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Proceedings of the 5th International Conference on Economics and Social Sciences (2022), ISSN 2704-6524, pp. 313-322

The 5th International Conference on Economics and Social Sciences
Fostering recovery through metaverse business modelling
June 16-17, 2022
Bucharest University of Economic Studies, Romania

Growth of Developing Countries in Global Value Chains, Focusing on Apparel Industry – A Literature Review

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DOI: 10.24789788367405072-028

Abstract

Trade liberalization and the economic openness of developing countries around the globe have placed value chains at the centre of discussions on the international dimension. This occurs in almost all value chains and their activities, from ancillary activities to the core activities of firms. The forms of entering a destination country are conditioned by the firm's internal motivations, the socio-economic picture of the host country, the nature of the industry, etc. The apparel manufacturing industry is one of the typical industries where products are produced in international networks within GVCs. The main purpose of this paper is to assess the level of integration of apparel manufacturing firms into global value chains and their growth within them. Offshore outsourcing for Textile and Apparel Industry (TAI) firms has as its main reasons the reduction of costs and the increase of efficiency. This study provides a theoretical overview of the factors that promote (hinder) the improvement of subcontractors within the global value chains in the clothing industry. The method used in this paper focuses on a systematic review of existing literature and also excludes the subjectivity of researchers while we have been pursuing the keyword literature.

Keywords: Offshore outsourcing, global value chains (GVCs), apparel industry, and value chain improvement.

JEL Classification: D12, F63, L16.

1. Introduction

The global organization of chains is the construction of a system of successive economic ties with other countries in the form of direct investments, joint ventures, licensing for the production of products, outsourcing, etc. GVCs for the textile and apparel manufacturing are *costumer-led supply chains*. The leading firms are clients, such as retailers, manufacturers of well-known brands, and popular trademarks (Gereffi, 2002). These clients coordinate global apparel manufacturing between

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end-consumer markets and the industries of developing countries. These chains are typically labour-intensive industries and are very important to developing countries (for example, agro-food industry, footwear, furniture, and the like) (UNIDO, 2005). The barriers that a country encounters to get involved in any GVC are based on unique knowledge and skills that not everyone can acquire. This isolates competing firms based solely on the price of the activity. In the apparel manufacturing GVCs, the activities with the highest added value are design, branding, and marketing. All of these activities are largely based on the knowledge that large clients have (Kaplinsky, 2005). The conditions for the integration of a developing country in the apparel GVCs are meeting the requirements of foreign customers in terms of quality, production capacity, delivery time, compliance with various social and environmental standards, distance, and tastes between developing countries and major export markets. Many developing countries are hyping themselves as destinations in certain industries based on their advantages, such as low-cost, skilled labour force, or information technology infrastructure (Farrel, 2006; Popescu, 2010). Small developing countries find it difficult to integrate into all GVCs. There are several arguments related to this issue, such as: moment of inclusion, nature of global demand, competitiveness, geographical proximity, priority sectors of the country's economy, cultural differences, capacities, etc.

These last years have shown that globalization, seemingly an ideal integration strategy for developed countries and especially those developing ones, turns out to be a challenge. This is due to the problems that the young 10-year-old is manifesting strongly. The COVID-19 pandemic and the stalemate that plagued global value chains empowered the adaptation of communication and information technology to the transformation of production processes, distribution systems, and sales (Rodríguez-Sánchez et al., 2020). In addition, many articles are questioning the phenomenon of globalization and the return of activities to their countries of origin or near shoring. This is especially true for the manufacturing industry, as in the case of the apparel industry. In the beginnings of this globally embraced strategy, toward the integration of firms and countries into global value chains, it seemed as if the benefits would be reciprocal for both developing and developed countries. The truth is different. The World Development Report (WB, 2020), although promoting such GVC participation as a development strategy for the latter, acknowledges that purchasing firms in developed countries reap higher profits while supply firms in developing countries are squeezed as a consequence of participation in GVC, (WB, 2020).

Research Question

The apparel industry is one of the industries which have had a great expansion under the trend of globalization. This is for a number of reasons which have been elaborated on throughout the paper. At the same time, various studies show the challenges that developing countries face in staying within the chain. The paper, therefore, conducts an extensive review of the literature to answer a question that arises today more than ever: “What makes developing countries successful within the global value chains in the apparel industry?”

