shift in attitude, in turn leading to shifts in business approaches and strategic choices. On the contrary, the fact that the Malaysian Government has to some extent shielded the industry from the severest competitive threats facing the industry (most notably labour shortages and cost) have meant many companies have been able to postpone more painful and fundamental adjustments. In combination with the relative abundance of particularly labour resources this has in part prevented more substantial adjustments.

In terms of supporting the entry and development of new segments the case of Singapore illustrates that inconsistent, uncoordinated policy, with limited awareness of the real or deeper issues and problems, is to an extent to blame for the limited success of these new segments. However, given other elements in the local and regional business environment, such as the limited sourcing base, small size and sophistication of local markets, etc., it is questionable altogether whether policies alone can encourage the development of such new segments.

*Research question 6: What is the role of actors in the global commodity chain – specifically lead firms – shaping adjustment and development trajectories of local firms and industry communities?*

Confirming earlier made observations in the footwear industry (Schmitz & Knorringa, 1999), the findings of the research point to the rather circumscribed role of buyers in adjustment strategies and development trajectories of producers. Although connections to (high-end) buyers indeed offers Singapore and Malaysian garment producers great opportunities in terms of process and product upgrading and keeping up with international standards and trends, buyers do not encourage upgrading 'beyond production' (Schmitz & Knorringa, 1999) hence development trajectories leading to fundamentally different positions or roles. Buyers mostly promote operational effectiveness and development within specific roles, and of existing products and specialisations. For most producers in Malaysia, however, this appears to be considered 'good enough'. Despite the efforts needed to keep up, contract manufacturing is still a reasonably straightforward way to make a good profit, although some companies complained about the fact that buyers were squeezing profit margins to the limit with all their requirements. Yet overall, producers appear quite happy with the arrangements they have with buyers and see little benefit in taking the risk of upsetting this fairly comfortable position by moving to roles requiring more initiative from their side. Because, obviously, with buyers not likely to engage in the teaching of fundamentally new skills or competencies, the responsibility (hence risk) for advancing roles principally lies with producers. This is illustrated by the strategic choices and development trajectories observed among producers in Singapore. Although some indicated that buyers had played some role in their decision to set-up overseas factories (for instance by (informally) requesting a producer look into moving production to a specific location), the decision to engage in such extensive internationalisation strategies lie principally with the producers. This initiative has indeed paid off and buyers regard them more as intermediaries and encourage them

accordingly. Thus as producers show initiative and demonstrate capabilities, buyers are more willing to transfer more responsibilities and - in the process - transfer some of the chain governance to Singapore producers. Good examples of such an interactive process were the companies that had set up separate buying houses (see box 6.1), functioning as agents for their main clients, sourcing not just products from their own factories, but also from others. Even in Malaysia one such case was found (see box 7.4), illustrating that very strong and dynamic strategic intent at the level of management in a company can transcend negative elements in the local business environment as well.

Essentially, 'learning from buyers' should become 'learning with buyers', i.e. learning should become an interactive process, whereby the initiative doesn't just lie with buyers. This reduces dependence on the part of the producer and leads to more dynamic development trajectories.

Overall, however, findings suggest that leveraging the opportunities offered by linkages to global buyers is 'easier' and more often successfully applied for advancement to positions as OEM+ suppliers, intermediary and specialised agent roles, than for advancement to different roles altogether, such as ODM and OBM. Such roles generally imply substantially less involvement of buyers and in fact impinge on their core competencies. Consequently advancement to these roles requires increasing initiative and dynamic strategic intent on the part of producers. This is illustrated by the fact that companies operating outside networks and chains were in fact more successful in achieving these roles.

*Research question 7: Are there other factors promoting or impeding development trajectories at the firm and industry levels?*

Time and again, what became clear during the interviews and company visits was how important the vision and choices of management are, in a firm's ability to adjust and cope with changes. The most successful companies, whether operating inside or outside global networks or chains, and whether located in Singapore or Malaysia, were the ones in which management was aware of competencies and opportunities and had a vision as to the preferred firm strategic direction. Such cases often can only be explained by their internal logic.

Most companies are less unique though, and although business attitudes are still internal to the company, they are strongly influenced by elements in the business environment, as was explained in the discussion of research question 5 above.

Business attitudes and strategic intent are also influenced by other factors though, including ownership of companies, their history and the organisation of the company. Foreign owned companies in Malaysia were more conservative in their strategic choices as they essentially remained dependent manufacturing branches of foreign companies, while locally owned companies in Singapore were the ones that weathered the storm during the crisis and shifted towards more offensive strategies and dynamic trajectories, as opposed to packing up and leaving, as many of the foreign owned companies did.

The history of a company, which initial strategic choices were made, usually influences choices further down the road, due to sunk cost and problems of unlearning and may create path dependence. This was most obvious with companies that had opted for an OEM role early on in their existence.

Confirming some of the assertions made with regards to the nature and behaviour of CFBs, small domestically oriented CFBs in Malaysia display the most non-committal business approaches and defensive strategies of all companies interviewed. However, successful and dynamic CFBs were encountered as well and the interesting phenomenon of the well educated and more

'exposed' second generation taking over from their parents may render this whole idea of the 'typical behaviour of CFBs' less relevant.

Besides business attitudes and the factors influencing them, a number of other factors can be identified as playing at least some roles in strategic decisions and development trajectories of garment companies in Singapore and Malaysia. These include quota and trade agreements and the nature of the industry. Quota protection enabled to an extent the kind of steady trajectories followed by most Malaysian OEM suppliers, while in the case of Singapore, quota and trade agreements are important factors behind the configuration of international production networks.

The nature of the industry with its limited automation possibilities and the large gap between competencies in production and design/marketing, have meant that certain strategies - labour intensification as opposed to technological innovations - are more likely, while certain development trajectories are extremely hard to embark upon. Core strategic assets in the industry - design, branding and marketing capabilities - are not anchored in production and production technology, and thus competencies development in production doesn't necessarily encourage competencies development in these key areas. In other words, they are not easily mastered through 'learning by doing' or through small, incremental technological innovations, as is the case in for instance the electronics industry (Hobday, 1995a, 1995b; Wong, 1999)

Factors that limit the (further) development of segments that could form viable new sources of growth and diversification at the industry level, were discussed in the answer to research question three above.

*Research question 8: How do the Malaysian and Singapore cases compare?*

A comparison between the two cases was implicit in all empirical chapters and can in part be derived from the answers to the above research questions. On the surface similarities are evident, while to an extent the industry in the two countries is intricately connected through ownership and subcontracting linkages. However, the study also reveals the numerous and rather fundamental differences that exist. These differences pertain to general industry characteristics, structure and positioning in chains (research question 1), as a result of different competitive adjustment strategies implemented (research question 2) and firm and industry development trajectories followed (research questions 3 and 4).

Explanations for these differences, particularly the fact that the industry in Malaysia seems to lag behind its counterpart in Singapore, can be found in the different timing and mode of entry into global networks and chains. In fact the entry of Malaysian garment companies, particularly in the Southern region, was in part driven by developments in Singapore. In addition, competitive pressures on the Singapore garment industry have been more severe and increased more rapidly than was the case in Malaysia, due to Government policies and the general lack of local resources. This forced earlier adjustments and a shift in business approach and strategic choices, as well as a shake-out at the industry level; developments that as of yet have not taken on any significant proportion in Malaysia.

However, even if time and mode of entry would have been the same, it is likely a great deal of the differences would have still existed. Given the fact that roughly similar buyers operate in the two countries explanations of their differences must therefore mostly be sought in differing business attitudes, in turn influenced and shaped by different conditions found in the local business environments of the industry in both countries. These were discussed in the answer to research question 5.

## Reflection and Interpretation

The study set out to do two things: to explore (1) to which extent and under which conditions are connections to global networks and chains sustained and whether/how success in this respect contributes to industry development relative to other avenues; and (2) whether and how firms and industries in LDCs operating in global production networks and chains, as well as institutional actors leverage the opportunities these linkages present for advancing to more rewarding roles/positions relative to chains.

The analysis has amply demonstrated the conditions for sustaining connections. Some of these conditions have generally been associated, in the literature, with upgrading. However, in addition a number of the conditions, such as more exploitative labour strategies and policies, in fact run counter to upgrading, and to industry development as defined in our study. More generally, the effects of successful sustaining of connections on industry development are ambiguous at best. On the one hand it has undeniably contributed to the growth of output and exports of individual firms and the industry as a whole, while it has enabled companies to reach, and keep up with, international standards, which it was unlikely to have achieved on its own. On the other hand, the study revealed that, in terms of competencies, positions and roles, all too frequently just aiming to sustain connections amounts to path dependent development along adjustment upgrading trajectories. Producers are able to follow such trajectories and maintain roles for quite a while, as they are not necessarily set on the kind of immiserisation trajectories referred to by Kaplinsky. Adjustment upgrading trajectories, particularly of the steady OEM kind, has therefore even become the main aim of many producers. In this way, however, producers have continued to place themselves precisely in those positions in chains, where competition is intense, dependence high and returns relatively low. Findings illustrated that when staying connected is a goal - as opposed to a means to achieve advancement through leverage of the opportunities offered by these connections - resultant development trajectories merely imply 'running to stand still'. This position carries with it inherent dangers of volatility and the possibility of disconnection in the longer-term.

The longer-term development effects of these trajectories are thus not necessarily positive. A strategic choice to sustain connections in this way, maintaining roles and relying mostly on buyer-driven incentives to adjust, leaves the responsibility for local industry development almost entirely up to buyers. Given the demonstrated inclination of the latter to encourage operational effectiveness and existing strengths, it is unlikely that such buyer- dependent development will result in the development of fundamentally different competencies, and the advancement of positions and roles.

Findings also revealed that, besides these adjustment upgrading trajectories associated with maintaining roles and sustaining connections, firms in both countries have followed a variety of development paths. Interestingly, development towards (local/regional) OBM roles is in fact easier achieved from extra-chain positions or if a company starts out as an OBM supplier, while this is hardly achieved by firms from OEM roles. It appears that, rather than providing a training ground and stepping stone to more advanced positions, sunk cost (investments in manufacturing capabilities and large-scale production) and the build up of knowledge and know-how in specific areas associated with the very connection to chains, result in path dependency, making shifts to other roles difficult.

Focusing on individual firm strategies and development trajectories and including both export oriented ('connected') and domestically oriented producers in the analysis, the study has been able to demonstrate that opportunities for successful development may be derived from both intra- and extra-chain trajectories. A number of domestically oriented companies demonstrated the possibilities and potential of network and chain building 'from within', i.e. the development of *regional* production networks and chains and the possibilities for local industry development they may offer. A trend towards the development of regionally concentrated commodity chains has been suggested by Gereffi (1997a), however, this suggestion has never really been backed by in-depth empirical research. Generally there is painfully little research on this subject and where development of commodity chains within LDCs is considered, this is often isolated from global developments or even developments in other countries (see e.g. Hassler, 2003).

As such, our research contributes to the understanding of extra-chain or alternative trajectories and their potential for local firm and industry development.

As to the second objective of our study, a number of observations can be made. First, the majority of companies did not leverage the opportunities linkages to lead-firms present for advancing to more rewarding roles/positions relative to chains. Many 'connected' firms merely aimed to sustain connections. In addition, for companies operating outside chains, this leveraging is not an option.

Second, due to apparent reasons, the ideal-type trajectories presented in much of the literature (CMT-OEM-ODM-OBM) rarely takes place, while cases of companies shifting to ODM supply in fact bypassed OEM roles. This raises the questions whether (i) trajectories considered ideal type are realistic; and (ii) seeing OBM as the highest attainable and therefore preferred production role for LDC firms entering into networks and chains is realistic and useful. These questions are relevant particularly since both policy-makers and academics have tended to prescribe branding as *the* solution to competitiveness problems. As was demonstrated, linkages to global networks and chains hardly result in advancement to these roles.

The difficulties of switching to such roles, prompt the issue of whether advancement can be given a broader meaning. In this respect our research indicates that alternative trajectories and positions might be given more consideration, as path-dependence need not always be bad. Considering the differences that exist between production; production organisation/co-ordination and sourcing knowledge; and design, marketing and retailing, specialisation in either roles may prove to result in equally rewarding positions, as long as a company strives to become the best in a certain role, to specialise and/or find specific niches. The OEM to OEM+ trajectory is a case in point. It constitutes a trajectory with demonstrated leverage (potential) achieving advancement, as it complies with the criteria for industry development as defined in this study. The TAP group from Hong Kong is a good example in this respect, as were a few other examples found in both Singapore and Malaysia.

