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Industrialization Trajectories in Madagascar's Export Apparel Industry: Ownership, Embeddedness, Markets, and Upgrading

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Summary. — The paper shows the importance of ownership as a conceptual category within global value chain (GVC) analysis through analyzing firm types based on their GVC linkage, market access, and ownership profile in Madagascar's apparel export industry. The central argument is that ownership leading to variances in embeddedness matters. Ownership characteristics of supplier firms shape the ability to shift between different end markets, respond to lead firm requirements, and pursue upgrading. With Madagascar's exclusion from AGOA benefits this has enabled locally embedded European/French diaspora-owned firms and regionally embedded Mauritian-owned firms to shift market channels and upgrade while Asian-owned firms largely exited the industry.

Key words — global value chains, upgrading, apparel, ownership, embeddedness, AGOA, Madagascar

1. INTRODUCTION

Since the turn of the millennium, several Sub Saharan African (SSA) countries (i.e., Kenya, Lesotho, Swaziland, Madagascar, and Mauritius) have developed or expanded export-oriented apparel industries. This was driven by three regulatory regimes: (i) the Multi-Fibre Arrangement (MFA) placing quotas on large Asian producer countries and leading to spreading apparel production; (ii) preferential trade agreements (PTAs) to the US and European Union (EU) markets, especially the African Growth and Opportunity Act (AGOA) that allowed duty-free access to the US market; and (iii) national policies supporting export-oriented firms, including the establishment of export processing zones (EPZ) and investment incentives. Foreign direct investment (FDI) has played a dominant role in the development of export-oriented apparel industries in these SSA countries. However, after the MFA phase-out on December 31, 2004, apparel exports declined from these major SSA apparel-exporting countries (Kaplinsky & Morris, 2006), accelerated by the 2008 global economic crisis (Staritz, 2011).

While an aggregated analysis of SSA apparel export growth is important, it masks the variety of firm types inserted in different value chain channels in these SSA countries. Firm variations and different forms of value chain insertion relate to ownership, end markets, governance structures, and firm set-up. In particular ownership dynamics manifest themselves in significant disparities in levels of local embeddedness, with important implications for the sustainability of apparel exporting operations and economic upgrading trajectories (Morris, Staritz, & Barnes, 2011; Staritz & Frederick, 2012; Staritz & Morris, 2012).

Although Madagascar shares characteristics with the other SSA lower income country apparel exporters, it is the differences that determine its distinctive industrialization trajectory. These are manifested in the dynamic interplay between market destinations and value chain dynamics, ownership patterns and local embeddedness, political instability, and access to regulatory advantages.

This paper aims to show the importance of ownership as a conceptual category within the global value chain (GVC) framework through unpacking the development trajectory of the Madagascan apparel export industry. It does so by analyzing different dynamics between types of apparel firms in Madagascar based on their GVC linkage, market access, and ownership profile, posing the following questions:

- What are the main characteristics and differences with regard to firm ownership, embeddedness, end markets, governance structures, and firm set-up?
- What are the implications of these distinct characteristics for economic upgrading and the sustainability of the industry?
- How did these factors affect the dynamics and sustainability of the industry following the political crisis in 2009 which led to the loss of AGOA preferential market access?

The research in this paper is based on trade and national industry data and fieldwork conducted in Madagascar largely in March 2012 and supplemented in December 2012. During the fieldwork interviews were conducted with representatives of apparel firms and relevant institutional actors.

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The paper comprises four sections. The introduction is followed by a conceptual discussion of the importance of ownership, embeddedness, and upgrading in GVC analysis. The next section sketches the development of Madagascar's export-oriented apparel industry, which provides the context for the analysis of four types of firm ownership and different GVC dynamics in Section 4. The last section concludes.

2. FIRM OWNERSHIP AND EMBEDDEDNESS IN GVCS

In the GVC literature, governance and economic upgrading are core concepts. Governance analyzes the relationships between actors in value chains, highlighting the power relations within value chains and particularly the role played by lead firms in establishing product specifications, technical, social and environmental standards, and cost and performance structures according to which global industries operate (Gereffi, Humphrey, Kaplinsky, & Sturgeon, 2001; Gereffi, Humphrey, & Sturgeon, 2005; Kaplinsky & Morris, 2001). Many developing countries are in constant competition for foreign investments by and contracts with lead firms. In this context, the sustained expansion of firms and industries depend on their capacity to pursue economic upgrading. Upgrading is broadly defined as moving to higher-value activities in value chains to increase the benefits from participating in global production (Bair & Gereffi, 2003; Kaplinsky & Morris, 2001). In the GVC literature it is stressed that upgrading processes are shaped by the type of value chain in which firms are inserted, and in particular by the governance structure of chains. Governance structures determine the flow and allocation of activities and resources within chains, hence, firms' prospects of entry and upgrading and the distribution of rewards and risks along chains (Gereffi *et al.*, 2001, 2005; Kaplinsky & Morris, 2001). Governance structures can both enhance and hinder supplier firms' upgrading (Humphrey & Schmitz, 2001, 2002).