2. Methodology

The purpose of a research paper is to review or synthesize existing knowledge, analyze existing circumstances or problems, provide a solution to problems, explore and analyze more general issues, build or create procedures or systems, explain new phenomena, and offer new knowledge or a combination of them (Collis, Hussey, 2003). The research methodology in this article consists of and has as a reference source the literature review, related to the Apparel Industry as one of the typical industries where the products are produced in international networks within the GVCs. Studying the varied literature related to this industry has helped to build a very clear summary of all the authors and the key issues that have been addressed in our study. To achieve the main goal of this paper, the following objectives have been set:

*(i)*theoretical overviews of the factors that drive (hinder) the improvement of subcontractors within the global value chains in the apparel industry

*(ii)*forms of improvement within global value chains

*(iii)*potential links between domestic producers and foreign customers in production networks

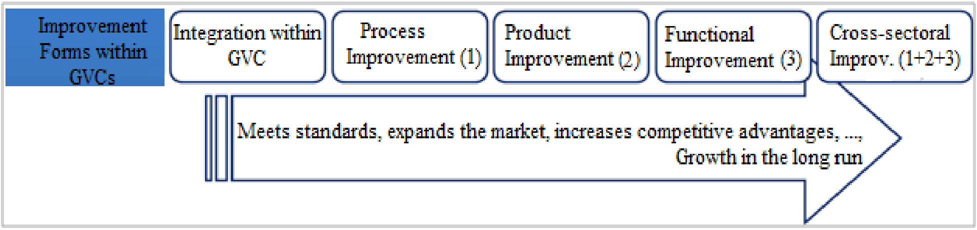
To provide a rigorous, transparent, and reproducible synthesis of the literature, in this article, we have used the method called systematic review (Gomezelj, 2016). The most appropriate and similar items to the purpose and objectives of our paper were selected according to a process that allows the identification of existing research to examine the value and relevance of the research topic (Becheikh et al., 2006).

3. Growth within GVCs: transition to higher value-added activity

Growth within GVCs is a matter of importance for developing countries. The growth of firms within them implies an increase in added value by domestic production and economic growth for the country. According to (UNIDO, 2004; Kaplinsky et al., 2002), improvement within the GVCs may occur in the following ways:

- process improvement (addition of new product lines, reduction of faults, shortening of delivery time, etc.);
- product improvement (quality improvement, introducing a new product on time, etc.);
- functional improvement (increasing added value through a new combination of activities within the firm or carrying out activities that require greater skills and knowledge);
- cross-sectorimprovement (transition to market segments where products are more technically sophisticated and have a higher added value).

Figure 1. Improvement forms within global value chains



Source: Adapted by Authors from the Fernandez-Stark, Bamber & Gereffi scheme (2011).

Textile and Apparel Industry (TAI) includes three basic operations: pre-packaging (design, categorization, marking (brand marking) and cutting), packaging (sewing), and post-packaging (advertising, distribution, and sales). All of these processes have different ratios in terms of capital and labour. Pre-packaging represents the stage requiring the highest capital intensity in the apparel sector, where quality and precision are key elements of production (Abenarthy, Volpe, Weil, 2004). The packaging phase in the apparel sector, no matter how modern the production process, continues to be performed by hand work; thus this production phase is more likely to be outsourced to low-cost countries.

Firms in the TAIs of developing countries are integrated within the GVCs thanks to intensive work with a low level of knowledge. The activities with the lowest value in the apparel GVCs are their production (CMT- cut, make, trim). In these types of contracts, the customer is the supplier of raw materials and indirect materials. The contract of outsourcers following their agreement signed with clients defines: the production and distribution according to the client's request and the fee on the performed service. The outsourcer is not responsible for any activity other than those contracted. Upgrading outsourcers to CMT activities can take place in three modes: process, product, or function.

Process improvement in apparel GVCs is achieved through the application of new technologies or the reorganization of existing production systems. Technology improvement occurs in most cases at the modelling or cutting stage. The sewing process still remains a labour-intensive activity, although there are studies that recognize process and product improvement thanks to technology transfer (Humphrey, Schmitz, 2002).

Product improvement involves switching to higher value-added product lines, which are more difficult to produce due to differences in technical characteristics and materials used. The ability of the outsourcer to produce products with a higher added value is strongly related to the level of improvement of the production processes.

Improvement is functional when a business moves toward more complex tasks within a GVC. Functional improvement refers to the transition to functions such as product design, self-supply of raw materials, introduction to the market with its own brand, and product marketing. Functional improvements come in several forms:

- Apart from production (CMT-cut, make, trim), performing direct procurement of raw material or distribution of the produced product;
- ODM- original design manufacturing;
- OBM- original brand-name manufacturing.

Process or product improvement does not imply improvement within the GVC, toward higher value-added activities. Process or product improvement is the improvement that occurs within the same functional node (e.g., improvement of cutting activities) and efficiency gains within that particular function (process improvement), and/or the production of products with a higher value added within the same product category (product improvement).