However, and thirdly, although successful development trajectories were identified both inside and outside chains, it is hard to speak of a more general pattern, as such paths were followed by relatively few companies, in which management had a clear vision and focused strategic intent. This points to the important aspect of entrepreneurship and related to this an institutional context encouraging such entrepreneurship.

Fourth, in the analysis we elaborated in detail on the issue of advancement beyond OEM roles and the fact that such advancement requires a different approach to business and more initiative (strategic intent) on the part of the producer, while it implies decreasing involvement of buyers.

As the general business approach, strategic intent and strategic choices of companies are often influenced by, and interact with, the local business environment, this implies that longer-term development prospects rely as much on local as on global dynamics. In combination with the fact that a number of successful extra chain development trajectories were identified, which were by definition dependent on local sources of growth, this points to the fact that the opportunities offered by external linkages should not be stressed to the point of excluding other means to achieve industry development. As successful local firms embarking on extra chain trajectories start expanding their production and distribution/marketing networks overseas, this puts the usual emphasis on connections to global networks and chains in a different perspective.

The latter observation is reinforced by the aspect of local linkages. It has been suggested that connections to chains may eventually encourage more integrated forms of OEM production with greater use of local forward and backward linkages. How this 'transfer' takes place remains rather vague, however, and evidence from our research is also inconclusive at best. In the case of Singapore, although geographical proximity to other companies (agglomeration effects) and the functioning of the local industry association have fostered information exchange and diffusion of ideas, strategies, etc. among industry members, OEM producers increasingly derive their competitiveness from their international linkages and networks, as opposed to local ones. This lack of local linkages thus does not seem to have affected competitiveness of local producers too adversely and perhaps have encouraged internationalisation as local sources were limited. However, as the discussion on new sources of growth and diversification demonstrated, the limited success of new segments in the industry is in part a consequence of the lack of local, complementary linkages.

In Malaysia on the other hand, while the potential for local linkages is more evident and has been explicitly addressed in policy, what has taken place in terms of 'clustering' has been mostly superficial and related to agglomeration effects, rather than the kind of clustering envisioned in the IMP-2.

The learning effects of connections to global networks and chains have hardly been passed on to substantial portions of local SMEs and suppliers through linkages and network forming. On the contrary, increasingly the export oriented segments and the domestically oriented segments and local suppliers seem to be detached from one another. In turn, local linkages, as far as present have not contributed in any significant way to the competitiveness of the industry, as quality of local inputs is low and often does not meet international standards, limiting possibilities for increasing flexibilities and reducing lead-times. Policy has been unable to reverse this trend.

At the industry level, in terms of local linkages, effects of connections to global networks and chains have been ambiguous, as was also observed in similar research undertaken in Mexico (Dooren, 2003) (see chapter 8) and may lead to dualistic developments within an industry, where advantages and opportunities created in one segment are rarely diffused to the other, nor do firms in either segments really consider opportunities in the other .

So where does all this leave us with regards to the main theme of this research, the meaning of economic globalisation for local industry development? The research revealed the complexity of this interrelationship and its outcomes, as opposed to the straightforwardness so often espoused in much of the literature. Many of the findings of the current study are not entirely consistent with, and thus nuance and broaden, the observations and approaches usually postulated in this literature.

While the study confirms that global production networks and chains form important transmission mechanisms between the global and the local, offering a number of opportunities and positive outcomes at the local level, it also demonstrates the apparent limitations to economic globalisation in the global production networks form.

The transmission mechanism may be conceived as operating in a 'triangle' between global lead-firms, local entrepreneurs and the institutional context at different levels. The outcomes, whether the effects on local development are positive or otherwise, are ultimately dependent on how 'the local' manages to deal with the global forces. This view shifts part of the industry development story to local actors and arrangements.

The meta-arguments about the global-local nexus often found in the literature, offer little real insight into these, as they tend to downplay local forces and dynamics. This research illustrates the flaws of such meta-arguments and stresses that gaining from economic globalisation also implies a long-term fostering of local sources and potential. This may not be an entirely new observation, but one still overshadowed by 'the global' in more recent approaches to local industry development under globalisation.



## Annex A Methodology

### Inventory of the Singapore Apparel Industry and Coverage of the Survey

Before being able to make a selection of companies for our survey, a database had to be established, of both producers and buyers located in Singapore. The following sources were consulted:

- 1) Industry and company directories including: ASEAN Series 1997/1998, volume 1, Key Business Directory of Singapore; Commercial/Industrial Singapore Yellow Pages, July 1997; Export series 1998/1999; the Kompas business directory; the Times Business Directory of Singapore, 1997/1998.
- 2) The membership directory of the Singapore Textile and Fashion Federation (TaFF).
- 3) In some cases internet sources or even company listings at the entrances of industrial estates.

The database also served as a first inventory of the industry

#### *Producer database*

The comprehensive producer database included companies of all size and positions within the chain (OEM producers, subcontractors, OBM producers etc.). All companies in the database were contacted to verify basic information such as whether they were still in operation, number of employees and organisation of production (in-house or all through subcontractors and/or overseas establishments). This basic information led to a categorisation presented in table A1, which enabled us to assess the coverage of the survey in a little more detail.

**Table A1 Inventory of Establishments & Coverage of Producer Survey in Singapore (1998)**

|   | Total Companies | Total employment | Interviewed companies | Employment <sup>1</sup> | Coverage companies | Coverage employment |
|---|-----------------|------------------|-----------------------|-------------------------|--------------------|---------------------|
| Total number of companies producing in Singapore                                    | 231             | 11.146           | 35 <sup>2</sup>       | 5.557                   | 15.2 %             | 49.9 %              |
| Number of companies which fully relocated production/ never had production in Sing. | 52              | 699              | 15 <sup>3</sup>       | 197                     | 28.8 %             | 28.2 %              |
| Companies which have fully outsourced production                                    | 80              | 1.182            | 7 <sup>4</sup>        | 258                     | 8.8 %              | 21.8 %              |
| <b>Total</b>  | <b>363</b>      | <b>13.027</b>    | <b>57</b>             | <b>6.012</b>            | <b>15.7 %</b>      | <b>46.2 %</b>       |
| TaFF (producer) members   | 127             | n.a.             | 52                    | -                       | 35.4 %             | -                   |
| TaFF members % of total   | 34.6 %          | n.a.             | 91.2 %                | -                       | -                  | -                   |
| Not traceable <sup>5</sup>  | 122             | -                | -                     | -                       | -                  | -                   |

<sup>1</sup> Numbers pertains to employees working in Singapore, not necessarily just in the interviewed establishment

<sup>2</sup> This number includes firms that still have production in the interviewed establishment; of these 35 companies, 29 also had overseas production

<sup>3</sup> Of these 15 companies, one still produced in Singapore, but only in other establishments/subsidiaries

<sup>4</sup> Of these 7 companies, 5 outsourced all production overseas

<sup>5</sup> Companies closed/moved into other business/unconfirmed status

The selection made for the survey was somewhat biased towards the larger and export oriented firms, and firms with a complete set-up. Although some interviews with subcontractors were undertaken, these were not included in the main survey, but served as complementary information. This biased selection was deliberate one, as for the purpose of our research we felt it was necessary to include the smallest firms and subcontractors in the database to give an overview of the industry as a whole, but these firms were less relevant for our survey (which dealt primarily with firms strategies from a commodity chains perspective), as their scope for strategy formulation was very limited and their position in chains very dependent.

As to the other firms in the database, previous experiences with company surveys have proven that many companies have a certain aversion against surveys and questionnaires, as it takes up time without offering a direct or tangible result. Moreover, some firms don't wish to give out detailed information about their operation. Thus response may not always be very high. Instead of taking a sample, a goal of at least 50 interviews was set, which means statistically response levels could not be calculated, but coverage could be (see table A2).

**Table A2 Coverage of Producer Survey by Size Category (1998)**

| Company size by employment | Total number of companies | Interviewed companies | Coverage (in%)    |
|----------------------------|---------------------------|-----------------------|-------------------|
| 0-9                        | 142                       | 9                     | 6.3               |
| 10-49                      | 170                       | 26                    | 15.3 <sup>1</sup> |
| 50-99                      | 20                        | 8                     | 40.0              |
| 100-499                    | 28                        | 12                    | 42.9              |
| 500+                       | 2                         | 2                     | 100.0             |
| Unknown                    | 1                         | -                     |                   |
| Total                      | 363                       | 57                    | 15.7              |

<sup>1</sup> A large number of companies in this group are subcontractors, which in part explains the relatively low coverage of this group (not approached). Five complementary interviews were, however conducted with companies in this group

The companies on the list were contacted by phone and asked whether they were willing to participate. As expected, many declined, but, with the help of contacts and the industry association, we managed to interview 57 companies. It must be noted though that generally speaking the larger companies and the ones that were a member of the local industry association were more willing to talk to us than the smaller and/or un-affiliated companies. The high non-response among small firms increased the bias towards larger firms that resulted from our initial selection.

The 57 companies interviewed presented a coverage of almost 16 percent of the total industry in terms of number of establishments. Although this appears to be a fairly low coverage, for several reasons the survey can be considered representative for the Singapore apparel industry in the context of our research. First of all, as becomes clear from the employment numbers and shares in table A2, the firms included in the survey did represent a large share of total employment in all categories. Secondly, as is illustrated in table A2, coverage varied substantially per size category, reflecting the above mentioned bias and consequences of high non-response among smaller companies.

Third, in 2000 a survey among garment producers was conducted by the TaFF with support of Temasek Polytechnic School of Design (TP). The survey included 27 companies, all of which had been included in our survey. It was estimated that these 27 companies accounted for just over 30 percent of domestic exports (TaFF, 2000), which means the companies covered in our survey accounted for at least the same and probably an even higher share of domestic exports.

A drawback of the relatively small number of companies in the survey is that it sometimes makes statistical testing of data somewhat difficult. For instance when subgroups are made, it is hard to ascertain statistical significance of observed differences between the group. Even in the Malaysian survey (see below) this was often the case.

#### *Buyer database*

Included in the buyer database were: (i) international/regional buying/sourcing offices of overseas buyers located in Singapore; (ii) international buying agents located in Singapore representing overseas buyers; and (iii) local agents representing overseas buyers. Excluded from the database were: distributors/retailers, importer/exporters and wholesalers, licensees and local department stores, though some of these were included in our fashion industry case study (see below). Finally there was another group of regional offices, which was not directly involved in sourcing and buying activities, and therefore not included in our survey. Many of these companies performed activities that extend beyond Singapore. They included for instance offices co-ordinating and overseeing regional distribution and retailing of international brands; regional QC centres; representative offices (e.g. overseeing regional licensing and retailing of their brand), etc. Although these firms were not

included in the survey, some of them have been interviewed. This was either because they were initially identified as buying or sourcing offices, but turned out during the interview not to be, or because the firm was chosen as an interesting complementary case, providing additional insights.

As the number of buyers in Singapore is relatively limited and therefore the number of interviewed buyers (26) was low, it wasn't possible to undertake an extensive quantitative analysis. However, these 26 buyers did represent 48 percent of all buyers/agents, which meant they provided a good enough basis for a thorough qualitative analysis.

Unfortunately, during the course of our research, a number of these buyers closed, shifted their offices out of Singapore, or reduced their presence. Although this made their firm specific information somewhat redundant, it did not affect our analysis at the industry level. Table A3 gives an overview of the buyer inventory and coverage.

**Table A3 Inventory of Buyers in Singapore and Coverage of Buyer Survey (1998)**

| Buyer type   | Number in Singapore | Number Interviewed | Coverage (%) |
|--|---------------------|--------------------|--------------|
| Regional buying house/sourcing office of int'l buyer (branded, retailer, catalogue company, etc.)          | 15                  | 9                  | 60%          |
| Int'l buyers that used to have office in Sing. but closed down/dormant/moved/changed function, etc.        | 5                   | 2                  | 40%          |
| International buying agents (part of multinational buying agencies)  | 14                  | 9                  | 64%          |
| Local buying agents <sup>1</sup>   | 20                  | 6                  | 30%          |
| <b>Total</b>   | <b>54</b>           | <b>26</b>          | <b>48%</b>   |
| Other regional offices not included in database and survey (e.g. distribution, QC, representative offices) | 39 <sup>2</sup>     | -                  | -            |

<sup>1</sup> It is likely that this group is much bigger, as they were harder to trace (spread over many different types of directories and often under different 'headings'); some were identified through interviews with producers.

<sup>2</sup> This is an estimate, as no comprehensive database of this (very diverse) group of companies was made; the total number is probably higher

### *Organisation of the Interviews*

#### *Producers*

The interviews with producers were conducted during a three-month period between September and December 1998 with the assistance of two graduate students of the section of International Economics and Economic Geography at the Department of Geographical sciences of Utrecht University.