Economic upgrading is generally categorized in four types: process upgrading by reorganizing the production system or improving equipment and technology; product upgrading by shifting to more sophisticated, complex, or better quality products; functional upgrading by increasing a firm's range of functions or changing the mix of activities to higher-value tasks such as input sourcing, logistics and distribution, product development, design, and branding; and chain upgrading by moving to a higher value industry (Gereffi *et al.*, 2001, 2005; Humphrey & Schmitz, 2001, 2002; Kaplinsky & Morris, 2001). We add three further dimensions that are crucial for upgrading dynamics, competitiveness and local value added, and have been identified in more recent empirical work on the apparel sector (Frederick, 2010; Frederick & Gereffi, 2010; Frederick & Staritz, 2012; Staritz & Morris, 2012): These are channel upgrading (also called end market upgrading and/or intra-sectoral upgrading) by diversifying to new buyers or geographic and product markets; supply chain upgrading by establishing backward linkages within the supply chain (e.g., establishing linkages from apparel production to textiles, trims, and support services); and skills upgrading by developing and improving local skills. The first two are closely related to the more traditional four upgrading dimensions, with channel upgrading often requiring product upgrading, and supply chain upgrading being related to functional upgrading (Frederick, 2010). However, we still highlight them as separate dimensions given their specificities in focusing on diversifying and adding new buyers and markets, as well as extending functions to manufacture or service inputs along the value chain. Skill upgrading is differentiated since the ability of firms to upgrade using any strategy is dependent on altering the workforce skills (Gereffi, Fernandez-Stark, & Psilos, 2011). Adding these dimensions facilitates analyzing the upgrading complexities that are observed empirically.

The strength of GVC analysis has been bringing the power of lead firms to the fore as drivers of requirements and standards down the value chain. However, notwithstanding foregrounding power, the emphasis has been on the various technical relationships embodied in value chains to the detriment of social, cultural, and political dimensions of power, among which we would identify ownership. We can think of ownership in three ways: the identification of various country end markets with their own characteristics, lead firm ownership driving requirements and standards, and supplier firm ownership responding to GVC dynamics.

Identifying the characteristics of different end markets and their impact on value chain requirements, as well as what supplier firms need to do in order to meet them, has been a focus for some time in the GVC literature. In the apparel value chain, the differential possibilities for economic upgrading in value chains geared to the EU and US market have long been recognized (e.g., Gibbon, 2003a, 2003b, 2008a, 2008b; Gibbon & Ponte, 2005; Kaplinsky & Wamae, 2010; Morris & Sedowski, 2009; Palpacuer, Gibbon, & Thomsen, 2005; Staritz, 2011). Recently, researchers have also pointed to the downgrading impact that value chains feeding into the Chinese and Indian markets may have on low cost developing country producers (Kaplinsky & Farooki, 2011; Kaplinsky, Terheggen, & Tijaja, 2011).

End markets are conceptually related to ownership. Gibbon (2004, 2008b) empirically identified the importance of end market segmentation for South Africa and Mauritius. He argued that apparel firms exported either to the EU or US, given the differing end market and buyers' requirements, and this was related closely to nationality. Asian-owned firms tended to export to the US market, and local or European-owned firms to the EU market. End market segmentation and ownership is also prominent in the other SSA lower income country apparel exporters Kenya, Lesotho, and Swaziland where Asian-owned firms export nearly exclusively to the US market. Exports from Lesotho and Swaziland to South Africa have increased since 2005–06, but these exports come largely from South African-owned firms (Morris *et al.*, 2011; Staritz & Morris, 2012). In Madagascar, Asian firms export to the US market whereas European/French diaspora, Mauritian, and locally-owned firms export largely to the EU and recently also to the South African market.

However, identifying the differentiating impact of country end markets is not equivalent to conceptually grounding *national ownership of firms* as an integral governance driver within GVC analysis—either in terms of top down governance where lead firms drive requirements and upgrading down the chain or of bottom up supplier processes of upgrading to accord with these requirements. This conceptual limitation of GVC analysis—not paying sufficient attention to socio-political concepts such as ownership—has been particularly highlighted in different ways by a number of authors operating within the global production network (GPN) framework, which in many respects is very similar to and overlaps with GVC analysis. The GPN criticism of the GVC literature is that value chains are grounded within, and should be opened up to, institutional and spatial dynamics, stressing the importance of horizontal in addition to vertical relations, which includes the impact of firm ownership on value chain formation and