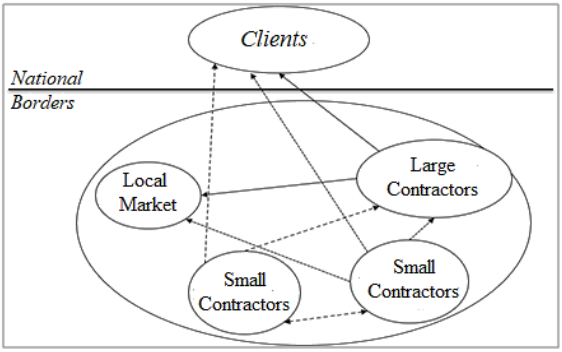
Firms in developing countries involved in global manufacturing networks and GVCs (where TAI is often the number one industry) are expected to improve the skills, knowledge, and technology used. All of the above factors are important to improve productivity and business growth (UNIDO, 2004).

Functional improvement requires organizational changes, product distribution, raw material procurement, etc. Functional improvement is directly related to the capacity of the outsourcer (supply firm) to carry out more complex activities. The role of the client in this regard is decisive, as it determines to what extent functions are delegated to the outsourcer. Accomplishing functional improvement is also related to the size of the domestic market.

An important factor in the improvement within the GVC is the nature of the demand. If the outsourcing firm produces for low-income markets, the product is standard, and the need for process/product improvement is low. Demand from high-income countries is increasingly sophisticated, with a special emphasis on product differentiation, quality standards, etc. The forms of development that emerge from these different requirements (criteria) have a significant impact. The sophisticated demand in high-income countries has increased entry barriers and favoured the consolidation of GVCs.

In addition to the client, manufacturing firms play an important role within the industry through the creation of clusters for the distribution of orders, technology, knowledge, etc. Building sustainable inter-firm relationships within TAIs in developing countries helps improve processes within firms. Moving further towards a comprehensive approach that constitutes a comprehensive analysis (financial, quality, profitability, competitiveness, etc.) of the activities carried out within the GVCs enhances the information, awareness, and cooperation between them.

Figure 2. Link between domestic producers and foreign clients in production networks



Source: Adapted and simplified by authors, according to the Kaplinsky & Readman scheme (2000).

Both approaches, clustering of firms and integration within the chain, underline the importance of *improvement* within the GVC. Improvement is a necessity in staying competitive and growing in the market (Humphrey, Schmitz, 2002). The pursuit of cluster-level strategies for improvement varies considerably by circumstances and industry (Xiaofen, Renyong, 2006).

An important factor for a sustainable growth of firms in the toll manufacturing industry is the environment where firms operate divided into two dimensions: the general environment and the environment within the industry. The general environment encompasses the political, legal, socio-cultural, technological, demographic, global factors that can affect the activity of the firm. While the competitive environment consists of other factors that affect the profitability of the organization, such as customers, local market, business associations, other firms in the industry, etc. (Miller, Dess, 1996).

Local and national initiatives (sometimes in collaboration with international agencies) aim to improve skills in specific sectors and industries so that they can meet the demands of international markets. Firm improvement comprises both technology upgrades and free market access. Complementary efforts at the local and national levels are needed to stimulate these two conditions (Humphrey, 2004). Government incentives play a central role, including regulations on export processing zone (EPZ)[2], reduced profit tax rates, and subsidizing land rents, buildings, and fees for other services (WB, 2011). Market distance (geographical position) can serve the benefit of firms, delayed in integrating into global supply chains, when they are closer than early-involved competitors.

[2] EPZs are special zones that are isolated from the domestic economy. In these zones, investors are not allowed, or only in a limited quantity, to supply domestic consumers as production is export-oriented. EPZs are a legal framework for export production where governments typically offer a package of incentives such as tax breaks, duty free imports, infrastructure provision, lower tariffs for public utilities such as water and electricity, and land and factory subsidies (WB, 2011).

Lack of regional transport networks, poor quality, high costs, and common delays hinder regional integration and impose significant additional costs that constrain regional and international trade. Ideally, investments through a regional fund and changes in regulations to improve intra-regional transport infrastructure and logistics processes will be central preconditions for increasing regional trade in textiles and apparel (WB, 2011).

Education remains a priority, both in terms of basic education for workers employed in manufacturing firms, but also in improving firms throughout the value chain. Education in vocational high schools and branches demanded by industry increases the capacity of firms to move towards other activities.

Regional integration is important not only in relation to end markets, but also in relation to regional production networks. This can increase added value within the region and the competitiveness of the apparel sector. Timeliness and flexibility have become central criteria in clients' decisions. Customers are increasingly hiring vertically integrated suppliers or located in regions that have a competitive textile sector. Greater access to low-cost financing is crucial in increasing the capacity of re-exporting firms (WB, 2011).