All companies were approached by phone and subsequently, if they agreed to participate in the survey, visited by the students and/or the main researcher. The interviews were performed through a structured questionnaire, with both open and classified questions. Because of the nature of the questionnaire (commanding thorough knowledge of every aspect of the business), the interviews were usually held with the manager/director of the company, or if they were not available, the marketing-, personnel-, production- or PR-manager. The interviews lasted between 60 to 90 minutes. All interviews were conducted in English, although in some cases a secretary or other employee would help explain questions in Chinese, or translate answers back into English.

The questionnaire consisted of 5 sections, comprising questions regarding:

- (1) The company profile (company structure, ownership, activities, etc.);
- (2) The manufacturing process (products, markets, buyers, suppliers, brands, etc.);
- (3) Changes in the past 10 years and problems encountered (changes in company organisation, size, products, markets, the business environment, etc.); and
- (4) Responses (competitive adjustment strategies) to these changes in competitiveness (in area of organisation, products, labour, technology, markets, etc.).
- (5) Current firm competitive position (outcomes of strategies), strategic focus, planned strategies and expected future developments.

*Buyers*

The buyer interviews were conducted in a four-month period from February till June 1999. All companies were approached by phone and subsequently visited, if they agreed to participate in the survey. The interviews were performed through a structured questionnaire, with both open and closed questions. Interviews were usually held with the manager/director of the company, or if they were not available, the marketing-, personnel-, or PR-manager. The interviews lasted between 60 to 90 minutes and were all conducted in English.

The questionnaire consisted of 4 sections, comprising questions regarding:

- (1) The (changing) position of Singapore producers in their regional/global sourcing networks;
- (2) The expected changes in the global industry and their regional/global sourcing patterns;
- (3) Changes in the position of (Southeast) Asia as a sourcing region; and
- (4) How this might affect Singapore's positioning within the GACC.

*Fashion industry case study*

Finally, in March and April 2003, a case study was conducted in co-operation with Temasek Polytechnic School of Design, Department of Apparel Merchandising and Design in Singapore, on the Singapore fashion industry. Because many of the firms included in this case study were part of the original database (OBM firms), it was not necessary to compile a completely new database, but it was possible to select relevant firms from the original producer database. However, it was necessary to complement this list, as a number of companies that were considered part of the local (garment) fashion industry were not listed in regular company directories, either because they were not related to production at all or not incorporated (i.e. very small with perhaps just a design studio to work from). In addition, quite a number had only recently been set-up or only recently become members of the industry association. The inventory thus made is presented in appendix C. A small survey (of approximately 15 companies) was conducted among local designer/label companies. In addition, several in-depth (open) interviews were held with a number of institutions and persons involved in the development of Singapore's fashion industry. This case study had a more qualitative character and focused both on the concept of OBM development and the policy aspect of industry development.

Towards the end of the project, in April 2003, a number of additional in-depth interviews were held with a few key figures in the industry, so as to verify some of the findings and check whether no major changes had taken place since our survey, making sure the results of our research were not outdated at the time of publication.

**Inventory of the Malaysian Garment Industry and Coverage of the Survey**

Compiling a database for the Malaysian apparel industry proved to be a more complicated and time-consuming job than in Singapore. Due to lack of co-ordination and information sharing between the different institutions keeping registries of firms, many sources had to be used and overlap had to be eliminated. In addition, many of the lists were outdated and thus it became hard to make selections beforehand, as basic information was often lacking or wrong (exceptions were the lists of the MTMA and MKMA). The only way to find out was to call the companies on the list. The following sources were used for the database:

- 1) The membership list of the Malaysian Textile Manufacturers Association (MTMA)
- 2) The members directory of the Malaysian Knitting Manufacturers Association (MKMA)
- 3) The members directory of the Malaysian Garment Manufacturers' Association (MGMA)
- 4) The Malaysian Industrial Development Authority (MIDA)
- 5) The Directory of Malaysian Factories; members directory of the Federation of Malaysian Manufacturers (FMM)
- 6) The Yellow Pages of the regions where interviews were held
- 7) The Ministry of International Trade and Industry (MITI)
- 8) The Human Resources Development Corporation (HRDC)
- 9) Other 'sources' such as walking or driving by, recommendation by other companies, etc.

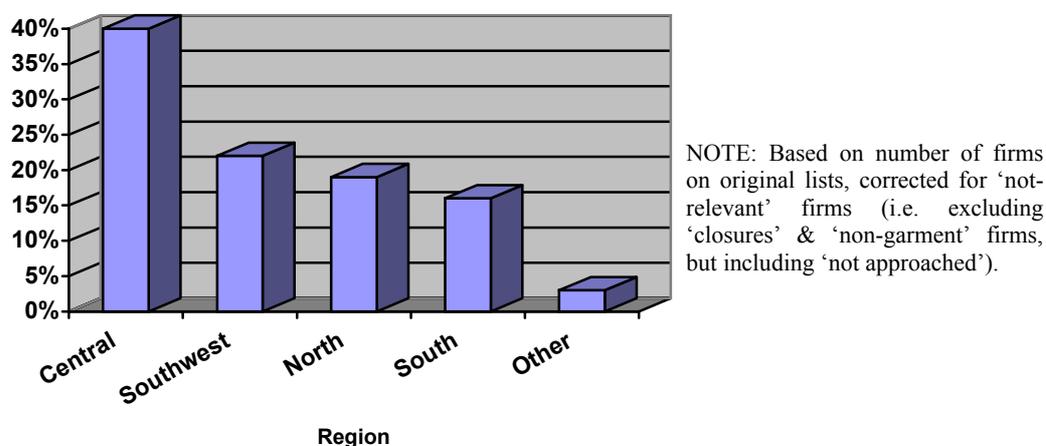
The number of establishments thus found (540) proved to be considerably lower than what is given in official statistics, which put the total number at approximately 1000 establishments nationwide. We feel this is primarily due to the lack of consistent data collection and updating of these data and the fact that registration of a business is compulsory, but subsequent changes of address, of business changes or closures are not recorded. The official number seems to be a mere estimation, which hasn't really changed over the past 10 years either. In addition, it is possible that the official number of 1000 includes all *factories*, in which case branch plants would be included as well. We decided not to include these, as they are mostly just extensions of the main factory and have no autonomy in terms of decision-making processes, administration, finance, etc. Finally a large number of subcontractors could not be traced in the official directories and registries, but they may have been included in the official number of a 1000 establishments.

A selection of companies for our interviews was made on the basis of two criteria: position in the chain and location. As in Singapore, for the interviews only independent set-ups were considered and sub-contractors were largely omitted, although a few of them were interviewed to provide complementary information.

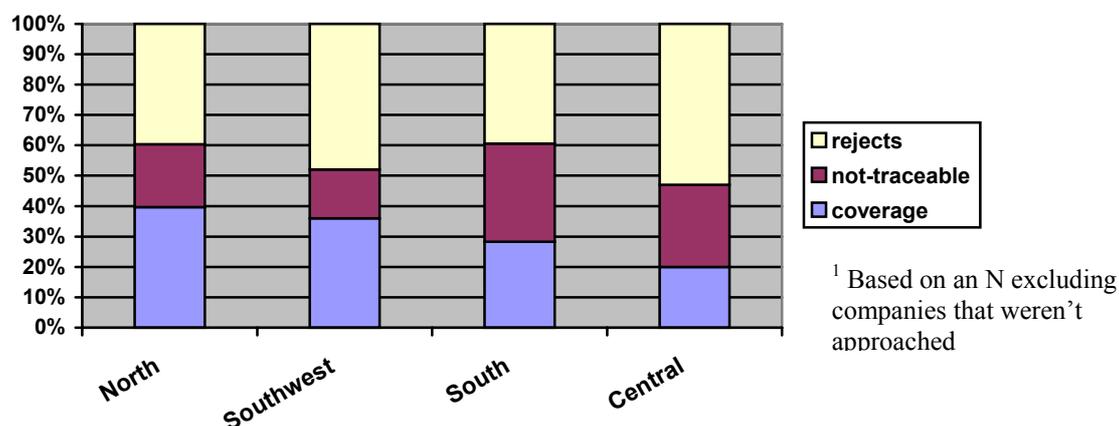
Figure A1 gives an overview of the distribution of the apparel industry by region based on the relevant companies on our initial list and including the companies that weren't to be traced.

The industry in Malaysia is concentrated in four regions: (1) the Central Region (Kuala Lumpur and Selangor); (2) the Northern Region (Penang, Kedah and Perak); (3) the Southwest Region (Batu Pahat, Kluang, Muar/Tangkak and Melaka); and (4) the Southern Region (Johor Baru & vicinity). Consequently we decided to conduct our interviews in these four regions. The rest of the companies were scattered over the country and not approached mainly for logistical reasons. Figure A2 illustrates the coverage per region.

**Figure A1** Distribution of Malaysian Garment Industry by Region



**Figure A2** Coverage by Main Region<sup>1</sup>



Upon trying to contact the companies on our initial list we were faced with several problems, which are reflected in the number of establishments in our final inventory list and coverage, presented in tables A4 and A5. These problems included:

1. Not traceable/no listing

Many of the companies listed in the source directories couldn't be traced. Upon calling them the line was either disconnected or not answered and the company couldn't be traced through the telephone directory service either. What happened to these establishments is not exactly clear. They might have closed, relocated or gone into another type of business. The number of these non-traceable companies differed considerably per source (see table A4). If we would assume these companies are no longer in operation, the number of establishments would drop to 409.

2. Misspelling, re-naming and outdated information in used sources

Some of the companies on the list could be eliminated because of misspelling (hence the same company would appear in different directories under different names), re-naming (companies that had changed their name in the past five years) and outdated information in the used sources (some companies had already closed or moved into another line of business).

3. Not relevant

Some of the companies initially included in our list, turned out not to be relevant for the purpose of our research and thus omitted. Not relevant implying they were not garment producers, but manufactured other products, such as textile/fabrics; accessories; and other textile products (e.g. travel bags, protective gloves, tents, curtains etc.). In addition there was a group of companies involved in garment production in the strict sense of the word, but not approached for reason of not being particularly relevant for our research, For instance producers of uniforms, bridal gowns, etc.

4. Time constraint/logistic considerations

Due to time constraint and/or logistics considerations, certain companies were not approached. This included (single) companies that were located too far away from the main concentration of companies and would have required a disproportionate amount of time/resources to visit. In addition, certain companies were given up on, as they were contacted many times, but failed to reply (often a problem of getting a hold of the person in charge). Finally with a number of companies we were faced with the problem of language barrier. Especially in the case of many smaller, domestically oriented companies, English was not spoken. In a few instances we have made use of an interpreter, but this poses limitations as well (quality of information, cost etc.). In addition, many of these companies felt uncomfortable and didn't want to speak to us at all.

5. Multi-establishment companies

Finally, there was the issue of multi-establishment companies. A distinction needs to be made between three types establishments: (1) Main/parent or holding companies (in the case of a group); (2) Subsidiaries; and (3) Branch plants. The first two categories are all included in the list, the third category often isn't as they are not listed as independent companies and often have limited operations and responsibilities. All interviewed companies are either main establishments or independent subsidiaries. In a number of cases several establishments belonging to the same company or group were interviewed. In other cases only one of the establishments was interviewed (this could be either a parent of subsidiary), and some information on the other establishments was obtained through them.

For the same reasons as mentioned in the case of Singapore, a goal of at least 100 interviews was set, with a minimum of 20 in each region. The total number of interviews exceeded this set goal and 117 interviews were conducted, with a reasonable spread over the regions (larger number of interviews in the Central region is justified by the larger number of companies here, whereas the relatively low number of interviews in the Southern region is again justified by the smaller number of companies in this particular region). Coverage by source reveals the unreliability of some sources, especially the MGMA directory.

As there are hardly any buyers in Malaysia, no survey of this group was conducted.

**Table A4 Inventory of Establishments and Coverage of Survey in Malaysia by Source (1999) (excluding double counting)**

| Source                   | No. of comp. | No. of comp. confirmed closed | N <sup>1</sup> | Interviewed |            | Rejects (not willing to participate) |            | Not traceable |            | Not approached <sup>2</sup> |           |
|--------------------------|--------------|-------------------------------|----------------|-------------|------------|--------------------------------------|------------|---------------|------------|-----------------------------|-----------|
|                          |              |                               |                | No.         | %          | No.                                  | %          | No.           | %          | GROUP                       | OTHER     |
| <b>MTMA</b>              | 154          | 2                             | 152            | 75          | 49%        | 50                                   | 33%        | 1             | -          | 14                          | 12        |
| <b>MKMA</b>              | 9            | -                             | 9              | 2           | 22%        | 5                                    | 56%        | -             | -          | -                           | 2         |
| <b>MGMA</b>              | 124          | 2                             | 122            | 5           | 4%         | 66                                   | 54%        | 45            | 37%        | 2                           | 4         |
| <b>MIDA</b>              | 73           | 11                            | 62             | 12          | 19%        | 16                                   | 26%        | 17            | 27%        | 5                           | 12        |
| <b>FMM</b>               | 45           | 3                             | 42             | 6           | 14%        | 15                                   | 36%        | 5             | 12%        | 3                           | 13        |
| <b>Yellow Pages</b>      | 64           | 5                             | 59             | 5           | 8%         | 24                                   | 41%        | 27            | 46%        | -                           | 3         |
| <b>MITI</b>              | 52           | 2                             | 50             | 9           | 18%        | 20                                   | 40%        | 9             | 18%        | 4                           | 8         |
| <b>HRDC</b>              | 8            | -                             | 8              | 3           | 38%        | 2                                    | 25%        | 1             | 13%        | 1                           | 1         |
| <b>Other<sup>3</sup></b> | 11           | -                             | 11             | 4           | 36%        | 4                                    | 36%        | 1             | 9%         | -                           | 2         |
| <b>Total</b>             | <b>540</b>   | <b>25</b>                     | <b>515</b>     | <b>121</b>  | <b>23%</b> | <b>202</b>                           | <b>28%</b> | <b>106</b>    | <b>21%</b> | <b>29</b>                   | <b>57</b> |

<sup>1</sup> All shares based on this N

<sup>2</sup> Not approached is GROUP: companies part of group of which other member was interviewed; and OTHER: companies inconveniently located or not relevant

<sup>3</sup> For example walked by, referred by others, etc.

**Table A5 Inventory of Establishments and Coverage of Survey in Malaysia by Region (1999)**

| Region                   | No. of firms | Firms closed | Firms not approached <sup>1</sup> | Firms not traceable | N1 <sup>2</sup> | N2         | N3         | No. of rejects | No. of firms interviewed | Coverage in % |            |            |
|--------------------------|--------------|--------------|-----------------------------------|---------------------|-----------------|------------|------------|----------------|--------------------------|---------------|------------|------------|
|                          |              |              |                                   |                     |                 |            |            |                |                          | N1            | N2         | N3         |
| <b>Central</b>           | 208          | -            | 18                                | 52                  | <b>209</b>      | <b>191</b> | <b>139</b> | 100            | 38                       | <b>18</b>     | <b>20</b>  | <b>27</b>  |
| <b>Northwest</b>         | 99           | 1            | 20                                | 16                  | <b>98</b>       | <b>78</b>  | <b>62</b>  | 31             | 31                       | <b>32</b>     | <b>40</b>  | <b>50</b>  |
| <b>Southwest</b>         | 132          | 20           | 26                                | 14                  | <b>110</b>      | <b>86</b>  | <b>72</b>  | 41             | 31                       | <b>28</b>     | <b>36</b>  | <b>43</b>  |
| <b>South</b>             | 86           | 4            | 7                                 | 24                  | <b>83</b>       | <b>76</b>  | <b>52</b>  | 30             | 21                       | <b>25</b>     | <b>28</b>  | <b>40</b>  |
| <b>Other<sup>3</sup></b> | (15)         | -            | (15)                              | -                   | -               | -          | -          | -              | -                        | -             | -          | -          |
| <b>Total</b>             | <b>525</b>   | <b>25</b>    | <b>71</b>                         | <b>106</b>          | <b>500</b>      | <b>433</b> | <b>327</b> | <b>202</b>     | <b>121</b>               | <b>24%</b>    | <b>28%</b> | <b>37%</b> |

<sup>1</sup> Including: Inconveniently located; not relevant for research & companies of which parent or other establishment was already interviewed.

<sup>2</sup> N1 = including firms not approached & not traceable; N2 = including not traceable & excluding not approached; N3 = excluding not traceable & not approached

<sup>3</sup> None of these companies were approached or interviewed and therefore not included in coverage at all

*Organisation of the Interviews*

The interviews were conducted in 4 phases or periods. From September 1999 till February 2000 interviews were held in the Central region, with the assistance of two graduate students of the section of International Economics and Economic Geography at the Department of Geographical sciences of Utrecht University.

During the entire research period in Malaysia we received assistance and support from the MTMA, our official local counterpart and during the survey in the Central region we even worked out of their Kuala Lumpur office.

All companies in the Central region were approached by phone and subsequently - if they agreed to participate in the survey - visited by one or two members of the research team. In addition, on a research executive of the MTMA joined in the interviews, which worked to our mutual benefit. The MTMA thus gained some useful insights into the issues in the industry, while she could assist with translation into English or Chinese when necessary.

From February 2000 till June 2000 companies were contacted and interviews conducted in the Northern region. Subsequently the Southern region and Southwestern region were surveyed from July till October 2000, and from November 2000 till February 2001 respectively. All of these interviews were performed by the main researcher personally. In the Southwestern region the MKMA, which has its main office in Batu Pahat, offered invaluable support and assistance.

The interviews were performed through a structured questionnaire, with both open and classified questions. Because of the nature of the questionnaire (commanding thorough knowledge of every aspect of the business), the interviews were usually held with the manager/director of the company, or if they were not available, the marketing, personnel, production or PR manager. The interviews lasted between 60 to 90 minutes. All interviews were conducted in English, although in some cases an interpreter was used.

The Malaysian questionnaire differed somewhat from the Singapore producer questionnaire in that it incorporated a few more detailed questions on technology and capabilities, which were included in an appendix to the main questionnaire. In addition questions were adjusted to the Malaysian. All this was done on the one hand to perfect the questionnaire and on the other hand to provide the MTMA with some additional information, which they specifically wanted to obtain.

## Annex B Main Concepts

**Table B1** *Explanation of Main Concepts Used with Regards to Organisational Units*

| Concept                      | Definition/Use   |
|------------------------------|--|
| Establishment                | Single set-up or factory, may be part of larger company (with several establishments) and may have a specific position within this company. If part of larger company, usually a further qualification will be added to clarify which, or what kind of establishment is indicated, e.g. Singapore establishment, interviewed establishment, overseas establishment, main establishment (or parent), independent establishment, manufacturing establishment, etc. The status of an establishment within a company may also be clarified by terms such as parent, branch, subsidiary or affiliate. |
| Company                      | Business enterprise or firm, either single- or multi-establishment. In other words, company refers to all establishments taken together, in some instances made more explicit by referring to the 'entire' company or group/group of companies.  |
| Parent/ Headquarters         | Main establishment within a company, where all executive management decisions are made.  |
| Holding company              | Investment company (often publicly listed) with a group of companies (possibly in different industries and sectors) underneath it. Only makes group management decisions and leaves most industry specific management decisions up to individual companies in the group  |
| Branch (office or plant)     | Separate, but dependent part of the company, without decision-making powers. Managed by parent company or sometimes even subsidiary  |
| Subsidiary*                  | Separate part of the company with some own decision making powers (although not at executive level) and often its own management and administration departments or even finances. An overseas subsidiary may in turn have its own branches or subsidiaries.  |
| Affiliate/affiliated company | Establishment/company not formally part of the company but linked through e.g. partnership or mutual share ownership of owners (sometimes also joint venture)  |

\* If an interviewed establishment was part of a larger company and had the status of (foreign) subsidiary in this larger company, other subsidiaries within that company are often referred to as 'other establishments'.

## Nederlandse Samenvatting

### Mondiale Netwerken en Lokale Industrie.

Veranderende Concurrentiekracht, Bedrijfsstrategieën en Ontwikkelingspaden in de Kledingindustrie van Singapore en Maleisië

#### Inleiding: thema en benadering

Een belangrijke vraag in het huidige globaliseringsdebat is hoe ontwikkelingslanden (of liever minder ontwikkelde landen of MOL) kunnen profiteren van economische globalisering, of waarom ze dat niet doen. De interrelatie tussen economische globalisering en lokale ontwikkeling vormt het centrale thema van deze studie. Dit thema is verder uitgewerkt en ingeperkt door te focussen op ontwikkeling van een lokale *industrie* en door te kijken naar een in toenemende mate relevante vorm van economische globalisering: de wereldwijde expansie van productie netwerken en zogenaamde ‘commodity chains’, aangestuurd door grote bedrijven (zowel detail- en groothandel- als productie bedrijven) uit het Westen, ook wel ‘lead-firms’ genoemd.

Gekeken is naar incorporatie van lokale bedrijven in deze *mondiale productie netwerken* en *global commodity chains* (GCCs) en welke kansen en perspectieven dit bedrijven en industrieën in MOL biedt voor *langere termijn ontwikkeling*. Deze kansen worden vaak gezien in de leermogelijkheden die de *lead-firms* bedrijven in MOL bieden om zich te ontwikkelen tot internationaal concurrerende bedrijven. De relatie tussen incorporatie en ontwikkeling wordt doorgaans (in de literatuur) echter als haast automatisch gezien. De studie beoogt een duidelijker inzicht te geven in de feitelijke dynamiek van dit proces.

Gesteld is dat op langere termijn niet alleen het behouden van connecties met de belangrijkste klanten in netwerken en ketens van belang is, maar dat de uitdaging in toenemende mate ligt in het kunnen aangrijpen en verwezenlijken van de kansen die deze connecties producenten in MOL bieden, om posities en rollen in netwerken en ketens te *verbeteren*. Zo’n verbetering kan gedefinieerd worden als doorstroming naar een positie of rol in, of wellicht buiten, netwerken en ketens waar - onder andere - de concurrentiedruk kleiner, opbrengsten hoger en afhankelijkheid (van lead-firms) minder is.

De studie gaat dus verder dan een analyse van de incorporatie fase alleen - zoals zo vaak te vinden is in de literatuur - terwijl expliciet aandacht besteed wordt aan de specifieke dynamiek van de lokale omgeving waarin bedrijven en industrieën fungeren - welke juist zo vaak onderbelicht lijkt in de literatuur over globalisering en lokale ontwikkeling.

Daarnaast is de insteek van de studie met betrekking tot lokale industrie ontwikkeling breder en de analyse focust niet exclusief op het idee van *upgrading* als enige maatstaf van ontwikkeling. In plaats daarvan ligt de nadruk op de *concurrentie strategieën* van bedrijven, *bedrijfs- en industrie ontwikkelingstrajecten* en de belangrijkste *krachten en determinanten* daarachter. Dit laatste, een overweging van de belangrijkste determinanten, geeft inzicht in zowel de lokale (institutionele) als de regionale en internationale omgevingsfactoren en hun invloed op gedrag van bedrijven en andere relevante actoren.

In de gekozen benadering is vooral erkenning voor het feit dat een scala aan strategieën kan worden toegepast door individuele bedrijven, met een scala aan ontwikkelingspaden en uitkomsten, in termen van concurrentieposities, tot gevolg. Niet al deze strategieën en trajecten zullen noodzakelijkerwijs leiden tot *upgrading*. Dit is in tegenstelling tot de bijna lineaire, ideaal-typische, ontwikkelingstrajecten van bedrijven en industrieën na incorporatie, die vaak gesuggereerd worden in de literatuur. Bij dergelijke trajecten volgen bedrijven een ontwikkelingspatroon waarin ze een aantal min of meer opeenvolgende rollen vervullen; van simpele assemblage van aangeleverde componenten (ook wel loonveredeling genoemd), via

massa productie van kledingstukken, waarbij alle processen van het inkopen van materiaal tot het afleveren van gereed product voor rekening van de producent komen ('original equipment manufacturing' of OEM), tot eigen ontwerp en uiteindelijk eigen merknaam en product ontwikkeling ('original design manufacturing' en 'original brand manufacturing', ook wel ODM en OBM). Zulke modellen zijn, zoals verschillende auteurs ook al hebben aangegeven, wellicht wat simplistisch in hun veronderstelde lineariteit en laten bovendien weinig ruimte voor een consideratie van alternatieve ontwikkelingstrajecten, mogelijk buiten de keten.

De studie beoogt twee dingen te doen in een poging de relatie tussen (geïncorporeerd zijn in) mondiale netwerken en GCCs enerzijds en lokale bedrijfs- en industrie ontwikkeling anderzijds, bloot te leggen: Ten eerste, wordt gekeken in hoeverre en onder welke omstandigheden bedrijven en industrieën in MOL connecties met mondiale netwerken en ketens behouden; en of/hoe, daarin slagen bijdraagt tot industrie ontwikkeling, in vergelijking tot andere paden. Ten tweede wordt nagegaan of, en hoe, in mondiale netwerken en ketens opererende bedrijven en industrieën in MOL, alsmede institutionele actoren, de kansen en mogelijkheden die deze connecties bieden ook daadwerkelijk (kunnen) benutten om posities en rollen in relatie tot de netwerken en ketens te verbeteren.