4. Results and Discussions

The main reason for offshore outsourcing for firms in western TAIs is the reduction of costs and the increase in efficiency. In summary, studies rank the main factors of offshore outsourcing as follows (EMCC, 2008; CBI, 2014):

Costs in the destination country: Outsourcing to a specific destination starts with estimating the level of costs such as labour costs, raw material costs, energy costs; etc. The main item is labour costs due to the fact that the apparel industry is labour-intensive.

Access to production factors in the destination country: The selection of a destination is not only based on the level of costs, but also on the capabilities of the supplying firms in the country in carrying out certain activities within the GVC. The decision in most cases constitutes a competitive strategy for foreign clients (ordering parties).

Timeliness and flexibility: Timely delivery and production flexibility have become indispensable conditions for western firms in the apparel industry. Almost all apparel market segments are increasingly shortening the product life cycle and reducing the volume of quantity launched in the market. The ability to quickly change the product confection process is critical to adapt to customer requirements.

Short distances: Countries near major markets are increasingly coming to the forefront for western apparel companies. The main reasons are the launch of the product as soon as possible, the reduction of transport costs, and the management of GVCs with strategic providers in geographical proximity to western markets. In the latest CBI study (2014), moving towards key market segments is a particularly important element related to the decision on the company’s allocation. Timely delivery (according to the just-in-time basis) favours business models oriented towards a faster delivery where production is close to the main markets in these segments.

The reconfiguration towards new styles and models has been accompanied by the establishment of a reward for shorter distribution cycles, improved production capabilities, and supply chain management, including apparel production and the material supply and finishing process.

At a global level, buyers and intermediaries around the world are increasingly turning to larger suppliers that can easily provide materials, coordinate distribution (logistics), and foster creative development in countries that can allow faster (shorter) cycles in distribution (Staritz, 2012). This has resulted in the consolidation of the supply chain. Leading buyers have moved from the supply of many small, old-fashioned firms - cutting, manufacturing and sewing structures to close relationships with a small number of strategic providers, thus managing production between multiple factories and international countries, sharing together financial liabilities, providing greater value-added services and ultimately ensuring greater benefits from the apparel and textile trade. These international networks also serve as an important source of employment and manifest a variety of effects in the domestic labour markets. This industry usually serves as a springboard for the industrialization of developing countries with limited capital that are export-oriented, mainly due to intensive work in production structures. As such, this industry, in particular the apparel sector, is contributing to generating the necessary employment. Large clients have moved from supplying very small, old-fashioned firms with traditional activities (cutting and sewing), to close relationships with a small number of strategic providers. The success or failure of offshore outsourcing is the timely response of large customers, thus managing production between multiple factories and international countries, sharing financial liability, providing greater value-added services, and ultimately providing greater benefits from the apparel and textile trade.

5. Conclusions

Global value chains have expanded thanks to trade liberalization and advances in communication and information technology. Foreign companies are choosing to grow by doing less and outsourcing more. Researchers consider both services and custom manufacturing activities within the GVCs, embodied in the value of net exports of some industries in developing countries (textile and apparel manufacturing industry, mineral extraction and fuel processing industry, production of communication and information technology equipment, ICT services industry, etc.).

The international services market today represents the fastest-growing segment in the international market. It is also one of the few promising sectors in the global economy, where a number of developing countries currently have a competitive advantage (Suri, 2005). The revolution of trading services has brought about a dramatic expansion of offshore outsourcing of services, allowing firms to take advantage of lower production costs in foreign countries (Liu et al., 2011).

The improvement of companies in the apparel industry is limited due to the improvement of production technology and the increase in produced quantity. Despite the fact that companies have a relatively long experience in the apparel industry, they still continue to carry out activities with low added value.

Not all developing countries have similar developmental characteristics. Small countries under cost pressure can no longer continue to follow old strategies in terms of low value-added activities, so they need to resize their industrial development strategies.

States need to look at the new global conditions (post-COVID-19), as firms are increasingly accepting near shoring as a potential strategy for carrying out production chain activities. This is due to new restrictions and rising costs.

Today, ICT and process automation are at the heart of global value chains. The tailoring industry, although characterized as a labour-intensive industry, does not rule out the possibility (especially in small developing countries) of seeking improvement within the chains through the improvement of the technological infrastructure.

Limitations of the Study

The objective indicators are the financial data of the firms, which are missing in this study. Analysis of financial data, combined with other factors, can yield new and more consistent results.

Another important constraint or outcome would be to assess the degree of integration of apparel firms into global value chains and the growth within them during the COVID-19 period. Analysis and results during the pandemic years may be part of further research.

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