Dit centrale thema en de specifieke insteek en doelen zijn bekeken in de context van de zeer dynamische mondiale kledingindustrie en twee cases in het bijzonder: Singapore en Maleisië.

### **Opereren in mondiale kleding productie netwerken en ketens, bedrijfsstrategieën en de Oostaziatische antecedenten**

De kledingindustrie wordt gekenmerkt door een hoge mate van deverticalisatie, wat inhoudt dat de verschillende stappen in de productieketen, van ontwerp tot stoffen snijden, assemblage, marketing en verkoop, in toenemende mate uit elkaar getrokken zijn en op verschillende locaties kunnen plaatsvinden.

Door deze hoge mate van deelbaarheid van het productieproces, in combinatie met een aantal andere specifieke kenmerken van de industrie, of liever gezegd van de verschillende stappen binnen de productieketen, is de kledingindustrie een van de eerste geweest die zich op grote schaal wereldwijd heeft uitgespreid en een mondiaal karakter heeft aangenomen.

Het feit dat met name assemblage activiteiten arbeidsintensief zijn, terwijl ze een lage technologische intensiteit hebben, maken deze stappen bij uitstek geschikt voor ontwikkelingslanden, die een overschot aan arbeid en een tekort aan kapitaal hebben en via export productie hun industriële ontwikkelingsproces willen opstarten. De Oostaziatische 'Newly Industrialising Economies' (NIEs) zijn wellicht de belangrijkste voorbeelden van succes van een dergelijke ontwikkelingsstrategie.

De meeste waarde in de kledingproductieketen wordt echter gegenereerd door ontwerp, marketing en merknaam-ontwikkeling (branding) activiteiten. Het zijn dan ook deze activiteiten die nog steeds voornamelijk door bedrijven in het Westen worden uitgevoerd. Hoewel velen zich in toenemende mate niet (meer) direct met productie bemoeien<sup>1</sup>, kunnen zij, door hun controle over de belangrijkste activiteiten en derhalve de toegang tot markten en strategische informatie, andere activiteiten in de keten sterk sturen. Aangezien deze kledingbedrijven hun producten doorgaans kopen in plaats van maken, worden ze ook wel inkopers of 'buyers' genoemd.

Vanuit het perspectief van de producent in een ontwikkelingsland is het zaak om na incorporatie in de netwerken van deze inkopers als afhankelijke producent, zo snel mogelijk door te stromen naar minder afhankelijke posities waar zij zelf meer controle over andere activiteiten hebben. Enerzijds omdat een toenemend aantal producenten in een toenemend

aantal MOL in staat blijkt tot contract productie (dus de concurrentiedruk in met name simpele assemblage is zeer groot), anderzijds omdat na incorporatie een groot aantal veranderende factoren in zowel de lokale, regionale als internationale productieomgeving van bedrijven het initiële concurrentievoordeel van bedrijven en landen weg erodeert. Toenemende lokale productiekosten, lokale arbeidstekorten en appreciatie van muntenheden betekenen dat bedrijven niet langer kunnen concurreren op kosten, terwijl internationale handelsbelemmeringen en verdragen bepaalde landen kunstmatige concurrentievoordelen kunnen geven. Daarnaast spelen veranderingen in de kleding markt, zoals de grotere nadruk op diversiteit, meerdere collecties per jaar, hogere kwaliteitseisen, etc., via de inkopers, een rol in toegenomen concurrentiedruk en kosten voor in netwerken en ketens opererende producenten. Zo stellen inkopers steeds hogere eisen ten aanzien van kwaliteit, flexibiliteit, en kortere 'lead-times' (de tijd toegestaan tussen bestelling van het product en feitelijke aflevering).

Al deze factoren dwingen producenten op zeker moment aanpassingsstrategieën toe te passen. Doen zij dit niet, dan zullen ze op termijn weer buiten de netwerken en ketens gesloten worden.

Idealiter leiden dergelijke strategieën tot een verbetering van de positie. Echter, wanneer alleen voldaan wordt aan vereisten gesteld door inkopers, bestaat de kans dat er wel een verbetering van de positie ten opzichte van de vorige positie ontstaat, maar niet noodzakelijkerwijs ten opzichte van concurrenten, immers zij voldoen aan dezelfde vereisten. Dit wordt ook wel vergeleken met 'hardlopen om stil te staan'.

Om daadwerkelijk een betere positie of rol te verwerven, zal een producent iets 'anders' moeten doen en een uniek concurrentievoordeel moeten ontwikkelen. Dit vereist vooral zogenaamde pro-actieve of offensieve strategieën, ontwikkeld uit eigen initiatief en gericht op het verbeteren van capaciteiten en competenties. Dit in tegenstelling tot defensieve strategieën die vooral gericht zijn op kosten reductie of -beperking, en dikwijls leiden tot arbeidsexploitatie en op termijn vaak niet houdbaar blijken.

Wederom vormen de Oostaziatische NIEs positieve voorbeelden. Producenten in deze landen stonden in zekere zin aan de wieg van de verregaande globalisering die de kledingindustrie heden ten dage kenmerkt. Velen begonnen al in de vijftiger en zestiger jaren op contract basis te produceren voor Westerse klanten. In de loop der jaren hebben zij hun competenties sterk ontwikkeld. Echter, kosten in deze landen stegen dramatisch, onder andere juist door hun grote succes. Hoewel veel bedrijven de concurrentiedruk uiteindelijk niet meer aan konden en hun deuren moesten sluiten, is een groot aantal bedrijven erin geslaagd te overleven en nieuwe rollen te ontwikkelen, die hen weliswaar een minder belangrijke positie gaf in termen van bijvoorbeeld kleding export, maar hun machtsposities binnen de netwerken en ketens versterkten. Niet langer waren ze direct betrokken bij productie, maar in toenemende mate besteedden ook zij productie uit en legden zich toe op de coördinatie en aansturing van productienetwerken in de regio, voor hun klanten in het Westen. In andere gevallen verschoven zij naar andere posities of specialisaties in de keten, bijvoorbeeld naar de productie van gespecialiseerde inputs, of legden zij zich toe op eigen product ontwikkeling en een verschuiving in de richting van 'eigen baas' over alle fasen in de keten (dus ook ontwerp en marketing).

Deze posities werden bereikt door het toepassen van een scala aan concurrentiestrategieën gericht op het versterken van relaties met en services voor klanten, relocatie van productie, specialisatie in productie organisatie, het ontwikkelen van ontwerp capaciteiten en zelfs eigen producten en merken. De vraag is of dergelijke succesverhalen ook elders voorkomen.

Een belangrijk gevolg van de ontwikkelingen in de kledingindustrie, de veranderende rol van de Oostaziatische NIEs en de daardoor ontstane 'productie driehoeken' in Azië, alsmede de internationale regulering van de industrie middels het Multi-Vezel Akkoord en het daaronder

ontwikkelde quota systeem, is een constante verandering van geografische patronen binnen de mondiale industrie. De internationale arbeidsverdeling die aan het eind van de jaren negentig was ontstaan is zeer complex, met een groot aantal locaties en bedrijven die verschillende rollen en posities innemen en verschillende deelprocessen uitvoeren, danwel aansturen.

### Cases en onderzoeksvragen

Singapore en Maleisië zijn twee van de meest succesvolle economieën in Zuidoost Azië. Middels het aantrekken van buitenlandse investeringen en een export gerichte industrialisatie strategie, sinds de jaren zestig en zeventig/tachtig respectievelijk, wisten de twee landen sterke groei te bewerkstelligen. De kledingindustrie speelde een rol in het initiële succes van de twee landen en werd onderdeel van mondiale netwerken en ketens, enerzijds door uitschuivingsprocessen vanuit de Oostaziatische landen (met name in het geval van Maleisië) en anderzijds via directe ‘sourcing’ (inkoop) op OEM basis door Amerikaanse en Europese inkopers.

Vreemd genoeg zijn Zuidoost Azië, en de kledingindustrie in deze regio in het bijzonder, onderbelicht gebleven in studies naar globalisering en lokale industrie ontwikkeling.

Om deze reden, en met in het achterhoofd de positieve voorbeelden van de Oostaziatische NIEs, is gekozen voor een analyse van de kledingindustrie in deze twee landen. Ookal gezien het feit dat beide landen, maar met name Singapore, inmiddels te maken hebben (gehad) met een soortgelijke erosie van de concurrentiepositie als het geval was in de Oostaziatische NIEs en aanpassing van concurrentiestrategieën dus *noodzakelijk was. Dit maakt de cases bij uitstek geschikt voor een analyse van langere termijn effecten van opereren in mondiale netwerken en ketens.* De analyse is zowel op het bedrijfsniveau, als op het industriële niveau uitgevoerd.

Niet alleen is getracht de dynamiek binnen de landen te beschrijven en verklaren, maar ook een verklaring van de verschillen tussen de twee landen is aan bod gekomen.

Een achttal onderzoeksvragen is geformuleerd als leidraad voor de studie:

1. Wat zijn de structuur en kenmerken van de kleding industrie in Singapore en Maleisië, met name in termen van de betrokken actoren; de activiteiten die zij uitvoeren; de configuratie van de mondiale netwerken en ketens waarin ze opereren en hun positie daarin; de nationale/lokale netwerken die ze gevormd hebben; en de werkgelegenheidspatronen?
2. Hoe hebben kledingbedrijven en de lokale industrie gemeenschap in Singapore en Maleisië gereageerd (welke strategieën zijn toegepast) op de veranderende concurrentie condities in de context van globalisering?
3. Is het mogelijk nieuwe bronnen van groei en diversificatie op industrie niveau te onderscheiden; wat is hun impact tot dusver en in hoeverre kunnen ze in staat geacht worden het profiel van de industrie, lokaal, fundamenteel te veranderen?
4. Wat zijn de te onderscheiden bedrijfs- en industrie ontwikkelingstrajecten als uitkomsten van concurrentie aanpassingsstrategieën en dynamiek op industrie niveau?
5. In hoeverre ondersteunt of ondermijnt de lokale industrie omgeving de capaciteit van lokale bedrijven en de industrie gemeenschap om zich aan te passen aan een veranderende concurrentie-omgeving en posities en rollen in relatie tot netwerken en ketens te verbeteren?
6. Wat is de rol van actoren binnen de *global commodity chain* – specifiek ‘lead-firms’ – in de aanpassingen en ontwikkelingstrajecten van lokale bedrijven en de industrie gemeenschap?
7. Zijn er andere factoren die ontwikkelingstrajecten op bedrijfs- en industrie niveau stimuleren danwel belemmeren?
8. Hoe laten de Singapore en Maleisië cases zich vergelijken? Wat zijn de overeenkomsten en verschillen en kunnen die verklaard worden uit een faseverschil in de geobserveerde processen of spelen ook andere factoren een rol?

Middels een uitgebreide survey in zowel Singapore als Maleisië, bestaande uit gestructureerde interviews met respectievelijk 57 en 117 kleding productie bedrijven, alsmede een survey onder kleding inkopers, interviews met institutionele actoren, secundaire data, en een uitgebreide analyse van al dit materiaal is geprobeerd een antwoord te vinden op deze vragen.

### **Bevindingen**

*Onderzoeksvraag 1: Wat zijn de structuur en kenmerken van de kleding industrie in Singapore en Maleisië?*

De kledingindustrie in beide landen vertoont overeenkomsten in termen van overwegend lokaal eigendom van bedrijven, export gerichtheid en positie in ketens als OEM producenten voor min of meer dezelfde grote klanten uit de Verenigde Staten en in mindere mate Europa. Belangrijke verschillen zijn er echter ook. Ten eerste is de gemiddelde bedrijfsomvang in Maleisië aanzienlijk kleiner dan in Singapore, terwijl productie organisatie structuren vaak simpeler en veel meer lokaal/nationaal gebaseerd zijn. Ten tweede is het percentage buitenlandse bedrijven (inclusief die met een buitenlands meerderheidsaandeel) in de industrie groter in Maleisië. Ten derde is het aantal bedrijven dat gerekend kan worden tot het zogenaamde OBM segment (producenten/marketers van producten onder een eigen merknaam) in Singapore relatief groter en lijkt dit segment er bovendien ten dele in geslaagd ook regionaal uit te breiden. Ten vierde heeft een aantal Singaporese bedrijven zich weten te positioneren in zogenaamde OEM+ rollen, waarbij ze meer en grotere verantwoordelijkheden binnen de keten op zich hebben genomen en extensieve internationale productienetwerken coördineren en orkestreren voor hun klanten. Dit in tegenstelling tot producenten in Maleisië, die nog bijna geheel lokaal opereren.

De geografische spreiding van de Singaporese kledingindustrie, met investeringen in wel 20 verschillende landen in zowel Azië, Afrika, als Latijns Amerika, is dan ook een van haar opvallendste kenmerken.

In Maleisië is een van de opvallendste kenmerken het opereren van twee totaal verschillende segmenten naast elkaar, met zeer weinig onderlinge connecties. Aan de ene kant een export georiënteerd segment gelinked aan zowel buitenlandse klanten als buitenlandse toeleveranciers van inputs, en met weinig lokale connecties (veelal beperkt tot subcontractors, buitenlandse toeleveranciers gevestigd in Maleisië en leveranciers van secundaire inputs).

Aan de andere kant een segment gericht op de binnenlandse markt, dat sterk afhankelijk is van lokale inputs en klanten. Vanwege de grotere omvang van de industrie in zijn geheel, alsmede de grotere lokale markt in Maleisië, is dit 'domestic' segment veel groter dan in Singapore en de scheiding tussen de twee segmenten veel scherper.

*Onderzoeksvraag 2: Hoe hebben kledingbedrijven en de lokale industrie gemeenschap in Singapore en Maleisië gereageerd op de veranderende concurrentie condities in de context van globalisering?*

In eerste instantie pasten bedrijven in beide landen vooral defensieve strategieën toe, zoals met name arbeidsintensivering en uitbesteding. Met toenemende concurrentiedruk voldeden deze strategieën alleen echter al gauw niet meer en vond er een verschuiving plaats naar meer offensieve strategieën, hoewel defensieve niet geheel verdwenen zijn. Deze overgang van defensieve naar meer offensieve strategieën is in Singapore echter uitgesprokener en komt in sterkere mate voort uit eigen initiatief van de producenten. Veel voorkomende strategieën in Singapore waren verbetering van producten en processen, het switchen naar hoogwaardigere inkopers (bijvoorbeeld van warenhuizen naar merkproducenten) en internationalisering. In Maleisië daarentegen worden meer offensieve strategieën - zoals verbetering van producten en productieprocessen - vooral gedreven door de belangrijkste klanten en blijven ze bovendien vaak beperkt tot verbeteringen binnen bestaande (productie)rollen en posities.

Verder speelt internationalisering nauwelijks een rol - Maleise producenten zijn eerder geneigd concurrentieproblemen in eigen land op te lossen - en arbeidsintensiveringsstrategieën zijn nog steeds erg populair.

Dit verschil is ten dele toe te schrijven aan de concurrentie-crisis in Singapore aan het eind van de jaren tachtig/begin jaren negentig. In een korte tijd veranderde bepaalde omstandigheden, zoals onder andere het loonniveau, quota verdelingssysteem, en buitenlandse werknemer beleid, zodanig dat kosten explosief stegen en veel bedrijven zich gedwongen zagen te sluiten of productie naar goedkopere lonen-landen in de regio te verplaatsen. Als gevolg is een sterke afname van productie in Singapore in deze periode waarneembaar, duidelijk af te leiden uit officiële productie en export statistieken. De crisis vormt in zekere zin een breuk, aangezien bedrijven niet langer konden overleven (laat staan hun posities verbeteren) door toepassing van defensieve en 'volger' strategieën alleen. Degenen die dat wel bleven doen bestaan inmiddels niet meer. De groep overlevenden daarentegen, lijkt sterker uit de crisis te zijn gekomen door een geslaagde overstap naar meer offensieve strategieën zoals internationalisatie, verbetering van services en diversificatie.

Een dergelijke crisis heeft in Maleisië (nog) niet plaatsgevonden. Overwegend defensieve en beperkt offensieve strategieën zijn hier tot recent voldoende gebleken om aansluiting met netwerken en ketens te behouden.

In het algemeen kan gesteld worden dat de aspiraties van producenten in Singapore langzaam verschoven richting meer zelfstandige en hoogwaardiger rollen in de netwerken en ketens. Dat deze verschuiving soms subtiel is blijkt als we relokatie en internationalisatie strategieën wat beter onder de loep nemen. Relokatie van productie vond al plaats sinds het begin van de jaren tachtig, maar had in eerste instantie vooral een defensief karakter en was bijna uitsluitend gericht op kostenbeperking. Sinds het begin van de jaren negentig verandert het karakter van deze strategieën en worden het vooral concurrentie strategieën gericht op verbetering in plaats van behoud van concurrentiekracht. Deze nieuwe internationalisatie strategieën veranderde de rol van de vestigingen in Singapore sterk. De laatste functioneren nauwelijks nog als productie eenheden, maar veeleer als regionale hoofdkantoren, waar de coördinatie van vaak wereldwijde productie en distributienetwerken en specifieke additionele services voor klanten plaatsvindt. Deze producenten zijn in feite verworden tot 'one-stop service centres' voor inkopers, die in hen de voordelen van verschillende locaties verenigd vinden. Singaporese OEM producenten ontleen in toenemende mate hun concurrentiekracht aan hun internationale opzet en connecties.

*Onderzoeksvraag 3: Is het mogelijk om nieuwe bronnen van groei en diversificatie op industrie niveau te onderscheiden; wat is hun impact tot dusver en in hoeverre kunnen ze in staat geacht worden het profiel van de industrie, lokaal, fundamenteel te veranderen?*

In Singapore kunnen twee nieuwe bronnen worden onderscheiden: ten eerste de vestiging van regionale kantoren van internationale inkopers en agenten en de daaraan gerelateerde ontwikkeling van een regionaal/internationaal inkoop- en handelscentrum voor kleding; ten tweede de ontwikkeling van lokale merknamen en een mode-industrie. Beide zijn non-productie activiteiten die kansen bieden voor hoogwaardigere functies en banen.

Hun impact is echter beperkt gebleven vanwege de vaak kleine omvang van de betrokken bedrijven in het mode-segment en de recente sluiting van een aantal inkoopkantoren.

In Maleisië waren inkoopkantoren nagenoeg afwezig (het land vervult geen centrale functie voor omliggende landen en er wordt niet genoeg product uit Maleisië zelf ingekocht om een apart inkoopkantoor te verantwoorden), terwijl het mode segment tot nu toe zeer beperkt is. Uitspraken over impact en potentieel zijn dus moeilijk te doen.

In Singapore is het potentieel van deze nieuwe segmenten als nieuwe bronnen van groei en diversificatie beperkt om een aantal redenen; (i) de relatief kleine 'sourcing base' (landen

waarvan inkoop van kleding gecoördineerd wordt vanuit Singapore) en het gebrek aan verkoop- en marketing kantoren van regionale producenten (oftewel verkopers), welke de aantrekkelijkheid van Singapore als een vestigingsplaats voor grote inkoopkantoren vermindert; (ii) de beperkte omvang van de lokale markt, en het gebrek aan handelsgeest en ondernemerschap onder ‘design-based’ bedrijfjes, alsmede de afwezigheid van sterke connecties tussen dit nieuwe segment en het bestaande productie-segment, welke in zekere zin de ontwikkeling van het mode-segment belemmeren; en (iii) de beperkte mate waarin de institutionele context in staat blijkt op een gecoördineerde wijze relevant nieuw/aangepast beleid weet te formuleren voor deze nieuwe segmenten.

Tenslotte lijkt het toekomst perspectief met name in het geval van de ontwikkeling van een mode industrie ook deels afhankelijk te zijn van meer ongrijpbare veranderingen in algemene attitudes t.a.v. van mode, individualiteit, vrijheid van meningsuiting, expressiviteit, etc. van alle betrokken actoren (overheid, bedrijven, ontwerpers, consumenten, etc.).

*Onderzoeksvraag 4: Wat zijn de te onderscheiden bedrijfs- en industrie ontwikkelings-trajecten als uitkomsten van concurrentie aanpassingsstrategieën en dynamiek op industrie niveau?*

Aan de hand van een typologie van bedrijfs- en industrie ontwikkelingstrajecten (grotendeels gebaseerd op de ervaringen in de Oostaziatische NIEs), gepresenteerd in een viertal tabellen in hoofdstuk 3, is een aantal veel voorkomende trajecten in Singapore en Maleisië onderscheiden.

In beide landen zijn zogenaamde constante trajecten het meest gangbaar. Constant wil zeggen dat ontwikkelingen binnen een bepaalde rol, bijvoorbeeld die van contract producent, plaatsvinden. Echter constante trajecten kunnen wel verbeteringen *binnen* die rollen inhouden, in welk geval gesproken wordt van zogenaamde *adjustment upgrading trajectories*. Het gevaar van dergelijke trajecten ligt in de kans dat ze op termijn leiden tot disconnectie van ketens, aangezien het hier in feite gaat om ‘hardlopen om stil te staan’.

Tot nu toe zijn deze trajecten echter voldoende gebleken om connecties te behouden en beide landen hebben zich weten te positioneren als betrouwbare producenten van hoogwaardige producten (hoewel wel voornamelijk van zogenaamde basics).

In Maleisië hebben verbeteringen nauwelijks geleid tot minder afhankelijke/hoogwaardigere posities binnen de keten. In Singapore waren ontwikkelingstrajecten in het algemeen dynamischer. Een groeiend aantal bedrijven lijkt zich te begeven in de richting van OEM+ rollen, gestimuleerd door extensieve internationaliseringprocessen

In beide landen waren ontwikkelingstrajecten van OEM naar OBM of zelfs ODM rollen zeldzaam. Als gevolg van verzonken kosten in grote productie capaciteit (welke bij een overstap naar - doorgaans veel kleinschaligere - OBM productie goeddeels onbenut zou blijven) en het grote verschil in competenties nodig voor productie enerzijds en ontwerp en marketing anderzijds (letterlijk twee vakken apart), is deze overstap zeer moeilijk. De switching kosten zijn vaak zo hoog en pad-afhankelijke ontwikkeling vaak zo sterk dat vraagtekens geplaatst kunnen worden bij hoe realistisch een OEM-ODM-OBM ontwikkelingstraject eigenlijk is.

Uit de studie is duidelijk geworden dat het juist bedrijven zijn die zich niet, of slechts heel kort in de netwerken en ketens bevonden, die het meest succesvol zijn in het volgen van trajecten leidend tot ODM of OBM rollen.

Tenslotte hebben in beide landen ook veel bedrijven exit trajecten gevolgd, wat duidelijk werd uit het grote aantal bedrijven dat niet meer te vinden bleek (Maleisië) en uit de consolidatie van de industrie in Singapore sinds het begin van de negentiger jaren. Een dergelijke consolidatie kan ook in Maleisië in de nabije toekomst verwacht worden.

Op industrie niveau hebben internationaliseringsprocessen en de positie van Singapore als regionaal handelscentrum (hoewel beperkt) ervoor gezorgd dat de industrie lokaal niet langer gebaseerd is op productie in de strikte zin des woords, maar op productie coördinatie, management functies en services. Een zekere 'reconstitutie' kan dus worden vastgesteld op dit niveau (d.w.z. de industrie is niet verdwenen, maar heeft een andere vorm aangenomen). Echter dit heeft bij lange na niet dezelfde vorm of proportie aangenomen als in bijvoorbeeld Hong Kong. Dit komt deels doordat de connecties binnen de door Singaporese bedrijven aangestuurde productienetwerken vooral gebaseerd op eigendomsrelaties, wat ze minder flexibel en ook minder extensief maakt.

In Maleisië is de industrie nog steeds sterk geworteld in productie. Trajecten op dit niveau worden ook nog steeds sterk bepaald door bestaande kledingproducenten, aangezien nieuwe segmenten niet tot nauwelijks een rol spelen.

*Onderzoeksvraag 5: In hoeverre ondersteunt of ondermijnt de lokale industrie omgeving de capaciteit van lokale bedrijven en de industrie gemeenschap om zich aan te passen aan een veranderende concurrentie-omgeving en posities en rollen in relatie tot netwerken en ketens te verbeteren?*

In de hoofdstukken 4, 5 en 8 komt de lokale bedrijfs-/industrie omgeving en het effect hiervan op het gedrag van kledingbedrijven in beide landen uitgebreid aan de orde.

De bevindingen illustreren dat dit effect, zowel direct als indirect, en zowel in positieve als in negatieve zin, substantieel is, hoewel het niet altijd precies te duiden is door het complex van factoren dat van invloed is op ondernemingsgedrag. Elementen in de lokale bedrijfsomgeving beïnvloeden attitudes in de industrie, welke op hun beurt weer de strategische intentie en keuzes van bedrijven beïnvloeden, terwijl zulke elementen ook in meer directe zin de strategische keuzes en opties van bedrijven mogelijk maken, stimuleren of juist belemmeren. Vooral de kenmerken van de onderliggende fundamenteën van de bedrijfssomgeving, zoals de dynamiek van algemene economische en institutionele structuren, de heersende economische ideologie, consistentie van beleid en zijn implementatie, mate van vertrouwen en openheid, blijken een belangrijke rol spelen. Deze elementen lijken allen sterker in het geval van Singapore, wat heeft geresulteerd in meer dynamische benaderingen en strategische intentie en een groter aantal bedrijven dat zich heeft vastgelegd op ontwikkelingstrajecten die leiden tot een verbetering van rollen en posities.

In Maleisië is sinds het eind van de jaren tachtig actief industrie-specifiek beleid ontwikkeld in het kader van het zogenaamde tweede Industrial Masterplan (IMP-2). Dit beleid was erop gericht herstructurering en een overstap naar hoogwaardigere producten en activiteiten in de industrie te bewerkstelligen. De kledingindustrie werd onderscheiden als een van de industriële clusters met sterke potentie om internationaal concurrerend te worden (blijven). Dit in tegenstelling tot Singapore, waar de industrie bij uitstek behoort tot een van de arbeidsintensieve industrieën waarvoor de regering in feite geen plaats zag (ziet) in Singapore en welke dus al sinds het midden van de jaren tachtig te maken heeft met een redelijk negatief, of op zijn minst niet aanwezig industriebeleid. Toch blijkt de industrie in Singapore dynamischer dan in Maleisië, wat in feite het belang van de onderliggende fundamenteën van de bedrijfsomgeving verder onderschrijft. Aangezien deze in Maleisië in veel opzichten relatief zwak zijn, blijft specifiek beleid vaak ineffectief. Zo biedt de overheid ondernemers vaak indirect mogelijkheden voor het omzeilen van bepaalde maatregelen gericht op stimulatie van meer offensieve strategieën. Zeker tot de crisis van 1997 heeft de overheid bijvoorbeeld een zeer coulant beleid gevoerd ten opzichte van gebruik (en misbruik) van buitenlandse werknemers, waardoor ondernemers langer van dit soort goedkope arbeidskrachten gebruik hebben kunnen maken en meer pijnlijke aanpassingen hebben

kunnen uitstellen. In Singapore werden dit soort vluchtroutes al gauw afgesneden door de overheid.

Naast overheidsbeleid bleken een aantal andere elementen en specifieke gebeurtenissen in de lokale bedrijfsomgeving bepaalde strategieën en trajecten ook te stimuleerden, danwel belemmeren. De voornaamste die een vermelding verdienen zijn: (i) corporatisme - wat een zwakke positie van georganiseerde arbeid tot gevolg heeft en dus exploitatieve strategieën (Maleisië) en relokatie (Singapore) vergemakkelijkt heeft; (ii) de rol van de brancheverenigingen; (iii) plotselinge toename in concurrentiedruk en (externe) bedreigingen - die een concurrentiecrisis in Singapore tot gevolg hadden, welke vervolgens heeft geleid tot een verandering in ondernemers attitudes en strategieën; en (iv) de aanwezigheid van lokale productiefactoren - het feit dat Maleisië gewoon een grotere beroepsbevolking heeft betekent dat arbeidstekorten in eerste instantie minder urgent waren dan in Singapore.

In beide landen hebben de brancheverenigingen min of meer de algemene tendensen in de locale bedrijfsomgeving, d.w.z. de dominante economische ideologie en de politieke economie van industriële ontwikkeling, gevolgd. Zo lag de nadruk bij de Maleise verenigingen vooral op proces verbeteringen en zogenaamde *benchmarking*, oftewel het volgen van door inkopers aangestuurde veranderingen. Anderzijds waren wantrouwen en beperkt bereik van de doelgroep (met als gevolg weinig effectieve implementatie van plannen en programma's) ook voor deze organisaties een probleem. De drie brancheverenigingen vertegenwoordigen daardoor elk een beperkt deel van de industrie, terwijl onderlinge samenwerking ook te wensen overlaat.

In Singapore richtte de branchevereniging zich in toenemende mate op non-productie activiteiten en zogenaamde 'fashion content', terwijl het ledenbestand niet langer alleen uit producenten bestaat, maar ook steeds meer uit lokale mode detailhandelaars, ontwerpers en merknaam 'producenten', alsmede vertegenwoordigers van inkopers en agenten met een kantoor in Singapore. Deze trend reflecteert algemene tendensen in de economie en industrie, maar ook het vermogen van de branche vereniging haar eigen rol en functies te herdefiniëren en zo haar brugfunctie naar de overheid te bewaren. Sinds het begin van de jaren tachtig was er namelijk van overheidswege uit toenemende interesse in een lokale mode-industrie in het kader van algemeen beleid gericht op de ontwikkeling van *life-style businesses*.

Wat betreft het effect van de lokale bedrijfsomgeving op nieuwe segmenten en hun ontwikkeling in Singapore, bleek dat inconsistent en ongecoördineerd beleid, en de beperkte inzage van de verschillende instanties en actoren in de werkelijke of dieper liggende issues en beperkingen voor deze nieuwe segmenten, belemmerend werkten. Echter, gegeven andere elementen in diezelfde bedrijfsomgeving, zoals de beperkte *sourcing* basis, kleine omvang van de lokale markt, weinig geavanceerde vraag, etc., is het de vraag of beleid überhaupt een verschil zou kunnen maken.

*Onderzoeksvraag 6: Wat is de rol van actoren binnen de global commodity chain – specifiek 'lead-firms' – in de aanpassingen en ontwikkelingstrajecten van locale bedrijven en de industrie gemeenschap?*

Het onderzoek bevestigt een aantal eerder gemaakte observaties door Schmitz & Knorringa (1999) in hun onderzoek naar de schoenenindustrie, namelijk dat de rol van inkopers - de belangrijkste aanstuurders binnen de netwerken en ketens, in de ontwikkeling van afhankelijke producenten wat beperkt is.

Hoewel de connectie met grote Westerse inkopers kledingproducenten in Singapore en Maleisië inderdaad veel (leer)kansen biedt t.a.v. het verbeteren van processen en producten en het bijblijven met internationale ontwikkelingen en standaarden, stimuleren inkopers in de regel geen overstap naar rollen die niet meer geworteld zijn in feitelijke productie. Dus voor

een ontwikkelingspad gericht op het bereiken van bijvoorbeeld een OBM rol, kan een producent vaak geen gebruik kunnen maken van de relaties met zijn inkopers, ook al omdat veel producenten niet direct durven/willen concurreren met hun belangrijkste klanten (wat productie van eigen merken in feite impliceert).

Inkopers stimuleren voornamelijk zogenaamde operationele effectiviteit (voldoen aan algemene vereisten en standaarden zonder een uniek eigen concurrentievoordeel te ontwikkelen) en ontwikkeling binnen bestaande (productie)rollen. Bovendien gaan inkopers vaak uit van bestaande product specialisaties en competenties van producenten en zijn zij niet geneigd fundamenteel nieuwe activiteiten direct te stimuleren.

Ondanks de moeite die het bijblijven kost en het feit dat de winstmarges van producenten door inkopers vaak sterk geknepen worden, is produceren op contract basis nog steeds een redelijk eenvoudige manier om een goede omzet te behalen. Veel producenten in met name Maleisië lijken dan ook tevreden met hun bestaande posities en relaties met inkopers en zien geen heil in het fundamenteel veranderen van hun rol, met het risico deze redelijk comfortabele positie te verliezen en veel meer eigen initiatief (ergo risico en kosten) te moeten nemen.

Uit het onderzoek komt naar voren dat een overstap naar meer geavanceerde rollen zoals ODM en OBM rollen, veel meer de verantwoordelijkheid is van producenten dan van inkopers (die zo'n overstap zelfs kunnen tegenwerken), hoewel in de literatuur vaak gesuggereerd wordt dat connecties met *buyers* een dergelijke transitie zou vergemakkelijken.

De meer dynamische ontwikkelingstrajecten onder bedrijven in Singapore, maar ook de meer succesvolle cases die in Maleisië waargenomen zijn, zijn dan ook vooral tot stand gekomen door eigen initiatief - dynamische *strategische intentie* - van producenten en niet zozeer met behulp van inkopers.

Een van de conclusies van het onderzoek is dan ook dat als een producent de relaties met inkopers wil aanwenden voor het ontwikkelen van nieuwe, hoogwaardigere rollen en posities *in* netwerken en ketens (bijvoorbeeld een OEM+ rol) het *learning from buyers* moet veranderen in een *learning with buyers*. Leren wordt dan een interactief proces, waarbij de verantwoordelijkheid niet langer alleen bij inkopers, maar in toenemende mate bij producenten ligt.

In het algemeen blijkt het echter 'makkelijker' om de kansen geboden door relaties met inkopers in netwerken en ketens te benutten voor een transitie naar OEM+ en intermediaire (coördinerende) rollen dan voor een overstap naar fundamenteel andere rollen zoals OBM en zelfs ODM. Wellicht juist daarom bleken bedrijven die buiten netwerken en ketens opereren ook beter in staat zulke OBM rollen aan te nemen.

*Onderzoeksvraag 7: Zijn er andere factoren die ontwikkelingstrajecten op bedrijfs- en industrie niveau stimuleren dan wel belemmeren?*

Uit het onderzoek blijkt vooral hoe belangrijk de visie en keuzes van het management van bedrijven is bij het vermogen van bedrijven om zich aan te passen aan veranderingen en de uiteindelijk gevolgde routes en posities die deze aanpassingen tot gevolg hadden. De meest succesvolle bedrijven, zowel binnen als buiten netwerken opererend, in beide landen waren die bedrijven waarin het management zich bewust was van competenties en kansen en een visie had ten aanzien van de strategische koers van het bedrijf.

De meeste bedrijven waren echter minder uniek en hoewel management attitudes in principe bedrijfsspecifiek en -intern zijn, worden zij vaak in sterke mate beïnvloed door elementen in de bedrijfsomgeving, zoals beschreven in het antwoord op onderzoeksvraag 5

Een aantal andere factoren die blijkens het onderzoek management attitudes en strategische intentie van bedrijven beïnvloeden dienen echter ook genoemd te worden. Dit zijn bijvoorbeeld herkomst van eigendom, de voorgeschiedenis en de organisatie van een bedrijf.

Zo blijken bedrijven die in buitenlands eigendom waren in Maleisië conservatiever in hun strategische keuzes, aangezien zij in essentie slechts afhankelijke productie filialen zijn van buitenlandse bedrijven. Ook in Singapore zijn het juist de lokale bedrijven (lokaal eigendom) die zich door de crisis van het begin van de jaren negentig wisten te slaan, terwijl buitenlandse bedrijven vaker hun vestigingen sloten en/of verplaatsten naar goedkopere locaties.

De voorgeschiedenis van een bedrijf - ooit gemaakte strategische keuzes ten aanzien van ontwikkelingskoersen - bleken sterk bepalend voor de verdere 'levensloop', als gevolg van erzonken kosten en het probleem van 'ontleren'. Ontwikkelingstrajecten vertonen daardoor vaak een sterke mate van pad-afhankelijkheid. Dit is vooral evident onder bedrijven die vrij vroeg in hun bestaan hebben gekozen voor een uitgesproken OEM rol en bijbehorend traject.

In een rijke literatuur die inmiddels bestaat over het fenomeen van Chinese familiebedrijven (CFB), wordt vaak gewezen op een aantal typische kenmerken van (gedrag van) dergelijke ondernemingen. Zo worden vaak familialisme, het belang van sociale netwerken in de externe bedrijfsvoering, een hiërarchische organisatiestructuur en een hoge mate van geslotenheid en wantrouwen jegens 'buitenstaanders' genoemd. Hoewel deze bedrijfjes vaak een hoge mate van flexibiliteit vertonen en onder moeilijk omstandigheden weten te overleven, zijn hun strategieën vaak korte termijn gericht en vrij conservatief. Aangezien de industrie in beide landen in hoge mate gekenmerkt wordt door etnisch Chinees familiebezit, was een reflectie van deze typische kenmerken en gedragingen te verwachten onder bedrijven in de survey. Inderdaad bleek een groep kleine, op de binnenlandse en regionale markten gerichte bedrijfjes in Maleisië aan dit profiel te voldoen. Zij vertoonden de minst uitgesproken strategische intentie en hanteerden vooral defensieve strategieën. Zolang er meer geld binnen kwam dan uitgang werden de zaken als goed gezien. Bovendien heerste onder deze groep sterk het idee dat als het niet goed meer ging, de zaak altijd opgedoekt kon worden en met iets anders begonnen kon worden. Kapitaal investeringen in deze bedrijven zijn doorgaans gering en het ontslaan van werknemers is relatief makkelijk/goedkoop.

Echter, er werden ook een aantal zeer succesvolle kleine CFB aangetroffen in beide landen, die een niche voor zichzelf hadden gecreëerd en zeer pro-actieve strategieën toepasten en trajecten volgden. Daarnaast doet het interessante fenomeen van de 'tweede generatie' eigenaren/managers zich voor. Deze is vaak hoger opgeleid en meer blootgesteld aan externe ontwikkelingen. Hun ideeën over de bedrijfsvoering zijn dan ook vaak dynamischer, opener en meer gericht op langere termijn overwegingen. De relevantie van etnisch Chinees eigendom als verklarende factor voor gedrag wordt daardoor wellicht minder.

Tenslotte moeten quota en handelsovereenkomsten, alsmede de aard van de industrie, genoemd worden als factoren die een rol spelen in ondernemersgedrag. Zo heeft het quota systeem Maleisië in wezen lange tijd beschermd tegen de ergste concurrentiedruk, waardoor constante trajecten voldeden om aansluiting met netwerken en ketens te behouden. In Singapore speelden quota en handelsovereenkomsten een bepalende rol in de configuratie van de overzeese productienetwerken die bedrijven hebben opgezet. De afschaffing van het quota systeem in 2005 zal waarschijnlijk vooral voor de Maleise industrie belangrijke gevolgen hebben en de vraag is ten eerste of tot nu toe geïmplementeerde strategieën en gevolgde trajecten nog zullen voldoen voor zelfs het behoud van connecties.

De aard van de industrie, met de beperkte mogelijkheden voor automatisering en de scherpe scheiding tussen productie enerzijds en ontwerp en marketing anderzijds, hebben bepaalde strategieën minder aantrekkelijk gemaakt. Technologische innovatie en R&D spelen dus nauwelijks een rol als concurrentiestrategie. Bovendien is het moeilijk de kennis opgedaan in productie aan te wenden voor de ontwikkeling van ontwerp en marketing skills. Deze kennis

ligt namelijk niet zozeer besloten in de technologie en het product an sich, wat het zogenaamde ‘learning by doing’ moeilijk maakt.

*Onderzoeksvraag 8: Hoe laten de Singapore en Maleisië cases zich vergelijken?*

Deels ligt het antwoord op deze vraag besloten in de antwoorden op de bovenstaande vragen. Aan de oppervlakte zin veel overeenkomsten waarneembaar, terwijl delen van de industrie in de twee landen met elkaar verbonden is via eigendoms- en uitbestedingsnetwerken.

Tallose, meer fundamentele verschillen kwamen echter ook naar voren, in termen van industrie structuur en positionering in netwerken en ketens, welke het resultaat waren van verschillen in toegepaste strategieën en gevolgde ontwikkelingstrajecten.

Een verklaring voor deze verschillen, met name het feit dat Maleisië een zekere achterstand op Singapore lijkt te hebben, kan gevonden worden in een faseverschil en verschil in wijze van incorporatie in netwerken en ketens. Daarbij was de concurrentiedruk in Singapore al vanaf een vroeger stadium hoger, door overheidsbeleid en de beperkte omvang van het land. Bedrijven zagen zich dus al in een vroeg stadium genoodzaakt tot fundamentele aanpassingsstrategieën.

Maar zelfs als de timing en wijze van incorporatie hetzelfde was geweest, valt te betwijfelen of de verschillen zoveel kleiner zouden zijn. Gezien het feit dat producenten in beide landen voor nagenoeg dezelfde inkopers werken, moeten verklaringen voor verschillen ook, en vooral, gezocht worden in verschillen in de houding en strategische intentie van bedrijven en de lokale context die daarop van invloed is (zie de antwoorden op de vragen 5 en 7)

### **Slotbeschouwing**

De studie heeft aangetoond dat bedrijven in beide landen er in redelijke mate in geslaagd zijn hun aansluiting met mondiale netwerken en GCCs te behouden. De condities waaronder bedrijven hierin geslaagd zijn, hangen echter vaak samen met het soort exploitatieve strategieën waaraan de industrie zijn vaak slechte naam te danken heeft. In het algemeen kan gesteld worden dat de effecten van het slagen in behoud van connecties op langere termijn allerminst ondubbelzinnig is.

Enerzijds kan het niet ontkent worden dat het opereren in netwerken en ketens bedrijven in staat heeft gesteld snelle groei te verwezenlijken en een internationale standaard te bereiken en behouden, waar ze op zichzelf wellicht niet in geslaagd waren. Anderzijds bleek uit de studie dat in termen van competenties en concurrentieposities, het willen behouden van connecties maar al te vaak leidt tot pad-afhankelijke ontwikkeling. Het behouden van connecties alleen is vaak een doel op zich is geworden voor bedrijven. Ten dele laat dit de verantwoordelijkheid voor lokale industrie ontwikkeling over *buyers*. Aangetoond is dat deze niet geneigd zijn tot het stimuleren van de ontwikkeling van fundamenteel nieuwe competenties en rollen, maar meer tot het stimuleren van zogenaamde operationele effectiviteit. Volledig door inkopers aangestuurd leidt dus doorgaans *niet* tot een fundamentele verbetering van rollen en herpositionering.

Hoewel het alleen voldoen aan de vereisten van inkopers lange tijd voldoende kan zijn, schuilt in een dergelijk streven bovendien op langere termijn het gevaar om weer buitengesloten te raken. Aangezien teruggaan naar rollen in de lokale markt voor veel OEM producenten geen echte optie is, betekent uitsluiting haast altijd sluiting of verkoop van het bedrijf.

De studie toont aan dat naast dit soort constante trajecten binnen ketens in een OEM rol, nog een groot aantal andere ontwikkelingspaden denkbaar zijn. Opvallend zijn vooral de succesvolle trajecten gevolgd door bedrijven die buiten de GCC opereerden. Blijkbaar is incorporatie en het vervullen van een OEM rol lang niet altijd de geijkte manier of beste opstap naar meer geavanceerde posities en rollen. Verzonken kosten en specifiek opgedane

kennis in massaproductie leiden immers vaak tot pad-afhankelijkheid, wat de overstap naar andere posities en rollen steeds moeilijker maakt.

In het verlengde hiervan, toont de studie aan dat de kansen voor succesvolle trajecten evenzogoed binnen als buiten ketens gevonden kunnen worden. Met name de trajecten gevolgd door *niet* geïncorporeerde bedrijven blijven in studies en artikelen over globalisering en lokale industrie ontwikkeling vaak onderbelicht, wat geen recht doet aan hun potentieel als alternatieve routes.

Wat betreft het benutten, door zowel bedrijven als institutionele actoren, van de kansen die connecties bieden voor verbetering van rollen en posities in relatie tot die netwerken en ketens, kan een aantal opmerkingen gemaakt worden.

Ten eerste bleek een meerderheid van de bedrijven en actoren de kansen niet te benutten, terwijl ze voor buiten de keten opererende bedrijven sowieso geen optie waren.

Ten tweede werd het ideaal typische CMT-OEM-ODM-OBM traject niet tot nauwelijks gevonden. Dit plaatst vraagtekens bij het realiteitsgehalte van een dergelijk traject, alsmede de relevantie van het zien van OBM als de hoogst haalbare positie of rol voor een bedrijf of industrie. Deze vragen zijn relevant omdat deze trajecten en posities door zowel academici als beleidsmakers vaak worden voorgeschreven als *de* oplossing voor verlies van concurrentiekracht. Bovendien blijkt opereren in netwerken en ketens in feite juist niet altijd directe kansen te bieden voor het overstappen naar dergelijke trajecten en rollen.

Dit leidt vervolgens weer tot de vraag of ‘advancement’ (in de literatuur zo vaak geduid als upgrading) niet een bredere betekenis zou moeten krijgen. In die zin geeft de studie aan dat alternatieve trajecten meer aandacht verdienen en dat pad-afhankelijkheid niet altijd slecht hoeft te zijn. Specialisatie in een specifieke rol, of het nu binnen of buiten ketens is, kan net zo goed lonend zijn, mits er een strategisch intentie is ook echt de beste te zijn en een specifieke niche te willen vinden. Het OEM-OEM+ traject is daarvan een goed voorbeeld.

Ten derde, ondanks deze wat meer optimistische observaties moet erkend worden dat dergelijke succesvolle trajecten nog steeds een uitzondering zijn en niet gesproken kan worden van algemene patronen. Slechts in een klein aantal bedrijven had het management werkelijk de visie en strategische intentie om doelbewust dergelijke ontwikkelingspaden te volgen. Dit onderstreept het belang van ondernemerschap en een institutionele context die ondernemerschap stimuleert aan.

Ten vierde komt uit het onderzoek naar voren dat voor langere termijn ontwikkelingsperspectieven lokale dynamiek evenzogoed belangrijk is als mondiale connecties en daarmee samenhangend is het belangrijk de kansen die deze mondiale connecties bieden niet te benadrukken ten koste van andere mogelijkheden om industrie ontwikkeling te bewerkstelligen. Temeer daar de door de literatuur vaak gesuggereerde positieve effecten van externe *linkages* voor de ontwikkeling en verbetering van lokale *linkages* in beide cases niet erg overtuigend is. Sterker nog, in Maleisië lijken het export georiënteerde (OEM) segment en de lokaal georiënteerde segmenten binnen de industrie in toenemende mate apart van elkaar te opereren, terwijl lokale *linkages* nauwelijks in staat zijn gebleken de concurrentiekracht van de industrie in haar geheel te vergroten. Ook gericht beleid heeft hieraan weinig kunnen veranderen. Dergelijke observaties zijn ook elders gemaakt, bijvoorbeeld in een onderzoek naar de dynamiek van lokale export clusters in Noord Mexico (Dooren, 2003)

Wat betekent dit allemaal voor de centrale vraag van dit onderzoek, namelijk wat economische globalisering betekent voor lokale industrie ontwikkeling?

Het onderzoek heeft vooral de complexiteit van deze interrelatie aangetoond, in tegenstelling tot de vaak gesuggereerde rechtlijnigheid in de literatuur. Daarmee nuanceert en verbreed het de observaties en benaderingen welke vaak in de literatuur gehanteerd worden.

Hoewel de studie bevestigt dat mondiale netwerken en ketens belangrijke transmissie mechanismen vormen tussen ‘*the global*’ en ‘*the local*’, dat een aantal kansen en positieve uitkomsten op lokaal niveau weet te bewerkstelligen, toont het ook de beperkingen van globalisering in de mondiale netwerken vorm.

Het transmissie mechanisme functioneert als het ware in een driehoek tussen *global lead-firms*, lokale ondernemers en de institutionele context op verschillende niveaus. De uitkomsten zijn uiteindelijk afhankelijk van hoe ‘het lokale’ om weet te gaan met het mondiale krachtenveld. Zo bekeken, krijgen lokale actoren en verhoudingen een grotere rol in het globaliseringsverhaal.

De in de literatuur vaak gehanteerde meta-argumenten aangaande de zogenaamde global-local nexus geven echter weinig echte inzichten in lokale krachten en dynamiek aangezien zij deze vaak van ondergeschikt belang achten. Het huidige onderzoek illustreert de tekortkomingen van dergelijke meta-benaderingen en benadrukt dat om te kunnen profiteren van globalisering een langere termijn perspectief moet worden ontwikkeld waarbij lokale bronnen en potentieel worden aangemoedigd en gekoesterd. Hoewel dit wellicht geen geheel nieuwe observatie is, is het er wel een die nog steeds overschaduwt wordt door ‘*the global*’ in meer recente benaderingen van lokale industrie ontwikkeling onder globalisering

## Noten

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<sup>1</sup> Sommigen van deze kleding bedrijven hebben zich in feite nooit direct met productie bemoeid (bijvoorbeeld Nike, GAP, veel warenhuizen, etc.), anderen hebben productie-activiteiten langzaam afgestoten en uitbesteed aan zogenaamde contract producenten (bijvoorbeeld Levi Strauss)

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## Curriculum Vitae

Floortje Smakman was born on April 30, 1973 in Velsen, the Netherlands. In 1992 she completed her secondary school education at the Murmellius Gymnasium in Alkmaar. In the same year she moved to Utrecht to study Human Geography at Utrecht University. After obtaining her propaedeutics exam in 1993, she switched to international economics and economic geography. She completed her master's degree in this field in December 1997, with a thesis on transborder economic integration in the US-Mexican borderregion.

Further specialising in development economics in an international perspective, in March 1998 she commenced work on her PhD research, which focused on developments in the garment industry in Singapore and Malaysia under globalisation. She spent approximately two years in these two countries for an extensive survey among garment companies and other industry representatives. Besides working on her PhD research she also taught at bachelor and graduate levels in both Singapore and the Netherlands.